

THE ABC OF THE SMALL AND MEDIUM SCALE ENTERPRISE DEVELOPMENT IN NIGERIA

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Abstract

The challenges of Small and Medium scale Enterprises (SMEs) are universal all over the world. In Nigeria, we have this peculiar problem of how to start and manage SMEs. This paper, using secondary sources, tries to x-ray the different steps necessary in setting up SMEs. It also tried to assess the role played by the SMEs in Nigeria's economic development and finally highlight some of the factors that militate against the effective contribution of the enterprises towards national development. The paper concludes by noting that the health and viability of the SMEs is the cornerstone upon which the future transformation of Nigerian economy can be anchored.

Introduction

Nigeria is a country of great, but largely frustrated, potential. It is Africa's most populous nation and the sixth largest crude oil exporter in the world. It is highly endowed with an array of extractive mineral and agricultural resources as well as diverse and conducive climatic conditions found in very few parts of the globe. Yet the country suffers from chronic underutilization of both human and material resources (Boswell, 1992).

In fact, by the time civilians came to power in 1999, the economy had grounded to a halt. No country worth its salt in the international financial community was prepared to have anything to do with Nigeria. But, the series of reforms introduced at the outset of Olusegun Obasanjo's civilian administration kicked off a reversal process that rekindled local and foreign interests, confidence and optimism in the economy (Emmanuel, 2003).

With great enthusiasm local investors went into investments in both small and medium scale enterprises. The economy began to look up. Nigerian government has not lacked initiatives to encourage the development of the SMEs, but the problem remains that of management. Some of the initiatives include the Small scale Industries Credit Scheme (SICS) of the 1970s, the Nigerian Bank for Commerce and Industry (NBCI) supervised loan scheme – the special fund for small scale enterprises loan scheme of 1980s, as well as the National Economic Reconstruction Fund (NERFUND) of the past government. The question that agitates the mind would be the reasons for the failures encountered in the past. Is it the general management inexperience and incompetence of most Nigerian entrepreneurs or how to take-off? (Essian, 2001). This is the focus of this paper.

Definition of terms

The concept of small and medium scale industries is relative and dynamic. Hence, there is no universal definition of small and medium scale enterprise. However, within the fixed co-ordinate of natural boundaries, it might be relatively easier as countries tend to derive their own definition based on the role SMEs are expected to play in economic development of the country and the programmes of assistance needed to achieve that goal. The first attempt to overcome this definitional problem was by Bolton Committee 1971, which formulated an economic and statistical definition of Small Scale Industries (SSI) under the economic definition. According to the Committee, a firm is regarded as small if it has a relatively small share of the market place, managed by the owner in a personalized ways, and

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is dependent in the sense of not forming part of large enterprise. The committee adopted different definitions of small firm for different sections and suggested three ways of differentiating between small and large scale firm other than size, uncertainly associated with being a price taker, limited customer and product base. For instance, a firm that can be categorized as small scale in an advanced economy, like that of the United States of America, given the high level of capital intensity, may be classified as medium or large in the developing economy, like Nigeria. Definition changes over time owing to the changes in price level, advance technology, etc. Even in the same country, definitions also vary with institution, depending on the policy focus. For instance, in Nigeria, the definition of small-scale industries also varies from time to time, depending on what they are meant to serve (Chibuzo, 1992).

The Central Bank of Nigeria (CBN) defines small scale industries in its monetary circular No. 22 of 1998 as an enterprise in which its total investment (including land, working capital) did not exceed N500,000 and an annual turnover did not exceed five million Naira following the persistent depreciation of the naira exchange rate.

In 1992 budget, the federal government of Nigeria defined small scale enterprises for the purpose of commercial bank loans, as those enterprises with an annual turnover not exceeding N500,000 and for merchant bank loans, those enterprises with capital investment not exceeding N2 million (excluding cost of land) or a maximum of N5 million.

Section 375 (2) of the Company and Allied Matters Decree of 1990 defined a small-scale enterprise as one with annual turnover not more than N2 million and net asset values of not more than N10 million. The commission of the European Communities defined micro and small-scale enterprise as:

- A micro enterprise which employs fewer ten persons and whose annual turnover or balance sheet total does not exceed European 2 million

- A small scale enterprise employ fewer than 50 persons and whose annual turnover or balance sheet total does not exceed European 10 million.

Hoel (1989) defined small-scale industries as a firm with less than or equal to 25 permanent members and with fixed asset excluding land with up to \$50,000.

