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WE are pleased to present the premier edition of our Micro, Small and Medium Enterprises (MSME) Study in Nigeria – titled: Strengthening access to finance for MSMEs in Nigeria, a collaborative effort of KPMG Nigeria and Enterprise Development Centre, a centre of the Pan Atlantic University. The survey which polled over 3,000 entrepreneurs, 18 banks and government/multilateral agencies was conducted between November 2013 and March 2014. The survey reflects both the SMEs and banks’ perspectives on the primary issues affecting the growth of this critical sector.

Globally, access to finance is a critical success factor in the growth and development of the MSMEs, and available statistics show that in the developed countries of the world, MSMEs are responsible for being the major drivers of growth in their economies. The existence of an environment that is conducive to doing business is very important in this regard and partly responsible for this development in developed countries.

Nigeria cannot afford to be an exception if she intends to be in the top 20 economies of the world by year 2020 according to Vision 20:2020, the nation’s economic blueprint. However, the development of MSMEs in Nigeria and their overall contribution to the economy are hampered by the fact that access to finance still constitutes a major obstacle to growth.

Over the years, traditional sources of financing for MSMEs have revolved around personal savings, loans from friends and family, and other informal sources. This scenario presents a conundrum as the impact of these sources of funding altogether represents only a fraction of the available potential when banks and the government become major contributors of MSMEs financing. This report seeks to chart a course towards analysing the major impediments to MSME growth in Nigeria; one of which is access to finance and the issues impacting MSME’s ability to effectively increase their contribution to the economy.

It goes without saying that strengthening access to finance for MSMEs requires the active participation of all the major players including the MSMEs, banks, other financial institutions, and the government. Therefore, this study also examines the role of each stakeholder in the process and seeks to find a rallying point where all the efforts of the stakeholders can become a more cohesive front, which will translate into positive growth and development for the Nigerian economy going forward. The recommendations in the report are based on iterative discussions with the major stakeholders and supported by analytical evaluation of the situation from relevant data.

In discussing the problem of access to finance by MSMEs, the report presents a balanced view clearly analysing the roles, contributions and expectations of all key stakeholders.

We would like to thank those who participated in this survey and hope the findings are insightful and useful to you in understanding the challenges faced by both the supply and demand side in SME financing.

Bisi Lamikanra
Partner & Head
Management Consulting
In over a decade that we have been supporting SMEs at the Enterprise Development Centre, I am intrigued each time the issue of “Access to Finance” is being discussed, how it constantly evokes passion, heated debate and in extreme cases, frustration. Of the SIX broad constraints that limit the growth of SMEs in Nigeria, lack of “Access to Finance” has drawn more venom especially from SMEs than any other. The six constraints which are captured in the acronym M-I-S-F-I-T are Lack of Access to:

- M – Market
- I – Infrastructure
- S – Support Services
- F – Finance (Capital)
- I – Information
- T – Technology

The hypothesis here is that if these constraints are removed or drastically reduced, then the chances of these SMEs succeeding will increase significantly. One thing is certain: All the stakeholders in the sector agree on the importance of SMEs from the perspectives of wealth and job creation. Consequently, financing their growth should ideally be a logical step.

The Federal Government of Nigeria has in the last few years renewed its determination to giving enterprises in Nigeria the much needed spin through various interventions: Youwin, The National Enterprise Development Programme (NEDEP), Central Bank of Nigeria (CBN) intervention funds, etc. The private sector on the other hand is deliberately stimulating the SME sector through capacity building, support services and SME promotion. Notable examples are Diamond Bank “Building Entrepreneurs Today,” Fidelity Managed SME Radio program, Etisalat - Market Access Nigeria & Easy business millionaires hunt, Stanbic IBTC “Enterprise stories” & Global Entrepreneurship Week to mention but a few. And many more are in the pipeline.

So why are SMEs not able to access the much needed capital for growth?

Majority of the Financial Institutions claim that lending to SMEs is risky and that a number of these SMEs are not ready for the rigour that goes with access to finance. While it may be fair to acknowledge that this position is somehow true, from the lens of an enterprise development agent like us, we will see this as an opportunity in waiting. Why is there no concerted effort to de-risk the sector? Why are the financial institutions constantly introducing banking products and outpacing each other in branding their institution as SME focused bank rather than understanding the SMEs and deepening their absorptive capacity to access capital? Why are we not coming up with policies that favour those supporting the sector?

The outcome of this extensive survey will hopefully reaffirm a number of what we already know while at the same time bring to fore some refreshing new insights. Our overall expectation is that this report will lead to focused dialogue, constructive engagement and ultimately unlocking those constraints restricting SMEs access to capital.

We are not under any illusion that this can be achieved overnight but the conversation must begin now if we are to make any real progress in the short to medium term. We will be happy to be part of that conversation.

Peter Bamkole
Director, Enterprise Development Centre
Pan-Atlantic University
Executive Summary

The MSME segment is an important engine of growth, employment and social cohesion in Nigeria. However, similar to MSME experience globally, the sector continues to face harsh business environment. The MSME Study in Nigeria titled: Strengthening Access to Finance for MSMEs in Nigeria, which covered over 3,000 entrepreneurs, 18 banks and government/multilateral agencies, was geared towards investigating the critical challenges faced by this segment, the factors limiting key stakeholders from supporting the segment and government’s initiatives to develop this critical sector.

Major Impediments to MSMEs Growth

This study has identified the three top challenges facing MSMEs operating in Nigeria as: non-conducive enabling environment (80%), inconsistent government policies (56%) and lack of access to finance/capital (45%).

Top 3 challenges - based on survey response rate

- Enabling environment: 80%
- Inconsistent government policies: 56%
- Access to finance/insufficient capital: 45%
- Cost of production: 25%
- Lack of skilled staff/experienced managers: 23%
- Unfair competition: 23%
- Lack of Business Support Services: 19%
- Lack of access to information: 7%
- Others: 2%

Enabling environment is defined as a combination of the following factors: quality of infrastructure, access to market, access to modern technology and low investment in research and development

It is important to note that enabling environment and favorable government policies have a direct impact on the ability of MSMEs to access finance.

With respect to access to finance for the MSMEs, the Central Bank of Nigeria (CBN) has intervened through several lending and credit facilitation programs such as Small and Medium Enterprises Credit Guarantee Scheme (SMECGS), Small and Medium Industries Equity Investment Scheme (SMIEIS), etc. However, due to the significant demand-supply constraints, the financing chasm 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 three years, the rejection rate of MSME loan applications by commercial banks was greater than 50% for nine of eighteen banks and as high as 90% for three of the banks. This has led to the negative perception among MSMEs (about 60% of the respondents) that banks are unwilling to finance the sector. As such, only about 20% of the MSMEs have applied for bank financing over the last 5 years, the majority preferring to raise funding through other personal channels e.g. friends, family, informal financiers etc., which can only cater for a small portion of the financing needs of the sector. This unmet demand presents a significant opportunity for the flow of banking credit which the supply is not poised to match.
Today, banks are the last resort for MSMEs for additional financing due to the following reasons: governance, prerequisites for bank loans and cost of credit. Analysis from the study revealed that 80% of the MSME respondents do not have a functional Board of Directors (BOD) or advisors since many MSMEs operate as sole proprietary firms. Hence, the firms’ structure is a huge limitation to effective corporate governance; attributable to the limited knowledge of the enterprises on the significance of corporate governance and its role in accessing finance.

Another major limitation faced by MSMEs in seeking funding from banks is the prerequisite - stringent documentation and collateral requirements. Globally, Sub Saharan Africa (SSA) is one of the most difficult regions to access finance having an estimated credit gap of $70bn-$90bn1, 20% of the debt is financed through private sector (mostly banks) due to the high risk involved in the unorganized enterprises. In terms of capital requirements, the study revealed that 67% of small firms borrow below N5m and use such funds for business expansion (36%) and working capital (33%) requirements.

**Banking MSMEs**

Although majority of banks acknowledge the strategic role the MSME segment plays in driving economic development and the huge opportunity that exists in banking the MSMEs, bank’s involvement in financing this segment remains low. Banks have attributed their limited play to two key challenges: informal nature of the MSME leading to a limited knowledge of segment and the higher risk involved in lending to the segment.

