

GOOD GOVERNANCE, ACCOUNTABILITY & INCLUSIVENESS AS PANACEA FOR ECONOMIC MANAGEMENT IN NIGERIA

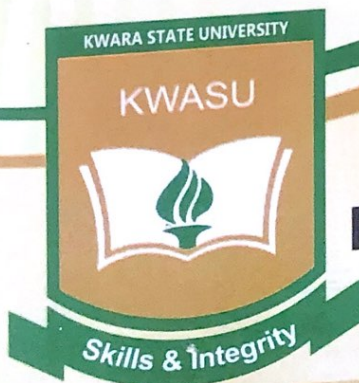
A BOOK OF READING

IN HONOUR OF:

PROFESSOR
**KENNETH
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70



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Published by:

Department of Accounting and Finance
Faculty of Humanities, Management and Social Sciences
Kwara State University,
P.M.B 1530, Malete, Kwara State.

majaf.editor@kwasu.edu.ng

www.journals.kwasu.edu.ng

Published 2019

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ISBN: 978 – 978 – 983 – 533 – 1

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Printed by:

Kwara State University Press,

P.M.B 1530, Malete, Kwara State.

CONTENTS

PART A: GOOD GOVERNANCE FOR ECONOMIC MANAGEMENT IN NIGERIA

1. Good Governance, Accountability and Inclusiveness as Panacea to Sustainable Economic Management: A Theoretical Approach
(Oyedele Oloruntoba)-----2
2. Nigeria's socio-economic development: questioning public administration ethics of yesteryears and years to come
(Lukman Adebayo Oke, Ibrahim Akanbi Bolaji)-----11
3. The Nexus between Corporate Governance and Corporate Culture of Firms
(Afolabi Adeoye)-----17
4. Sustainable Development in Nigeria: A Conceptual Approach
(Ademokoya, Alade Ayodeji, Abdul Rahim Ridzuan, Sakariyau, Rilwan Ola)-----33
5. Energy Infrastructure and Growth of Domestic Investment: A Panacea for Sustainable Development in Nigeria
(Adekunle Ahmed Oluwatobi)-----47

PART B: ACCOUNTABILITY FOR ECONOMIC MANAGEMENT IN NIGERIA

6. Comprehensive Performance Measurement Systems: Tools for Effective Economic Management
(Abdulrasaq Mustapha, Mubaraq sanni)-----56
7. Environmental Federalism, Deposit-Refund System Accountability and Sustainable Economic Management in Nigeria
(Musa Ilias Biala)-----69
8. Improving Accounting Practices through Artificial Intelligence
(Muhammed Kamaldeen Usman)-----85
9. Public Sector Accounting, Accountability and Accountability Management in Nigeria
(Sanni, M., Salami, A. A., Owoade, O., Suleiman H. B.)-----91
10. Taxation as a Tool of Economic Development in Nigeria
(Adegbite, Tajudeen Adejare, Bojuwon Mustapha)-----111
11. The Relevance of Traditional Budgeting in Business Organizations: A Critical Evaluation
(M. L. Nassar, Adebawale Ogunsola, Solomon Adetunji Ajewole)-----126
12. Transfer Pricing and Multinational Companies in Nigeria
(Adegbite, Tajudeen Adejare, Lawal, A. T.)-----134
13. Improving your Understanding of International Financial Reporting Standards
(Daudu Ismaila Aliu)-----145
14. Government Accountability and Tax Compliance: The Nigeria Experience
(Lukman Adebayo Oke, Yusuf Olamilekan Quadri)-----160

PART C: INCLUSIVENESS FOR ECONOMIC MANAGEMENT IN NIGERIA

15. Small and Medium Scale Enterprises Access to Finance and Economic Growth in Nigeria
(Ijaiya, Muftau Adeniyi, Kolawole, Kayode David)-----169
16. Financial Inclusion in Nigeria
(Biliquees Ayoola Abdulmumin)-----180
17. ICT and Economic Development: The Role of Artificial Intelligence and Financial Technology
(Babatunde Mudathir. A)-----188
18. Market Efficiency: Applicable Theoretical Clarifications
(Kamaldeen I. N., Abdullateef A., Sherifdeen I. N., Abdulrasheed B. Y.)-----197
19. A Model for Optimal Profitability and Remuneration Strategy for Nigerian Banks
(Adam, Lukman Shehu)-----208

SMALL AND MEDIUM SCALE ENTERPRISES ACCESS TO FINANCE AND ECONOMIC GROWTH IN NIGERIA

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Abstract

Small and Medium Scale Enterprises SMEs in Nigeria are faced with many problems and this has been a major setback for their development in the country. These problems led to the dismal performances and contributions of the sector to Nigeria's economic growth. This research finding shows that there are many sources of finance open to SMEs in Nigeria but the major problem is access to the various sources of finance from the formal financial sources of funding. This credit constraint is primarily due to lending conditions of formal financial institutions. This study therefore recommends that formal finance institutions should relax their lending requirements to enable SMEs borrow as much as they need to increase their contributions to the economic growth of Nigeria.