Statement of problem

The role of SMEs in Nigeria's postwar economic development has attracted much attention in recent years. Some believe that they have played a more important role in Nigeria than elsewhere and that their relative importance meant that Nigeria postwar growth path has been close to that of free market capitalism. The fact that Nigeria has fared much better than her neighbours in the African financial crisis has made this view ever more popular. It is further argued that the abundance of SMEs made Nigeria's economy more flexible and hence more resilient to crisis. Some revisionists of course have raised doubt about this claim.

This paper will assess this claim, by examining the role played by the SMEs in Nigeria, as well as the different steps necessary in setting up SMEs to undertake initial investment and production in heavy industries where private capital was reluctant to enter at the early period due to high risks.

Characteristics of Small Scale Industries

The varying definitions of small scale industries among countries notwithstanding, their characteristics are universally recognized, viz (Zaky, 1995):

- They are typically small owing largely to limited/access to financial revenues and thus, have special problem with respect to growth, since they are constitutently faced with financial vulnerability, which usually increase rather than decrease the risk.

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- They are characterized by single management structure, which generally combines with ownership management in one person, hence they revolve around a single owner/manager, rather than separating the ownerships from management.
- The operation of small-scale industries has a high level of flexibility in decision-making and provenance of largely informal employer-employee relationship.
- High labour intensive ratio and low employer turnover of the small-scale industries is more closely attached to the; product that launch them. They find it difficult to shift what they produce to something else.
- They are reluctant about risk taking when compared to merchandising enterprises where lending risk are admittedly greater.
- The unavailability of fund often results to the non-adoption of certain technology.

Sources of Financing Small Scale Industries

There are four (4) main sources of enterprise financing open to small-scale industries in Nigeria. These are as follows (Nnanna, 2001):

- Formal financial institution, such as Commercial Bank, merchant bank, saving and loans banks, insurance companies and development financial institution.
- Informal financial institution consisting of moneylenders, credit and saving association (like “ISUSU”) friends, and relations.
- Personal savings
- Other financial scheme, such as SME Arex Loan Scheme, NERFUND, NEXIM etc.
- Majority of small-scale industries in Nigeria, because of the inability to meet the condition of financial lending institutions, have resorted to alternative sources of financing in the informal financing institutions. Various studies have indicated that most small-scale industries source larger portion of their financing from the informal sector.

The Economic Potential of Small and Medium Scale Enterprises

The critical importance of adequate credit delivery to small scale industries is derived from the fact that the development of small scale industries is what is required to enable the country's industrial sector meet the contemporary challenges of globalization. The economic significance of small-scale industries has been recognized worldwide. In 1952, the United State of America enacted the "small-scale business act", which read in part: "... the essence of the America economic system of private enterprise is competition. It is the declared policy of the congress that government should aid, counsel, assist and protect, and as much as possible the interest of small-scale business concerns in order to prepare them from competitive enterprise."

However, small scale industries are particularly more suited to the circumstances of developing countries. There is greater reflection on a country's relative factor endowment to promote employment and enhance international economic competitiveness. This is crucial in an increasingly globalizing world economy.

Another major advantage of small scale industries in a capital scary economy like Nigeria is their relatively shorter gestation period, which enables them to field quicker returns on investment for further productive investment and foster growth. Small-scale industries also have greater potential facilities for the development of indigenous entrepreneurship and economic independence. They can be used to meet the output needs of large enterprises. This has been the major factor in the success of the industrialized countries.

Relatively the enhancement of international competitiveness by small scale industries stimulates the expansion of industrial disposal and balanced development. Small-scale industries alleviate rural-urban migration and it's and economic social consequences.

Finally, small-scale industries are useful in mobilizing small saving for productive investment and enhancement of industrial capital formation in a country with low level of saving like Nigeria. Small-

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scale industries are ideal for the mobilization of resources for economic development.

The importance of SMEs to longer-term economic stability derives from their size and structure. Under adequate condition, the market allows them the flexibility and ability to weather adverse economic conditions. SMEs are more labour intensive than larger firms and therefore have lower capital costs associated with the creation of jobs. Consequently, SMEs play an important role in fostering income stability, growth, and employment. Modern economics operate as complex network of firms in which a firm's competitive position depends in part on the efficiency of its suppliers. Therefore, SMEs competitiveness affects the competitive position of the economy as a whole (Emmanuel, 2003).