As a result, over half (56%) of the banks surveyed have MSME loan portfolio contributing less than 10% (most of the Tier 1 banks have less than 5%) to their bank’s total loan portfolio.

The low participation of commercial banks in providing finance to MSMEs in Nigeria may be associated with the poor knowledge of the segment. Only about 50% of MSMEs believe bank relationship managers understand their needs and provide appropriate advice on credit and other bank products. This study also reveals that most banks may not be appropriately organised to serve this segment.

Capturing the opportunities in the MSME space would therefore require banks to implement good internal practices and adopt more innovative processes as traditional methods may be ineffective in serving this dynamic market segment. Banks with a serious focus on the MSME segment stand to improve their chances of capturing the MSME opportunity on a significant scale by adopting some of the following approaches:

- Develop a thorough understanding of the MSME segment to be able to offer tailor-made solutions

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1 The African Development Bank, 2013 ‘Financial Inclusion in Africa’

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The percentage of the bank’s total credit portfolio dedicated to MSMEs

*Despite the MSME segment being identified as critical by banks, 84% of the banks surveyed reported that MSME loan portfolio is less than 20% of their total loan portfolio.*

- Less than 5%: 5%
- 5-10%: 5%
- 10-15%: 11%
- 15-20%: 28%
- 20-30%: 28%
- More than 30%: 17%
- N/A: 6%

*Source: 2014 MSME Banking Study*
• Embrace customized risk management methods such as relationship lending as collateral based lending may not have the capacity to facilitate the expected development of the segment

• Intensify engagement with government to implement initiatives that will improve the business environment necessary for facilitating lending to the MSMEs

• Refresh customer experience and service delivery as it is established to have a strong potential to increase profitability

**Government’s Role**

The role of government in the development of the MSME segment is substantial from a regulatory, policy formulation and financing standpoint to overcome the challenging business environment. Some of the areas of impact include: policy development, capacity building, business incubation, access to finance and market access development.

Government’s involvement in MSME development should therefore not be limited to provision of adequate infrastructure but also support the segment by articulating favourable policies and championing initiatives that support the growth of MSMEs such as:

• Direct government interventions through development banks, credit guarantee schemes and other forms of subsidized financing.

• Tax incentive policies to provide MSMEs easy access to raw materials and production inputs (power, water etc.).

• Credit reference bureau as well as improving the judicial process and incentivizing the banks to provide affordable loans to MSMEs.

• Simplified company registration process, which takes into consideration the peculiarities of MSMEs compared to larger companies.

Finally, creating the enabling environment for MSMEs to deliver its full potential of job creation and national growth, all stakeholders – MSMEs, commercial and developmental banks, business development service providers and government must be ready to play their roles.
The MSME segment is defined differently in various countries. While businesses in this segment play a critical role in most economies, with significant contribution to employment generation, GDP, per capita income, etc., they share some common concerns across the various jurisdictions.

Access to finance, poor infrastructure and stringent regulatory requirements are some of the most critical and common challenges that MSMEs face in emerging markets. While governments in many emerging market continues to establish support mechanisms and dedicated institutions to support small and medium enterprises; approximately 50-60% remain unserved or under-served. (World Bank MSME database 2011).

The funding constraint is a universal challenge that MSMEs face; driven mainly by banks' unwillingness to lend without collateral, lack of proper documentation and excessive bureaucratic procedures. As such, MSMEs resort to alternate, costlier channels for funding. This issue has gained prominence and become more critical after the global liquidity crisis in 2008-09.

<table>
<thead>
<tr>
<th>Region</th>
<th>Number of MSMEs reached by the top five banks serving MSMEs (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Latin America</td>
<td>68</td>
</tr>
<tr>
<td>East Asia</td>
<td>50</td>
</tr>
<tr>
<td>Eastern Europe &amp; Central Asia</td>
<td>31</td>
</tr>
<tr>
<td>Middle East &amp; North Africa</td>
<td>24</td>
</tr>
<tr>
<td>South Asia</td>
<td>17</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>14</td>
</tr>
</tbody>
</table>

Source: IFC/World Bank MSME Finance 2011
According to an estimate by the World Bank, access to finance is disproportionately difficult for smaller firms in the least developed countries; with 43% SMEs in these countries reporting access to finance as a major constraint to their growth and development compared to 31% in middle-income countries and 17% in high-income countries. Among emerging market regions, Sub-Saharan Africa lags behind the rest of the world with only 5% of SMEs are catered for by the major banks (top 5) in the region.

In addition, 52% of MSMEs in low income countries cited electricity as the most critical concern for growth (World Bank Enterprise Survey). Challenges such as these often have multiplier effect and adversely impact economic growth. (World Bank Enterprise Survey).

### Financial and Non-financial Barriers to MSME Growth by Country Income Group

<table>
<thead>
<tr>
<th>Tax Rates</th>
<th>Corruption</th>
<th>Information</th>
<th>Finance</th>
<th>Electricity</th>
<th>Transportation</th>
<th>Regulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>36%</td>
<td>20%</td>
<td>20%</td>
<td>17%</td>
<td>28%</td>
<td>16%</td>
<td>37%</td>
</tr>
<tr>
<td>37%</td>
<td>42%</td>
<td>34%</td>
<td>31%</td>
<td>37%</td>
<td>21%</td>
<td>42%</td>
</tr>
<tr>
<td>39%</td>
<td>35%</td>
<td>34%</td>
<td>43%</td>
<td>52%</td>
<td>25%</td>
<td>38%</td>
</tr>
</tbody>
</table>

**Source:** World Bank Enterprise Survey

Besides poor infrastructure and financing constraints, taxation, corruption and regulatory bottlenecks are other issues that impede growth in the MSME segment. For instance, India imposes a number of indirect taxes on transit of goods from one state to the other within the country. While the government has made effort to introduce a uniform pan-India tax on goods & services, long bureaucratic processes and political compulsions have not let that happen so far.

Many of these problems are faced by MSMEs in developed economies as well, albeit in different order of severity than their emerging markets counterparts. These challenges also vary by region, sector and size of the firm.
In the EU-28, access to finance is an area of concern for micro sized firms, while lack of skilled staff is for small and medium sized businesses. MSMEs’ inability to deal with regulatory complexities is also another critical concern.

Most critical problems facing MSMEs in the EU-28 in 2013

<table>
<thead>
<tr>
<th>Problem</th>
<th>Medium</th>
<th>Small</th>
<th>Micro</th>
<th>All MSMEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost production of labour</td>
<td>12.0%</td>
<td>14.3%</td>
<td>12.6%</td>
<td>12.9%</td>
</tr>
<tr>
<td>Competition</td>
<td>16.4%</td>
<td>12.0%</td>
<td>13.4%</td>
<td>13.8%</td>
</tr>
<tr>
<td>Availability of skilled staff or experienced manager</td>
<td>15.9%</td>
<td>18.0%</td>
<td>11.0%</td>
<td>14.2%</td>
</tr>
<tr>
<td>Regulation</td>
<td>15.7%</td>
<td>13.5%</td>
<td>13.8%</td>
<td>14.2%</td>
</tr>
<tr>
<td>Access to finance</td>
<td>11.5%</td>
<td>14.9%</td>
<td>17.9%</td>
<td>15.4%</td>
</tr>
<tr>
<td>Finding customers</td>
<td>23.7%</td>
<td>21.4%</td>
<td>22.5%</td>
<td>22.4%</td>
</tr>
</tbody>
</table>

Source: European Commission/European Central Bank

Key government initiatives to support MSMEs

The European Commission and National Governments provide a structural, Europe-wide support to the MSME segment under the Small Business Act (SBA). SBA was adopted in 2008, driven by challenges faced by the MSMEs in Europe following the global financial crisis. Based on the outcome of the survey conducted by European Commission on the needs and requirements of MSMEs, several policy measures were introduced to assist the segment.

Percent distribution of policy measures implemented per SBA principle in EU-28 -2013/14

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Access to Finance</td>
<td>26%</td>
</tr>
<tr>
<td>Entrepreneurship</td>
<td>19%</td>
</tr>
<tr>
<td>Skills &amp; innovation</td>
<td>13%</td>
</tr>
<tr>
<td>Responsive admin</td>
<td>10%</td>
</tr>
<tr>
<td>Internationalisation</td>
<td>9%</td>
</tr>
<tr>
<td>Environment</td>
<td>7%</td>
</tr>
</tbody>
</table>

Source: European Commission/European Central Bank
A case study on Developmental Impact of India’s Micro Finance Program

In 2001, Small Industries Development Bank of India (SIDBI) and Department for International Development (DFID) UK commissioned a 7-year long study to assess the impact of India’s micro finance program on income, women empowerment, socio-economic landscape, enterprise growth, etc.