1. Introduction

The creation and development of small and medium scale enterprises (SMEs) have provided essential impetus to the growth and development of many countries particularly developed countries such as the United States of America, the United Kingdom, France, and China. In such countries, SMEs consist of over 98 per cent of the entire businesses and play a part in more than 65 per cent of employment opportunities, thus contributing over 50 per cent to the Gross Domestic Product (GDP) of those regions (Deen, 2003). SMEs also play significant role in producing import substituted machinery, mitigating rural-urban drift, producing specialised items in small quantities to meet diverse needs, mobilising local resources as well as encouraging technological development and innovation (Ogunleye, 2000). Fashola (2013) opined that the SME sector is the main driving force behind job creation, export earnings, poverty reduction, wealth creation, income redistribution and reduction in income inequality, apart from contributing to efficient allocation of resources. Thus, the expansion of SMEs boosts employment more than large firm growth because SMEs are more labour intensive (Onakoya, Fasanya and Abdulrahman, 2015). In the sector, 27 per cent employ less than 20 persons, 22 per cent employ less than 50 persons while about 18 per cent employ less than 100 persons (World Bank, 2010). In addition, SMEs also constitute 95 per cent of registered businesses in the world. Particularly in the European Union, its constituted 99.8 per cent of all businesses as well as employing around 76 million people which represents around 67.4 per cent of total employment in 2010.

In Nigeria, SMEs have performed poorly in terms of contribution to the nation's GDP with less than 10 per cent despite the fact that it constitutes over 70 per cent of businesses in Nigeria (Nigeria Bureau of Statistics, 2018). The reasons for this poor performance are attributed to poor banking facilities in the areas of inadequate financing, advisory services, interest rate and collateral

requirements. Other challenges apart from poor banking facilities are shortage of skills among the entrepreneurs, weak infrastructural facilities, inability of the SMEs to transform ideas into reality, poor demand for finished goods, restricted access to land, difficulty in input procurement, and continuity problem after the death of their owners.

The concern of this paper therefore is to examine SMEs access to finance and economic growth in Nigeria. The subsequent sections focus on review of related literature; explication of the characteristics of SMEs; problems of SMEs; SMEs access to finance in Nigeria; government policy on SMEs financing in Nigeria; roles of SMEs in Economic Growth; conceptual framework on SMEs access to finance; and recommendation and conclusion.

2. Concept of Small and Medium Scale Enterprises

According to Duru (2011), early scholars viewed SMEs as entrepreneurship based on the functions they perform which include; inventor, imitator, innovator, or more appropriately as a calculated risk taker. However, Odunayo (2015) describes an entrepreneur as one who contributes significantly more than others to the economy by virtue of innovation and realising new combinations which involve creation of a new product, a new method of production, the opening of a new market, the capture of a new source of supply, or a new organisation of industry which all aims at turning resources to wealth for owners and the employed. No wonder, SME is defined in terms of assets, values and the number of employees depending on the level of a country's development (Aruwa, 2009; Onwumere, 2000). Carpenter (2003) also includes various combinations of the following: number of employees, financial strength, sales value, relative size, initial capital outlay and types of industry, while Inang and Ukpong (1992) stressed the indicators prominent in most definitions to include, size of capital investment (fixed assets), value of annual turnover (gross output) and number of paid employees.

At countries levels, Joseph, John and Kala (2013) observes that SMEs are businesses that employ not fewer than fifteen (15) employees under the Australian Fair Work Act (2009) to fewer than 500 employees under the US. The European Union Commission (2003) defines medium businesses as enterprises which employ not fewer than 250 persons, and not more than 50 million Euros turnover and/or have an annual balance sheet total not exceeding EUR 43 million.

At institutional levels, the World Bank (2006) describes small enterprises as that with fewer than 50 staff members and annual turnover up to 3 million US dollars while medium enterprises have fewer than 300 employees and annual turnover not exceeding 15 million US dollars. On the other hand, the Central Bank of Nigeria (1993) views SMEs as enterprises whose annual turnover do not exceed #500,000. The Federal Ministry of Industry's guidelines to the defunct Nigeria Bank for Commerce and Industry defines it as one with a total cost of not exceeding #500,000 excluding cost of land but including working capital. The National Economic Reconstruction Fund (NERFUND) put the ceiling for small-scale industries at 10 million. Section 37b (2) of the Companies and Allied Matters Decree

of 1990 defines a small company as one with an annual turnover of not more than 2 million and net asset value of not more than 1 million naira (see Ekpenyong & Nyong, 1992). Small and Medium Industries Equity Investment Scheme (2003) views SMEs as an enterprise with a total capital of not less than ₦ 1.5 million but not exceeding ₦200 million including working capital but excluding cost of land and or with staff strength of not less than 10 and not more than 300. National Council of Industries in Nigeria also refers to SMEs as business enterprises whose total costs, excluding land, is not more than two hundred million naira (₦200, 000,000.00) only (Onugu, 2005).