Before Setting up a Small and Medium Scale Enterprise

Small and medium enterprise development is not for everyone, whether disabled or not, and needs a high level of discipline, dedication, persistence and creativity as well as a lot of work. The micro-entrepreneur must be capable of decision-making and have the ability to manage employees (if any) and accounts. Furthermore, small-scale enterprise development for persons with disabilities involves a multitude of additional challenges, which requires specific attention and strategies. Before setting up a small or medium scale enterprise, it is necessary to deal with some issues, including (Essian, 2001):

1. ***Deal with specific challenges:*** In any business venture, specific challenges need to be addressed. These include:
 - Seed money;
 - Physical location of the business venture;
 - Management skills;
 - Accounting skills;
 - Marketing skills;
 - Maintenance of equipment, machinery and premises.

In the case of persons with disabilities, their physical and mental capabilities have to be reviewed for suitability to the enterprise. You may wish to ask these questions. What are my strengths? What are my weaknesses? How can I compensate for my weakness? What are my current personal needs? Who will be working with me?

2. ***Choose the right business:*** The right business certainly varies from one person to another. Personal preferences, along with physical and mental capabilities are the main deciding factors. Nevertheless, the focus should be on market demand and its limitations to determine if the business can be successful. A planned small-scale enterprise should be able to produce sufficient income to justify the time and energy invested in the venture. Family support also plays a major role in the selection of the business since a person needs help in accomplishing certain tasks, especially during the start-up of the enterprise. Make a list of what you could like to do, and also make a list of what you are good at doing. Go through the following steps to guide the choice of business.
 - Start with what you like and be realistic.
 - Investigate the market and its needs and try to be objective.
 - Review the competition i.e. the market.
 - Avoid Saturated markets and look for opportunity.
 - Make sure you can do it yourself, hiring means spending money.
 - Consult with others, discretely, not to divulge ideas.
 - Discuss with your family and check impact on family.
 - Keep in mind that if there is competition, it means what is readily available and required in terms of raw materials and local demand.

3. **Review market demand and the competition:** Review of the competition is necessary. Competition means there is market, but how big is the market? It is important not to saturate the market and to supply the right type of product or service, something that is in demand. You may wish to ask these questions: Who are my competitors? Who are my customers? How much can the market absorb before saturation? Is there a shortage or surplus?

Location of the market is also important for micro entrepreneurs with physical disabilities. Agricultural produce, for example, has to be sold at the fresh market, which must be accessible to the disabled person micro-entrepreneur. If it is too far, proper transportation arrangements will be necessary or else the product will have to be sent by a hired delivery person or sold to a middle person. Hiring people increases production costs. Marketing is easier for a farm-based enterprise located within a small community where the production can be sold directly to the villagers.

Check seasonability. Agriculture and farming products are often seasonal. The following questions must be considered. Is the crop or product available only during certain seasons? Are raw materials available all year round? Can the product be kept in storage? Is the service or product only required during certain periods of the year? Can there be off-season production? Some products can be given off-season, generating substantial profits since there are few competitors during that period. Such products, although requiring more time and attention, can offer a niche market opportunity for micro entrepreneurs.

4. **Decide on Business Size:** Care must be taken in deciding the size of the business. If too small, the business may not be feasible. If too big, it becomes too difficult to manage properly and may require extra help, which adds to cost.

If too big, the market may not be capable of absorbing the produce. It is usually better to start small and expand the business slowly once the market has been tested and income starts coming in. Initially, self-sufficiency and the capability of handling the business by oneself is the best indicator of the right size of the enterprise.

Several questions need to be answered before determining the size of the enterprise. Who are the clients? Where are the clients? How many clients are there? How much produce or services can each client use? Are there seasons or days of the week when the produce or service is more in demand? Who else is offering the same service or produce? What percentage of the business share can I expect to take? How much money do I have to start the business? How much can I manage by myself? How can I ensure quality?

5. ***Identify the Location:*** Location plays a crucial role in starting a small scale enterprise, while a farming or farm related enterprise needs not be accessible to the business. The micro-entrepreneur will have to travel to the market to sell the produce. When the business involves fresh produce, timely sale is crucial. For example, fruits, vegetable and flowers are highly perishable and have to be sold quickly. Easy access to market is important. It is necessary for a micro-entrepreneur with a disability to be able to reach the market or to have easy contact with potential buyers. In some cases, it may be necessary to hire someone to help in the delivery of the produce.