- Effect of micro finance on enterprise growth: According to the results of the study, between the baseline and the endline surveys (different phases of the study), the number of enterprises of the client households increased by 1.2% while those supported by micro credit increased by 5.7%. Furthermore, 54% of those surveyed credited micro finance program for increase in size of their business activity.

- Effect on income levels: The study assessed increase in acquisition of assets, which is an indication of capital formation and improvement in the living standards of clients. In the case of very poor category, the percentage of households reporting acquisition of assets increased from 32.3% in baseline to 40% in endline.

- Effect on women empowerment: The proportion of women households saving with formal financial institutions increased from 14.2% to 16.2% between baseline and endline surveys. At the same time, savings of women with the informal sector declined from 11.2% to 6.5%.

The report further highlights that “while micro finance movement in India is making rapid strides and has raised high expectations in the country about the role that it can play in poverty reduction and women empowerment”, there continues to be a vast unfulfilled demand. As at 2013, the MSME sector had debt finance demand of over USD530billion. Out of this, banks and other formal financial institutions could lend only USD100billion.
Major Impediments to MSME growth in Nigeria

Top 3 challenges facing MSMEs - enabling environment, government policies and access to finance

The MSME segment is an important engine for growth, employment generation and social cohesion in Nigeria. However, the creation, survival and growth of MSMEs is often hampered by several challenges; prominent among these are non-conducive enabling environment, inconsistent government policies (including taxes) and access to finance. These challenges have stifled the growth of the segment and limited its contribution to the overall economy.

Top 3 challenges - based on survey response rate

1. Enabling environment:

Enabling environment factors were highlighted as the greatest impediments to the growth of MSMEs, these factors include: lack of access to modern technology, low investment in research and development, poor access to markets and weak infrastructure - electricity, water, road infrastructure, etc.

According to the Association of Nigerian Development Finance Institutions (ANDFI), “Finance is usually considered as the major constraints of MSMEs. However, empirical evidence has shown that finance contributes only about 25% to the success of MSMEs.

Inadequate and inefficient infrastructural facilities continue to affect the performance of MSMEs, escalate their costs of operation as the MSMEs are forced to resort to private provisioning of utilities such as water, electricity, transportation, communication, etc. According to the World Economic Forum’s Global Competitiveness Index 2012, Nigeria ranked 130 in infrastructure out of 144 countries rated globally. Previous studies, such as World Bank’s World Development Report 2005 and United Nations Economic...
Commission for Africa’s Economic Report on Africa 2004 also highlighted similar concerns with regards to infrastructure deficiencies and its impact on industrial output.

Lack of access to appropriate technology as well as near absence of research and development capacity also pose significant challenges to the growth of MSMEs in Nigeria. Many small businesses in Nigeria continue to adopt crude methods for the production of goods and provision of services and this has an impact on the cost of production, production capacity and quality of the outputs.

Although Nigeria boasts of a huge market potential for Nigerian made goods, local MSMEs encounter challenges such as: restricted market access, weak demand for locally produced goods and unfair trade practices characterized by the importation and dumping of substandard goods by unscrupulous businesses.

The plight of MSMEs is further worsened by lack of knowledge - a few fundamental business practices e.g. market planning, research and market segmentation - which results in a less than optimal business performance.
2. Government policies:

Across the globe, government plays an important role in the growth of MSMEs and acts as a partner in its development by providing the following incentives and support:

- Direct interventions funneled through development banks, credit guarantee schemes and other forms of subsidized financing.
- Tax incentive policies to provide easy access to raw materials and production inputs (power, water etc).
- Creation of credit reference bureaus as well as improving the judicial process and incentivizing banks to provide affordable loans to SMEs.
- Simplified company registration process, which takes into consideration the peculiarities of MSMEs compared to larger companies.

Recently, the Nigerian Government made a few policy changes to drive the development of the sector. Some of the changes include the prohibition of some classes of fully-manufactured products, the new automobile policy of the Federal Government to discourage the importation of used cars.

Government should implement policies that will encourage banks to extend loans at subsidized interest rate and no collateral. – MSME survey respondent

Government should, through its relevant agencies, fund the provision of the basic infrastructure like power, access roads, production equipment for identified clusters of SMEs etc. on a shared platform basis. – Bank survey respondent

3. Access to finance:

To encourage greater bank led financing, the Central Bank of Nigeria (CBN) has increased its focus on the MSME sector through several lending and credit facilitation programs. In 2010, CBN established a N200 billion Small and Medium Enterprises Credit Guarantee Scheme (SMECGS) for promoting access to credit to SMEs in Nigeria. As a part of another initiative, the apex bank introduced Small and Medium Industries Equity Investment Scheme (SMIEIS) in conjunction with the Bankers’ Committee - an umbrella body comprising the CBN, Deposit Money Banks (DMBs) and Discount Houses, to provide long term financing. Furthermore, the CBN also earmarked N200 billion for the refinancing/restructuring of bank’s existing loan portfolios to the Nigerian MSME/manufacturing sector.

Respondents listing access to finance as one of the top three challenges

45% of the MSMEs surveyed have rated access to finance as one of the top three most critical challenges their businesses face today. Of the respondents who consider access to finance as among the top three challenges, over 50% consider it to be the most critical challenge their business faces today.
In addition, the Nigerian government launched a US$500 million agric-focused fund to support a sector that boasts of very many micro and small enterprises. However, given the significant demand-supply constraints, the financing chasm has grown and MSMEs continue to face significant funding challenges to meet their business requirements.

The study revealed that in the last three years, the rejection rate of MSME loan applications was greater than 50% for nine out of eighteen banks surveyed and as high as 90% for three of the banks. Furthermore, MSME loan applications to commercial banks had to undergo a series revisions, specifically pertaining to loan amounts, structure and/or repayment period before final approval.

This has led to a negative perception among MSMEs, where a majority (about 60%) of the respondents think that commercial banks are unwilling to finance the sector. A similar proportion of MSME respondents also do not consider it easy to access other products and services from banks.

Findings from the study also revealed that only about 20% of the MSMEs have applied for bank financing over the last 5 years and prefer to raise finance for their businesses through personal channels i.e. friends, family, informal financiers etc., on account of higher chance of success.
This unmet funding demand presents a significant opportunity for the flow of banking credit. Across the globe, sub-Saharan Africa is one of the most difficult regions to access finance by MSMEs with a credit gap estimated at between $70bn-$90bn. Approximately 20% of this amount is debt financed through the formal sector in which banks have the largest share. The risk perception attached to unregistered or unorganized enterprises i.e. MSMEs is due to a lack of transparent financial data, limited immovable collateral and the lack of credit assessment skills of banks for some of the less understood business segments and sub-segments.

What is the highest amount you have ever borrowed from a bank?

Majority of the firms typically borrow less than N5m. These ‘large’ borrowers are mainly from Transport & Logistics (22.2%), Manufacturing (14.8%), and Real Estate (11.1%) sectors.

Source: 2014 MSME Banking Study

What MSMEs Use the Loans for?

Debt for business expansion, working capital financing and to a lesser degree for capital expenditure (land and equipment finance) are the top three uses of finance by MSME.

Source: 2014 MSME Banking Study
Challenges Confronting MSMEs

While large businesses and corporates have the ability and resources to easily expand, this may be more challenging for MSMEs as there are obstacles they need to overcome in order to thrive.

The major challenges that need to be addressed immediately have been identified as, but not limited to:

- High cost of doing business occasioned by poor infrastructure (power, roads, water, etc.), multiple taxation, high cost of legal documentation of credit facilities at both the States Lands Registries and the Corporate Affairs Commission (CAC).
- Bureaucracy in obtaining title to land and State Governors’ consent to mortgage property, etc.
- Inadequate capacity building on the part of the MSMEs in the areas of entrepreneurship, skills acquisition, etc. and on the part of the financial institutions in understanding the dynamics of the MSME sector resulting in their perception of the sector as high risk.
- Poor attitude to loan repayment by the borrowers.
- Limited access to credit occasioned by the above factors among other reasons.

Addressing the Cost of Doing Business

Key improvement areas include:

- Addressing power and other infrastructure challenges. This is already in progress as part of the Federal Government power sector reforms programme.
- Adopting a cluster approach to MSMEs development by setting up Industrial/Cluster Parks with all necessary amenities. This would address the issue of infrastructure, high legal documentation registration fees, etc. The cluster approach should also include the possibility of setting up small renewable energy (solar, hydro, wind, etc.) captive off-grid power plants of 1-5 MW capacity or more to serve the clusters and the immediate community. The Industrial Development Centres (IDCs) under the management of SMEDAN can be used as a launch pad for immediate take-off of the industrial/cluster parks.
Accessing Finance from Banks - Key Considerations

Today, banks are the last resort for MSMEs seeking additional financing. Based on the outcome of our survey, we delved into a few of the critical reasons why this is so.
Governance

Findings from the study revealed that a significant majority (77%) of MSMEs do not have a functional Board of Directors (BoD) or advisors as they operate as sole proprietary organisations, completely managed by the owners. We note that the absence of a Board of Directors may be as a result of a lack of awareness among these enterprises regarding the significance of proper corporate governance practices or that these organisations are averse to adopting these practices because of the additional cost of implementation.

There is therefore a need to create awareness among the MSMEs about the benefits and role of corporate governance to enable easier access to finance.

Do you have a functional BoD or Advisors for your company?

<table>
<thead>
<tr>
<th>Option</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>1%</td>
</tr>
<tr>
<td>No</td>
<td>22%</td>
</tr>
<tr>
<td>N/A</td>
<td>77%</td>
</tr>
</tbody>
</table>

Which of the following best describes your company?

<table>
<thead>
<tr>
<th>Option</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner managed</td>
<td>79%</td>
</tr>
<tr>
<td>Hired manager</td>
<td>7%</td>
</tr>
<tr>
<td>Relative manager</td>
<td>9%</td>
</tr>
<tr>
<td>N/A</td>
<td>2%</td>
</tr>
</tbody>
</table>

How many people are on your BoD or serve as advisors?

<table>
<thead>
<tr>
<th>Option</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 to 3</td>
<td>10 and above</td>
</tr>
<tr>
<td>3 to 6</td>
<td>7 to 9</td>
</tr>
<tr>
<td>10 and above</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Source: 2014 MSME Banking Study

Prerequisites for Bank Loans

MSMEs are of the opinion that a few of the documentation requirements from commercial banks for obtaining loans e.g. business plans, collateral, cash flow or financial statements etc. may be too stringent and therefore constituting a roadblock. Due to their informal nature, MSMEs often find it difficult to provide the requisite documents to support their loan applications. This trend is not peculiar to Nigeria as research has shown that MSMEs across Sub-Saharan Africa and other developing nations face this constraint. Banking the MSMEs must necessarily require a more dynamic and supportive approach by banks, as the traditional methods of banking may not address the peculiarities of this segment.

Our survey highlights a clear gap between documents readily required by banks before credit can be extended and documents available with MSMEs. Although Business plans and Financial Statements are considered to be the important prerequisites by banks, only 38% and 22% MSMEs respectively have these documents.
Reasons for loan rejection

On the global and local front, collateral requirements have become increasingly stringent since the recent financial crisis. In order to compensate for the increased risks resulting from information asymmetry, collateral requirements are even more rigorous for the MSME segment.

Our study revealed that about 20% of the MSMEs that have not applied for loans in the last 5 years have not done so because they do not have the required collateral. Furthermore, among the ones that applied and were denied a loan, 35% attribute such rejections to collateral issues.

The traditional mode of extending credit based on collateral pledge is not a feasible approach to banking MSMEs, as most MSME businesses start with virtually no tangible assets. Drawing upon insight from developed countries, as well as, progressive developing countries, collateral based lending is gradually being de-emphasised and more attention is paid to the peculiarity of each business to identify creative ways of securing the banks’ exposure to this segment.

Developing countries now promote their MSME segments through initiatives such as credit guarantee schemes. For example, in India, a Credit Guarantee Trust has been set up to help MSMEs without the requisite collateral. The fund provides both term loans and working capital facility, extended by banks up to US$170,000 per borrowing unit.
Cost of Credit

Reasons for MSMEs not applying for loan through commercial banks

- **39%** Interest rate too high
- **15%** Sufficient internal funds to run
- **13%** Fear of possible rejection
- **7%** Do not like bank loans
- **7%** No collateral to pledge
- **1%** Unaware that bank(s) provides loan facilities to MSMEs
- **1%** Others

Source: 2014 MSME Banking Study

Another key factor that prevents MSMEs from approaching the banks for credit is the high cost of the credit. About 30% of MSMEs that have not applied for loans from commercial banks consider high interest rates as a major deterrent. Participants from an MSME focus group discussions also confirmed that for most MSMEs, the bank is always the last resort for funding.

One major reason for the high cost of funds can be attributed to the relatively high default rate on loan repayments, as banks have to factor in the cost of heightened risks resulting from information asymmetry. The often weak or unavailable credit history of MSMEs make the credit-evaluation process even more expensive.

67% banks surveyed agree that the default rate on loan repayments by MSMEs is higher than that of large corporate entities, while 55% of banks agree that the MSME default rate is higher than that of the retail segment.

**So how can the challenge of access to finance be addressed?**

MSMEs response: Areas of impact to address the issue of access to finance from commercial banks

- **26%** Interest rate
- **13%** Government Policies
- **12%** Collateral
- **5%** Loan Repayment Terms

Source: 2014 MSME Banking Study
WITH over 17.3 million small businesses in the country, Nigeria can be said to have an entrepreneurial culture. However, this entrepreneurial culture, driven by the activities of MSME’s have not been met with a favourable environment for MSMEs to thrive; the result has been high mortality rate of small businesses and a stunted growth trajectory such that these businesses hardly formalise their operations or never cross over from small to large corporations.

We decided to adopt a holistic approach to address MSME development in Nigeria – the National Enterprise Development Scheme (NEDEP), as our experience has shown that previous programs and initiatives sought to solve just one or a few aspects within the whole cycle.

NEDEP was initiated after consultation with stakeholders and many months of research and is a new way of delivering enterprise development in Nigeria. NEDEP incorporates Nine (9) priority areas to improve the operating climate for SMEs in Nigeria:

- Strengthening Institutional framework
- The development of a revised National SME policy
- Increasing MSME access to affordable finance
- Increasing access to markets for MSMEs
- Developing business development skills for entrepreneurs
- Developing technical skills in MSME operators
- Promoting youth inclusion
- Taking measures to reduce the high operating cost for MSME operators
- The implementation of a robust delivery and monitoring structure

The implementation of NEDEP began in 2013, and it has three main implementing agencies: the Small and Medium Development Agency of Nigeria (SMEDAN), the Industrial Training fund (ITF) and the Bank of Industry (BOI). The ITF ensures that Nigerians are trained in the area of Skills development. The Small and Medium Enterprise Development Agency of Nigeria (SMEDAN), which ensures that entrepreneurs receive the right business support and training, and then the Bank of Industry (BOI) which lends to qualifying applicants under the scheme. This is the first time that this three agencies in Nigeria are coming together to deliver a program of this nature. Our goals are ambitious and stretching, but so is the magnitude of the challenges facing MSMEs in Nigeria.

In its first year of implementation, we have already recorded some gains.

- Re-organisation of SMEDAN to improve its coverage and responsiveness to Nigerian; currently represented in the 36 states of the federation.
- Cost reduction for business registration - to encourage more businesses to move from informal to formal status, the cost of registering businesses in Nigeria has been reduced by 60%. Furthermore, the need for a lawyer has been removed from the process for business registration. There have also been road shows and media campaigns to encourage more firms to register their businesses.
- Set-up of national and state SME councils – the responsibility of these councils is to discuss the issues affecting MSME development and recommend solutions/initiatives to improve the operating environment of MSMEs. The national
council is chaired by the vice president and will have pertinent stakeholders in the MSME space as members. Similarly, the state councils will be made up of trade associations and chaired by the governor or his/her designate(s) in each state. Currently, we have officially set up SME state councils in 10 states in Nigeria.