In the case of services, micro enterprises location should encourage people from the village to come to the entrepreneurs' explore. It must be easily accessible to clients, and be somewhat alternative. Low cost decoration can be used to attract clients, while good service will ensure their return.

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6. ***Land and Premises:*** Land and premises are needed for the establishment of any enterprise. In case these have to be acquired, the start-up costs will increase. If the new micro entrepreneur already owns these, he or she may have to spend on renovation. The following question should serve as guidelines: How much space do I need? Do I have a piece of land or building I can use? What will be the cost of the land? Do I need to rent the premises? Does a new building need to be built? Can the existing building be renovated? Do I need decoration? Decoration is needed to attract customers.

7. ***Check the Availability of Raw Materials:*** Raw materials for making the produce should be readily available. Scarce materials should be avoided because this will make it difficult to ensure a steady supply. It is important to avoid reliance on a single supplier, as this will give the supplier a monopoly and is most likely to lead to any increase in prices over time. Because the profit margin in a micro-enterprise is generally small, it is necessary to keep production costs under close control. It is important to ensure constant quality. Alternative sources of raw material may also be considered, such as forest products that are readily available and free of charge. Recycling and re-use is another way of reducing costs. The steady availability of water is another important consideration, while selecting the enterprise and identifying the raw materials.

8. ***Identify Funding:*** Anybody/person wanting to start a micro-enterprise may obtain a loan for this from family or community members. However, the start up funds often has to be sought externally. It must be kept in mind that loans have to be repaid and therefore, one must know the minimum amount needed for start up and running expenses until the venture starts generating income.

Several countries also have disability funds offering loans at low or no interest rates to individuals with disabilities who are registered with the responsible government authority. The loan can be repaid over a period of several years. The loan sometimes requires endorsement by a family or community members in case of non-repayment.

9. **Review of Market:** Marketing is very important since competition can be fierce. The following factors must be taken into consideration.
- i) **Packaging:** Packaging may or may not be required, depending on the product. For the sale of fresh fruits, vegetables or other agricultural produce, there is generally no need for packaging. A simple plastic or paper bag is sufficient.
 - ii) **Presentation:** Presentation can play a role even in the sale of fresh raw products. Neatness, cleanliness or organization makes the sales outlet attractive and appealing to customers.
 - iii) **Market Test:** It is sometimes interesting to test different types of presentation or packaging to find the one that appeals to customers.
 - iv) **Competition:** Competitors offering the same or similar product must never be ignored, as they clearly have clients and may be more experienced. Check their presentation, price and sales technique. As a new micro entrepreneur, you can learn from the experience of others and adapt it to your personality. A lot can be learned by having the competition.

The following are some of the things that need to be checked against. Who are my customers? Is there growing demand for my product? Who are my competitors? How are other businesses doing? Are they growing? Steady? Decreasing? What are their strengths? Their weakness?

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How does their product differ from mine? If it is the same, why do I think I can take a share of the market. What is the right sales price for the product or service?

Sales price, quality and service ensure that few customers become regular clients. If the sales price is too high, customers will go to the competitor, even if the entrepreneur is a person with disabilities. Clients may buy once to encourage the micro-entrepreneur, who is disabled person, but will buy the lower priced product if it is of equal quality. If the price is too low, customers will think that the product quality is also low and continue buying from the regular supplier. The right price should be similar to that of the competition while offering better service and same or better quality.

10. ***Check Feasibility before Starting the Enterprise:*** Too many people start a new small business blinded by the attractiveness of the product or by what seems to be an attractive market. However, many micro enterprise close down after a few months or years of operation, shattering the small scale entrepreneurs' dreams of what appeared to be the perfect way of making a decent living. In order to avoid this, a pre-feasibility study should be conducted. Although this may be based on estimates, it helps to prepare for the future and in some cases shows that another activity may be better.
11. ***Avoid Common Mistakes:*** Numerous factors may jeopardize the success of an enterprise. The following are some common mistakes.
 - Insufficient know-how. The micro entrepreneur does not sufficiently understand the process and therefore cannot easily find alternatives or solutions to problems encountered, including pest control, disease, mechanical and other problems.