• Private Equity and Venture Capital Committee - this team comprises of private practitioners, regulators and investors in the PE/VC space. Their mandate was to provide recommendations and actionable items that will boost the PE/VC industry in Nigeria, such that the PE/VC industry is expanded to provide funding and expertise to help small businesses grow. The committee will invest, not just funds in deserving businesses, but also expertise and governance needed to grow businesses from small to large concerns.

• Closely related to the work on the development of the PE/VC industry is our work on the improvement of the financing value chain. We realise that Commercial banks are not the only source of finance for MSMEs and that businesses require different forms of capital at different stages of their development. It is in this light that we are making a number of recommendations on improving the financing value chain in Nigeria so entrepreneurs can access funds at every stage of their business from start up to early stage and through various mediums from angel investors, commercial banks, the stock exchange, private equity and venture capital funds.

• Bottom of the Pyramid (BOP) scheme - BOI has also begun a Bottom of the Pyramid (BOP) scheme whereby they lend to qualifying microfinance banks for on lending to micro and small enterprises. They already have four partner micro finance institutions and this will grow as time goes on. In addition, BOI has commenced the group lending model for the micro and small enterprises whereby they cross guarantee themselves and the need for physical collateral is reduced.

• Youth entrepreneurship program - We are encouraging young people to take to entrepreneurship in order to create jobs, not just for themselves but also for others. In order to drive this, we launched the Universities National Entrepreneurship Development program (UNEDEP) in November 2013. This scheme will involve going round the universities in Nigeria with some identified business mentors who have achieved a measure of success in business. These people will mentor and inspire young people to take up entrepreneurship, act as judges for regular business plan competitions and also contribute seed funds for budding businesses and business ideas.

• Another key pillar of NEDEP is engagement with the private sector. In this regard, we are continuously engaging with:
  – Commercial banks – We are entering into partnerships with a number of them in areas like training, monitoring of loan recipients and the overall development of the MSME credit proposition.
  – Large Corporations – We are partnering with a number of them to ensure the MSMEs become part of their supply and value chain.
  – Business Service providers - We are partnering with these service providers to ensure that business development training and support is offered to a lot more people than the government agencies can presently provide.
  – International Development Partners – A number of them are implementing partners under NEDEP and will be bringing their expertise and funding to make the project a success.

Essentially, NEDEP is meant to encourage every Nigerian who has a business idea to move from the stage of thinking to actualising and running a business. The program will remove bottlenecks of enterprise development.

We would also like to use this medium to encourage SME operators and stakeholders to continue to give their feedback on how we can further improve the environment by sending their suggestions through http://www.smedan.gov.ng/.
Banking MSMEs: a double edged sword - how do Banks ensure a win-win in situation

Banks in Nigeria may have began, albeit cautiously, to identify the MSMEs as an important sector of the economy and are taking different steps to deepen their understanding and play in this segment. This realization is not unconnected to the thinning margins in transactions with large corporates and the increased determination of various governments to drive economic growth and development agenda through the MSME segment. Government will continue to rely on the banks to serve as a vehicle to administer developmental funds, as well as extend other lines of credit to increase the financing options to MSMEs.

Insights from the study revealed that for Nigerian banks, MSME financing has gone beyond a social objective and for a few banks, MSMEs are a critical part of the banks’ strategy.

Reason for involvement in Banking MSMEs

- **100%**: MSME is a strategic sector for growth of the economy
- **67%**: High risk-adjusted profit of the sector
- **50%**: Social objective
- **44%**: CBN’s influence to focus on MSME sector
- **39%**: Increased competition

Source: 2014 MSME Banking Study
The MSME segment: a critical part of banks’ strategy?

- 50% Yes
- 50% No

Source: 2014 MSME Banking Study

Percentage of the bank’s total credit portfolio that is dedicated to MSME’s

- 6% Less than 5%
- 5% 5-10%
- 6% 10-15%
- 28% 15-20%
- 28% 20-30%
- 11% More than 30%
- 17% Not applicable

Despite the MSME segment being identified as critical by banks, the share of MSMEs in the credit portfolios of banks is quite low. 84% of the banks surveyed reported that MSME loan portfolio is less than 20% of their total loan portfolio.

Source: 2014 MSME Banking Study

The low participation of commercial banks in providing finance to SMEs in Nigeria can be associated with the poor knowledge of the sector. The study reveals that only half of the MSMEs believe bank relationship managers understand their business and are able to provide appropriate advice on credit and other bank products. Furthermore, only about one third of banks have significantly banked the segment for more than 5 years. Interactive sessions with the surveyed banks also highlighted that the focus on the MSME segment is a recent occurrence, with many banks still grappling to understand this segment.

How long have you been providing services to this business segment?

- 29% < than 6 months
- 24% 6 months - 2 years
- 12% 2 - 5 years
- 29% > than 5 years

Source: 2014 MSME Banking Study
Providing banking services for MSMEs beyond deposit mobilisation and cash management has been a challenge for banks in other markets as well. This is primarily due to the difficulty in ascertaining whether organisations have the capacity and/or are willing to pay. Many banks are realising that supporting this segment will require increased focus and a dedicated business unit within the bank to address the peculiar needs of the segment.

In Nigeria, about 80% of the banks surveyed have constituted a dedicated unit to serve the MSME segment since 2011. Majority of the Tier 1 banks that have a dedicated SME units operate the unit under the Retail/Consumer Banking or Commercial Banking division. Banks in other emerging markets also operate dedicated units for MSMEs; according to a World Bank survey (2006), 88% of banks in Chile, 100% in Columbia and 88% in Serbia had dedicated units for SMEs.

The financial inclusion initiatives in the Nigerian banking sector has led to an increase in the number of MSMEs with bank accounts, however, there is a need to deepen these banking relationships as over 92% of MSMEs surveyed currently utilise only one or two banking products from their respective banks. At the same time, Nigerian banks are now adopting a combination of product strategies e.g. risk assets, cash management/ deposit mobilization as well as value-added services i.e. trainings, advisory services, creating networking platforms etc. to penetrate this segment. From the focus group session with the banks, we sensed a general preference for banks to provide more value added services (VAS), as this could be a veritable way of establishing strong relationship with MSMEs and deepen the understanding of the nature of their businesses. Minimum emphasis is currently given to risk assets creation in this segment, with more than 50% of banks having MSME loan portfolios less than 10% (<5% for Tier 1 banks) of their bank’s total credit exposure. Banks will need to create more awareness among MSMEs on the benefits of their varied service offerings, beyond just the deposit products in order to address the gap between services offered by banks and those demanded by MSMEs.

### Number of services used by MSMEs

- 1 - 2 services: 5%
- 3 - 4 services: 3%
- No service: 5%
- 5 or more services: 92%

Source: 2014 MSME Banking Study

### Type of banking services used by MSMEs

- Deposits: 96%
- Loans: 18%
- Trade Services: 10%
- Advisory Services: 8%
- Other: 1%

Source: 2014 MSME Banking Study

### What differentiated products and services do you offer to MSMEs (number of banks)

- Credit Products: 17
- Transactional products: 16
- Advisory services: 15
- Deposits products: 15
- Others: 8

Source: 2014 MSME Banking Study
Nigeria also lags behind other African nations when it comes to banking the MSME segment. A 2013 World Bank report estimates the share of MSMEs in the credit portfolios of banks in Nigeria is at 5%, much lower than other African markets, such as Rwanda (17%), Kenya (17.4%) and Tanzania (14%).

**Banks’ involvement with MSMEs: a comparison with African countries**

<table>
<thead>
<tr>
<th>Region</th>
<th>MSMEs Share of Total Bank Lending</th>
<th>Contribution of MSMEs to Bank’s Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nigeria</td>
<td>5%</td>
<td>11%</td>
</tr>
<tr>
<td>South Africa</td>
<td>8%</td>
<td>15%</td>
</tr>
<tr>
<td>Tanzania</td>
<td>14%</td>
<td>16%</td>
</tr>
<tr>
<td>Rwanda</td>
<td>17%</td>
<td>20%</td>
</tr>
<tr>
<td>Kenya</td>
<td>17%</td>
<td>21%</td>
</tr>
</tbody>
</table>

Source: IFC/World Bank

**The contribution of MSMEs to banks’ net income is higher than the share of loans, indicating high profitability of MSME portfolios due to selective lending and high interest rates.**

**Banks’ Services Portfolio: Comparison with other African countries**

<table>
<thead>
<tr>
<th>Region</th>
<th>Credit</th>
<th>Deposits and Account Management</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nigeria</td>
<td>22%</td>
<td>53%</td>
</tr>
<tr>
<td>South Africa</td>
<td>27%</td>
<td>50%</td>
</tr>
<tr>
<td>Kenya</td>
<td>68%</td>
<td>13%</td>
</tr>
<tr>
<td>Rwanda</td>
<td>71%</td>
<td>11%</td>
</tr>
<tr>
<td>Tanzania</td>
<td>73%</td>
<td>12%</td>
</tr>
</tbody>
</table>

Source: IFC/World Bank

An analysis of the revenue distribution of banks in some African markets highlight important differences. Banks in Kenya, Rwanda and Tanzania extend more credit (in % terms) to MSMEs, compared to banks in Nigeria and South Africa. A World Bank 2013 study also estimates that on average, credit-related revenues comprise about 39% of overall revenues in developing markets. The relatively better scenario in Kenya and Rwanda is driven by a flexible and relationship-oriented banking environment.
In Nigeria, First Bank emerged as the most popular bank among MSMEs for both deposit transaction and credit/loan activities.

The finding above suggests that there is scope for banks to improve on their relationships with MSMEs particularly with respect to deepening their understanding of the various segments/ sub-segments.

Similarly, in terms of ease of doing business, the study revealed that about 50% of MSMEs do not find it easy to access relevant services from their banks. This could be due to banks not having specialised MSME relationship managers at branches, preferring to rely on retail relationship managers to serve MSMEs. The survey revealed that only about 5 Nigerian banks have SME business managers in their branches, however, focusing largely on financial targets (revenue, deposits and loans), instead of developing products that address the needs of MSMEs.

Amongst alternate sources of funds for MSMEs, Development Financial Institutions (DFIs) are not necessarily preferred by the MSMEs. The study also revealed that only 2% of MSMEs have obtained loans from a development bank e.g. NEXIM, BOI, BOA etc. either directly or through some other bank.

Have you obtained loans from any development bank e.g. NEXIM, BOI, BOA etc. either directly or through any other bank?
Capturing Bankable Opportunities in the MSME Segment

Capturing the opportunities in the MSME space would require banks to implement good internal practices and collaborate with government to create a platform that drives the growth of this segment. We believe banks will improve their likelihood of capturing the MSME bankable opportunities through the following:

**Relationship Model:**

Banks need to develop a thorough understanding of the MSME segment to be able to offer tailor-made solutions. In developing markets, MSMEs are typically more dispersed and banks need to be able to identify strategic locations in which the MSMEs operate in order to determine the market size and potential bankable revenue.

Based on these, banks can develop tailored products and services specific to each strategic MSME sector.

In addition to the above, banks need to intensify advisory and value-added services. Majority of the banks interviewed noted that poor business plans and lack of experience of business managers are some of the reasons for the high rejection rate of MSME loan applications. This may be attributable to the level of business acumen and financial literacy of the business managers and MSMEs at large.

Many banks have a start-up package to help MSMEs in terms of business support. For example, majority of the Banks interviewed run business seminars, SME clinics and other advisory services for their MSME clients to introduce them to business skills, such as inventory management, supply chain management, and financial reporting.
**Customized risk management**

The approach to banking MSMEs must change as the traditional method of banking -- collateral based lending does not have the capacity to facilitate the expected development of the segment. Banks in other climes explore relationship lending to bank MSMEs. This method of banking requires banks/relationship managers to develop a relationship with MSMEs/MSME clusters and reduces the opaqueness of MSME business. The set-back with the relationship lending approach is the high cost associated with the approach. Other arm’s-length lending approaches driven by technology credit scoring and significantly standardized risk-rating tools and processes, as well as special products such as asset-based lending, factoring, fixed-asset lending, and leasing - are deployed to bank as a substitute. Banks will also need to develop and deploy more specialized SME bankers across all their branches to provide customized services/solution to these segment.

Furthermore, MSMEs rarely possess the information required for a traditional credit scoring model – a credit rating, financial statements or collateral. The biggest challenge with MSMEs by far is lack of information and a few banks are beginning to introduce new and creative ways to assess MSME credit. One of the banks interviewed has established an initiative to support MSMEs in the area of financing without collateral. Specifically, the bank, in conjunction with RSL Derivatives, has set up a club called the Paris Club SMEs, where qualified customers are given a certificate of membership with which they would be able to approach the bank to finance their business. Rather than demand for collateral, the bank withholds 10 per cent, which is put in an investment protection fund.

Credit scoring is only one element, and to succeed in the MSME segment, banks must review all parts of their credit process covering credit origination, underwriting, monitoring and collections.

**Role of Government**

Government and banks constantly brainstorm on initiatives which will encourage banks to lend to this segment.

Banks therefore need to intensify their engagement with government to improve the business environment necessary for facilitating bank lending to the MSMEs. Some of government initiatives that could be beneficial to banks and the MSME segment include government participation in risk sharing facilities. For example, the UK government has created several enhanced incentives for banks to lend to MSMEs such as the £2 billion Enterprise Finance Guarantee fund which provides a 75% government guarantee on long-term (10-year) MSME loans to banks. In Singapore, Under Micro-Loan Programme, loans of up to $100,000 at 5.50% interest rate for a period of up to 4 years are granted for local SMEs with 10 or less employees.

A well-functioning and comprehensive credit information system is imperative for access to finance by MSME. The set-up of a credit bureau may lead to a significant increase in loan approvals and a reduction in default rates as seen in other developing economies.

Furthermore, dialogue with government particularly in terms of leveraging government information to identify underserved and unserved segments/markets. From the Bank’s perspective, information is the first step in understanding and overcoming finance challenge for MSMEs. Banks must therefore proactively engage governments on issues they need to resolve to facilitate MSME lending.
What MSMEs want

- Knowledgeable and effective relationship managers/bank representatives who have an understanding of MSME banking requirements, particularly at the beginning of the relationship.
- Product and services that meet specific needs of the MSMEs. These products must be simple, easy to use and reflect the peculiarity of MSME's business.
- MSMEs often require access to unsecured credit due to the hassle and bureaucracy involved in providing collateral acceptable to the banks - C of O in choice locations.
- Quick transaction processing turn around time. Maximum of 3 days for loan requests.

What Banks are saying

- MSMEs are a critical part of the Bank’s strategy. Average yield of providing banking services to MSMEs are typically higher than that of large corporates.
- Provision of credit to the MSME segment is a strategic priority to 78% of the banks interviewed due to the immense opportunity in the sector.
- Percentage of loans dedicated to MSME sector expected to increase. Whilst 56% of the banks interviewed have dedicated 5% of their loan portfolio to MSMEs, over 80% of them noted that this will grow over the next 5 years as provision of credit to the MSME segment is a strategic priority to three quarters of the banks interviewed due to the immense opportunity in the sector.
- Insufficient documentations and poor information on the MSME segment limits banks’ ability to lend. Around 40% of the banks interviewed listed insufficient documentation and poor business plans as a critical reason for MSME loan rejection.
- Government intervention required to facilitate lending to MSMEs: Majority of banks noted that the current government policies are insufficient to grow the level of credit extended to MSME. Government therefore needs to create an enabling environment to facilitate lending to this crucial sector.

Recommendations from Focus Group Session Participants

Financial institutions need to simplify their requirements for accessing finance. Considering the structures and business models of MSMEs, documentation requirements should be simplified and standardized.

Banks should consider introducing specialized financial products and services that can cater to the specific requirements of the MSME segment. Banks should also design credit facilities with more attractive lending terms.

Training sessions could be conducted to spread awareness among SMEs about available financial sources, banking products/services, and existing schemes that the government has undertaken for the disbursement of credit.
Structuring MSME sub-sector and maintaining stakeholders’ engagement - Small and Medium Enterprises Development Agency of Nigeria (SMEDAN)’s journey so far

SMEDAN was established by the SMEDAN Act of 2003 to promote the development of the MSME sector of the Nigeria Economy. The Agency engages the services and partners with a wide range of stakeholders using the PPP (public-public partnership or public-private partnership) model. The agency, since its formation, has been part of a number of initiatives.