- Lack of marketing strategies. Competition may be healthy, but too much competition may destroy the market unless creative marketing strategies are developed. Although a person with a disability may receive special consideration, it is necessary to compete with sometimes powerful and wealthy groups. The issue of disability is not a marketing strategy.
- Insufficient cash-flow is often what destroys most companies. Careful forecasting of start-up and running expenses is necessary.
- Too large start up: It is always better to start small with a minimum investment and to grow slowly with the market.
- Poor record keeping: Income, profits, and losses need to be closely monitored. This helps decide whether the market is good, whether the new small-scale enterprise should be expanded, reduced or halted because of losses.
- Giving samples and present: Generosity needs to be controlled. A certain amount of gratuities should be established, but it is always dangerous in personal business to give small amounts of the product or free service to members of the family and neighbours. This could equal or surpass the profit margin.
- Management: Management of the business is, and will always be, the key to success. Not all people are good managers, and therefore management skill may need to be developed or acquired through training.
- Maintenance: Maintaining the equipment and keeping the business premise clean and in good running condition certainly contributes to reducing operating expenses.

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In summary, there are eleven basic and unavoidable steps in preparing to start a business. They are as follows:

- secure funding
- open Bank account
- identify premise location for the enterprise
- build or renovate the structure or building required
- arrange necessary infrastructure (water, electricity, communication and others)
- request permits (if necessary). Verification should be done at the very beginning so that permits can be processed during preparation for starting the enterprise
- purchase and adapt necessary tools, equipment and assistive devices (when required)
- identify suppliers of raw materials and consumables
- start production
- control quality
- device marketing and sales strategy.

12. ***Managing the Business:*** Running a small-scale business is not only buying, producing and selling. It also means:

- keeping clear records – make a list of all items bought and sold every week
- verifying profit and loss
- managing cash-flow
- maintaining tools, equipment and buildings
- reviewing the market regularly
- expanding the business wisely.

13. ***Verify Profit and Loss:*** Although setting up the micro enterprises may have its difficulties, making it a profitable venture is the biggest challenge. It is therefore necessary to closely monitor each investment and purchase cost to know the exact profit. Finding out whether the enterprise is making money or not is crucial for the venture. Sometimes it seems

that there is a lot of money coming in but when compared to the costs, there is little profit left. This is called feasibility. It is necessary to review the feasibility by asking the following question:

Am I making money?

Is it worth continuing?

What can be changed to increase profit?"

It is especially important to verify the profit margin. More production does not necessarily generate more income. It depends on the profit margin, which is calculated by subtracting the production cost from the income as follows:
Income – production costs = profit margin.

14. ***Manage the Cash-flow:*** Cash flow is the money moving in and out of the enterprises. It is the total amount of money coming in and going out of the business. If all the money received is put in the bank and all expenses are paid from the money in bank, the cash flow is the total amount of money moving in the bankbook. However, care must be taken not to spend what appears to be profit before reviewing future investment needs. These needs can include:

- Purchase of raw materials
- Payment for utilities (electricity, water, etc.)
- Repair of broken equipment
- Payment for extra labour
- Repayment of the loan
- Replacement of tools and materials.

Note: An emergency fund should be set up for the replacement of broken equipment and tools and for purchasing other necessary input.

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15. **Maintain Tools, Equipment and Building:** The life of tools and equipment can be extended by proper maintenance. Metal tools should be protected from rust while wooden tools have to be protected from termites and decay. Mechanical tools must be lubricated regularly.

16. **Review the Market Regularly:** A micro entrepreneur must always review development in the market if he or she is to remain successful. These and other questions need to be addressed regularly since a market is continuously changing with new people, new products, new technology and new competition
 - Am I selling more or less than before?
 - Do I have regular customers?
 - Did I lose customers lately?
 - Is there new competition, what is the quality of the product in the market? What is the cost? Etc.

17. **Expand the Business Wisely:** Expansion is always a sign that the business is doing well. However, this should be based not only on current sales but also on future sales. When expansion is considered, decisions need to be made on the type of expansion (1) produce more of the same product in the same location? (2) Produce more of the same product in another location? Join with others to open outlets for branches? Etc.

It is recommended that expansion should only be done when the micro-entrepreneur has accumulated enough money to pay for the expansion. Borrowing money to expand a business is always dangerous and often results in failure.

Conclusion

In the course of the paper, we have highlighted the positive contribution of SMEs in development. We have also highlighted some of the factors that militate against the effective contribution of the

SMEs in Nigeria as well the required steps for sailing for successful SMEs development. It is our view that if the suggestions advanced above will be taken, SMEs will fare better and will make greater impact in national development.

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