These initiatives/policies have been responses to some of the identified factors hindering the growth of the MSME segment.

The National Policy on MSMEs: The first version of the policy was developed in 2007 with the financial support of United Nations Development Programme (UNDP) and the technical support of all stakeholders in the MSMEs sub-sector in Nigeria. The policy, which became a platform for creating an enabling environment for MSMEs in Nigeria, was approved by the Federal Executive Council (FEC) in 2007. In 2010, the policy was updated to address identified gaps.

The 2010 National MSMEs Survey: The dearth of a credible database was identified as another major constraint to the development of the MSMEs sub-sector in Nigeria. Due to the absence of a robust MSME database, the Agency and other principal stakeholders could not proactively evolve sustainable intervention strategies towards repositioning and developing an efficient and sustainable MSMEs sub-sector in Nigeria. The Survey highlighted that there are 17,284,671 MSMEs in Nigeria, employing about 32,414,884 Nigerians and contributing 46% to the GDP in nominal terms.

The Market Access Nigeria (MAN) programme: The MAN programme is a partnership between the Federal Ministry of Industry, Trade and Investment, SMEDAN, EDC (Pan-Atlantic University) and ETISALAT Nigeria. The purpose of the programme is to link Small and Growing Businesses (SGBs) to the value chains of Large Enterprises (LEs) for the purpose of enlarging the market of SGBs and for capacity enhancement. The MAN programme has held consecutively for 3 years (2012, 2013 and 2014) in Abuja, Lagos, Port-Harcourt, Calabar each year. In addition, Enugu hosted the MAN Programme for the first time in 2014. About 1,200 SGBs have benefitted from this project. The programme continues in 2015.
Entrepreneurship Development Programmes: The capacity of MSMEs’ operators is considered very necessary if MSMEs must operate optimally and deliver the maximum benefits of job creation, wealth creation and poverty alleviation to Nigerians. This is why SMEDAN places so much emphasis on the various capacity building programmes for her various target groups. In order to ensure reach, quality and value for money, the Agency engages the services of various stakeholders in both the public and private sectors. Enormous successes have been achieved through engaging stakeholders in this process.

The National Enterprise Development Programme (NEDEP): Recently, NEDEP, a strategic and holistic approach to delivering enterprise development in the country, was developed and implemented to directly address the critical factors that have inhibited the growth of the sector through stakeholder engagement. NEDEP provides the tools to assist enterprises grow from micro to small, small to medium and medium to large. The programme aims to create a minimum of one million jobs annually by strengthening the existing MSMEs in the country. NEDEP is one of the direct responses to the challenges identified by the 2010 National MSMEs survey performed by SMEDAN and NBS.

The Sub-Contracting and Partnership Exchange (SPX) Project: The Programme is a unique enterprises-linkage tool by the United Nations Industrial Development Organisation (UNIDO) for promoting investments, subcontracting, outsourcing and match making for products and enterprises in the MSMEs sub-sector. It links the MSMEs sub-sector in a host country to a credible global database of manufacturing concerns that is beneficial to both manufacturers and buyers of goods both within and outside the country. There is a global network of more than 75 SPXs in 41 countries. The 1st SPX in Nigeria was established by UNIDO in partnership with SMEDAN. The objective of SPX is to support MSMEs in Nigeria to gain a competitive edge and foster our participation in the global supply chain through recognition, participation and involvement of domestic and foreign buyers who are operating at the national, regional and the international level.
Customer Service: critical to servicing MSMEs

Exceptional customer service has been established to have a strong potential to increase profitability, particularly in service companies. A number of studies by different researchers provide some credence to this assertion: service improvement efforts produce increased levels of customer satisfaction at the process or attribute level, which results in increased overall customer satisfaction, higher overall service quality and increased behavioral intentions, such as greater repurchase intention. The increased behavioral intentions further leads to behavioral impact, including repurchase or customer retention, positive word-of-mouth and increased usage; which then results in improved profitability and other financial outcomes.

Nigerian banks have aligned with international brands across the globe to develop corporate strategies centred on excellent customer service to grow their revenues in the light of decreasing margins and increasing competition. The thinning margins across banking relationships with corporate clients has contributed favourably to the increased attention on the MSME segment, though with caution, due to the inherent risk in banking this segment.

A comparison of the survey results from the MSME study and 2014 KPMG Banking Industry Customer Satisfaction Survey (BICCS), which is also consistent with a 5-year review of the KPMG BICCS reveals key buyer values for the MSMEs as: understanding of MSME business segment, prompt transaction processing time; effective transaction platforms; friendliness & proactiveness of staff; efficient complaint resolution mechanism and appropriateness/suitability of bank’s products that meets customers’ needs. The 2013 edition of the KPMG BICSS also revealed that over 25% MSMEs highlighted excellent customer service as the primary reason for choosing to maintain banking relationship with their respective banks.

Successful MSMEs will become the multinationals of tomorrow; banks can drive loyalty to their brand by delivering excellent customer service and providing prompt and efficient transactions/platforms.

Banking services that need to be improved (MSME Study)

- Friendly, polite and proactive staff: 50%
- Reduction in wait times for transaction processing and requests: 45%
- Availability of products and services to meet your needs: 39%
- Fast and effective complaints resolution: 39%
- Competitiveness of interest rates, fees and charges: 38%

Banking services that need to be improved (BICSS)

- Reduction in wait times for transaction processing and requests: 22%
- Friendly, polite and proactive staff: 19%
- Improved delivery of services through channels: 18%
- Competitiveness of interest rates, fees and charges: 15%
- Fast and effective complaints resolution: 10%
Government’s Role: Key to Success for Growth

MSMEs in other climes, have had similar challenges in the history of their development and a key learning point is the pivotal role of the government in the transformation of this critical segment. Some of the areas of impact include: policy development, capacity building, business incubation, access to finance and market access development.

Generally, government defines effective policies to address the issue of excess taxation/levies, piracy and abuse of intellectual property, etc. Brazil’s government reduced tax bureaucracy for MSMEs by simplifying the tax filing (from eight documents to a single document), and unifying federal, state and municipal taxes under the Simple National tax reduction programme. By July 2011, 3.6 million small enterprises had been granted tax exemption by subscribing to the programme.

Capacity building and business incubation are fundamental stages in MSME development. Participants of MSME focus group discussions highlighted that poor business management skills and unavailability of skilled workers/talent retention play a significant role in the failure of their business. The United Arab Emirates (UAE), for instance, has implemented a business incubation program for entrepreneurs; the program runs for three to four years which includes: a pre-incubation phase which lasts for a year or less. The objective of the pre-incubation phase is to assist entrepreneurs develop their business ideas. The incubation stage runs for a year to three years where participants are supported to establish the right networks, trained to acquire critical business management competencies, mentored by successful businessmen, etc.; and ends with graduation at the end of the 3rd year after the participants must have fulfilled all the necessary requirements.

In developed countries, MSMEs are categorized into clusters to ensure the formulation of an all-inclusive access to financial scheme/strategy for MSMEs that caters for the different clusters. In UK, the Enterprise Finance Guarantee (EFG) is targeted at viable businesses that have been turned down by commercial banks due to the lack of security or proven track record, amongst other features the guarantee covered facilities between 3 months to 10 years life cycle; the Enterprise Capital Funds (ECF) is a programme set out to address the long-term structural weakness in the provision of risk capital for MSMEs, the initiative combines both private and public money to support high growth businesses; European Regional Development Fund (ERDF) is aimed majorly at public sector projects – further education, local authorities, government departments, voluntary organisations – in some circumstances the fund can be used for investing in MSMEs, particularly if they are in partnership with a public sector body; Export Enterprise Finance Guarantee (ExEFG) provides short-term financing option, usually about 2 years, to viable MSME businesses that are unable to secure commercial loans due to lack of security; Business Angel Co-Investment Fund (Angel CoFund) – a consortium of private and public sector bodies – is aimed at providing “angel” investment into MSME businesses at an early, high-growth stage. Other funds include the Business Finance Partnership (BFP), the Seed Enterprise Investment Scheme (SEIS) and National Loan Guarantee Scheme (NLGS).

Different thought leaderships/reports on the impact of MSME on economic growth have highlighted the huge potential of employment, participation and sustainability the segment has to offer.
The Nigerian government has since identified these potential and articulated a clear plan to achieve the objective of supporting MSMEs to play a strategic role in the country’s development (Vision 20-20). In 2013, the Federal Government through the Ministry of Trade, Industries and Investment, implemented the National Enterprise Development Scheme (NEDEP), a new approach for delivering enterprise development in Nigeria.

Over the last decade, the Nigerian government and other developmental agencies have implemented a number of initiatives and funds to address some of the issues facing MSME – National SME policy, Small and Medium Scale Development Agency of Nigeria (SMEDAN), SME National Database initiative, MSME Rating project, BOI Intervention fund, Nigeria Incentive-backed Risk sharing Agricultural Lending (NIRSAL), SME Credit Guarantee Scheme (SMECGS), Agricultural Credit Guarantee Scheme Fund (ACGSF), YOUWIN, to mention a few. Most of these funds are administrated through the commercial banks. Our study also reveals significant concerns by banks around the inconsistency of frameworks/policies “supposedly” meant to drive access to finance to the MSME sector. For instance, MSMEs usually do not have collaterals to pledge to access loans from commercial banks and the regulators do not factor these scenario into the periodic stress testing exercise carried out on banks; this circumstance has also limited the level of support the banks offer MSMEs.

The NEDEP scheme is quite promising and if properly implemented has the potential to transform the MSME segment. The scheme combines nine (9) initiatives – the national MSME policy; strengthening the institutional framework; MSME access to affordable finance; access to market; business development skills for entrepreneurs; technical skills for MSME operators; promoting youth inclusion; reduction of MSME operating cost; and implementation of a robust delivery and monitoring structure.

Beyond access to finance, the study also reveals other notable issues hindering the MSME segment delivering its expected value: poor infrastructure (power supply and road network), multiple taxation, high cost of production, inconsistent government policies, etc.
Government has a direct or indirect influence on a number of the highlighted factors that have limited the growth of MSMEs in Nigeria. With a significant part of the finance sought by MSMEs expended on working capital requirements, provision of basic infrastructural facilities would reduce the dependence of MSME growth on access to finance.

The Nigerian government has set out in the right direction to address some of these issues but the primary question remains: at this rate can the Vision 20:20:20 target be achieved? Recently, the Federal Government implemented the power reform act, involving the private sector to provide a lasting solution to the power challenges in the country. Though the distribution sub-sector has been privatized; issues around gas supply and pricing, AT&C losses etc. are taking longer than necessary for the initiative to deliver the expected gains.

Are Government policies and economic laws support sufficient and favourable to MSMEs?

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<th>Strongly agree</th>
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<th>Disagree</th>
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Source: 2014 MSME Banking Study

The general perception of MSMEs on government’s sincerity to develop the segment is below average, with less than 35% agreeing that the recent government policies and laws affecting MSMEs are sufficient and favourable for the development of the sector. Government will need to ensure full and timely implementation of the NEDEP scheme and address other issues around creating a conducive business environment for MSMEs.
Comments from focus group discussions

Government is making some giant strides but so much more needs to be done. Policies that have supported the growth of SMEs:

- Import duty on agricultural products;
- Taxation on agricultural products — focus group

Government should mandate DFIs (BOI, Bank of Agriculture, etc.) to enter into risk sharing agreements rather than the request for collateral for disbursement of funds in their custody — bank survey respondent

Operator friendly policies from government and regulatory bodies to create an enabling environment to enhance growth in the sector — bank survey respondent

Banks are not structured to support SMEs and most bank representatives are more interested in achieving their financial target than assisting in solving their business challenge — accessing funds.” banks are always the last resort for reasons such as: high interest rate, unrealistic conditions e.g. property collateral in the state capital with the Minister’s approval — focus group

Initiatives for product innovation and enhancement to cater the growing and emerging needs of the segment has been taken to grow the SME segment within the bank — bank survey respondent — bank survey respondent

Recommendations from Focus Group Session Participants

The government, along with the Central Bank of Nigeria, could consider promoting banks to provide loans at better terms to facilitate lending to MSMEs. These may include longer loan repayment periods, simplified documentation, and relaxed collateral requirements

The government could set up an agency whose primary responsibility would be to help MSMEs fulfil loan-application requirements such as guidance on preparing business plans, help with firm registration, getting accounts audited, and so on.

The government should promote the lending activities of development banks and other government agencies such as Bank of Industry, NACRDB and microfinance banks, whose primary role is to make finance accessible to MSMEs at reduced costs
From all indications, the government is set to drive the development of this critical sector and the general public perception on initiatives by government to transform the sector is quite positive. However, a peek into our history on the implementation of laudable initiatives creates uncertainty in the minds of Nigerians.

To ensure the effective implementation of the transformation initiatives, we recommend the establishment of a programme management team. The mandate of the team would be to:

- Facilitate the development or revision of the programme strategic plan.
- Align projects and initiatives with overall goals and objectives of the transformation plan for the sector.
- Work closely with all stakeholders involved in the programme and manage idea generation to eliminate redundancy and implementation of similar initiatives.
- Conduct multi-year programme planning, identify annual performance milestones and set-up a performance monitoring system.
- Track and monitor effectiveness of the various initiatives under the programme and proactively propose corrective measures to address identified gaps.
- Participate in all event organized under the transformation program or related to the MSME sector and distil the implication of the overall transformation program for the sector.
About this Survey

The MSME Banking Study in Nigeria is a product of a collaborative effort of KPMG Nigeria and Enterprise Development Centre (EDC), a centre of the Pan-Atlantic University. The objective of the study was to validate the most critical impediments facing the growth of MSMEs in Nigeria and understand the reason for this trend.

The study captured the perspectives of key stakeholders: MSMEs, commercial banks and some government parastatals/ agencies involved in SME development in Nigeria. We deployed a combination of techniques: surveys, focus group sessions and one-on-one interviews to facilitate accuracy and consistency in the data obtained from the different sources. The MSME survey respondents were selected through a random sampling approach, though at targeted market and key SME clusters, to ensure a holistic view of the segment.

The MSME questionnaire focused on the following areas:

• key issues facing SME business,
• SME lending experience with commercial banks,
• SME perception of government initiatives/ efforts and SME perception of banking products and services;

The bank questionnaire was centred on the following areas:

• banks’ perception on SME banking;
• bank’s perception on government’s interventions to the segment; and
• Limitations to SME banking.
Demographics

Profile of MSMEs: Total number of firms covered - 3186

Age of business

Source: 2014 MSME Banking Study

Number of Employees

Source: 2014 MSME Banking Study

Total Assets (excluding land and working capital)

Source: 2014 MSME Banking Study
Nature of Organization

Source: 2014 MSME Banking Study

MSMEs Sector of operation

Source: 2014 MSME Banking Study
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  - Ecobank Transnational Inc.
  - Enterprise Bank Limited
  - FCMB Plc
  - Fidelity Bank Plc
  - First Bank of Nigeria Limited
  - Guaranty Trust Bank Plc
  - Heritage Bank
  - Keystone Bank Limited
  - Mainstreet Bank Limited.
  - Skye Bank Plc
  - Stanbic IBTC Bank Plc
  - Standard Chartered Bank Plc
  - Sterling Bank Plc
  - UBA Plc
  - Wema Bank Plc
  - Zenith Bank Plc
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- KPMG Global Services team – Amit Sukhija, Richa Kumari and Palak Jain
References

In addition to information gathered through the two surveys and focus group discussions, we have included information from some publicly available sources.

These include:

- Central Bank of Nigeria
- African Development Bank Group
- The World Bank
- The World Economic Forum
- Export-Import Bank of India
- State Equity and Corporate Finance Department, Ministry of Finance, Shanlihe, Beijing, China
- European Commission
- The European Money and Finance Forum
- Central Bank of Malaysia
- The Associated Chambers of Commerce & Industry of India (ASSOCHAM)
- Association of Nigerian Development Finance Institutions (ANDFI)
- United Nations
- Bruegel Policy Contribution

- The Role of Government in Supporting Entrepreneurship & SME Development - Mohammed Bin Rashid Establishment for SME Development
- SMEs: What funding is available to you? – Sage
- Augusto de la Torre, María Soledad Martínez Pería, Sergio L. Schmukler , ‘Bank involvement with SMEs: Beyond relationship lending’, Journal of Banking and Finance
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