3. Characteristics of Small and Medium Scale Enterprises in Nigeria

SMEs can be recognised by their characteristics as observed by Onwumere (2000) and cited by Nwachukwu (2012) where the study identified 21 characteristics of SMEs in Nigeria as follows: poor capital structure; inaccessibility to international market; labour intensive production processes; high mortality rate; poor access to vital information; over-dependence on imported raw materials and spare parts; lack of succession; use of obsolete equipment and inefficient technology; poor managerial skill; absence of research and development section; poor inter and intra-sectional linkages; high cost of funds and bank charges; poor management of financial resources; low entrepreneurial skills; concentration of management on the key man; little or no training for their staff; limited access to long term funds; poor product quality output, high production costs; lack of adequate financial record keeping; and poor documentation of strategy and information systems.

Discussing the nature of SMEs which falls under the characteristics of SMEs, Odubanjo (2000) itemises the following as the nature of SMEs: they exist in the form of sole proprietorship and partnership, though some could be registered as limited liability companies; management structure is simple thus decision-making is easy; ownership and management fuse together in one person or few individuals; relationship between employer and employees is largely informal; operate in many areas of economic activities e.g. manufacturing, transportation, communication, etc; majority are labour intensive, requiring more human capital per unit of production; technologies involved are always very simple; limited access to financial capital, (suffer from inadequacy of collateral); make greater use of local raw materials; and enjoy wide dispersal throughout the country by providing a variety of goods and services.

4. Problems of Small and Medium Scale Enterprises in Nigeria

The problems of SMEs can be linked to its characteristics. These problems can be examined first from the government and regulatory bodies' point of view such as inconsistent government policies; lack of essential services and infrastructures; inadequate security; incidence of multiplicity of regulatory agencies and taxes. Secondly from the financial institutions point of view is the problem of inaccessibility to source funds (Adelaja, 2013). The international conference on "supporting growing business in Africa: a challenge for the 21st century" organised by Wottingham Business in Nairobi, Kenya in March 1998 identified the following barriers to business (including SMEs) growth

in Africa: access to capital and inability to raise capital; access to appropriate technology; lack of managerial and marketing skills; lack of raw materials; a hostile business environment; inadequate infrastructure; limited market for goods and service; cumbersome laws and regulations; lack of a business plan; lack of marketing strategies; and entrepreneurial incompetence (Nwoye, 2011). However, Duru (2011) describes the challenges faced by entrepreneurs in developing countries as being monumental and quite similar. The challenges are as follows:

- i. **Lack of Credit Facilities:** It is obvious that most entrepreneurs undergo lots of stress in accessing credit for their enterprises. Despite the availability of financial institutions meant to offer business loans, entrepreneurs get discouraged due to the collateral conditions and high interest rates banks and other lending institutions charge on loans.
- ii. **Inconsistent Government Policies:** It is so unfortunate that entrepreneurs have no power over governance. However, they can influence government policy with respect to enacting favourable business laws by possessing a political power and huge resources or fighting the ever changing policy of the government, keeping an intense look at government laws and promptly adjusting their businesses to align with the policies.
- iii. **Multiple Taxation:** Entrepreneurs have the responsibility of paying tax to the government but most of these taxes paid are unlawful and indirectly increase the cost of operation. Although Nigeria's Companies Income Tax Act (CITA) has approved only 39 taxes and levies, there are over 500 various levies and taxes that are imposed by state and local government agents.
- iv. **Inefficient Infrastructural facilities:** Establishment of business enterprise requires the availability of certain infrastructure such as good roads, water, electricity and the likes for efficient production and services. In cases where the existing infrastructure have deteriorated or are even absent, the cost of doing business and accessing credit from banks will enormously rise.
- v. **Insecurity issue:** It may be difficult to establish or run a successful business enterprise in a situation whereby security of lives and properties are not guaranteed. Arizona (2009) was reported to have claimed that Nigeria has become a den of kidnapping, resulting in incessant hostage taking and unjust harassment.
- vi. **Poor planning:** Individuals who have successfully managed major dealings are aware of the fact that success mostly come as a result of hard work as well as systematic and strategic planning. Therefore, any venture that lacks proper planning is bound to fall in a very short period of time.
- vii. **Lack of patronage for local products:** Most citizens have negative attitude towards goods and services produced in Nigeria and this may lead to collapse of the business.

5. Small and Medium Scale Enterprises Access to Finance in Nigeria

Access to formal finance is often confused with participation in various formal finance institutions, as well as government and other agencies finance programmes. Access to finance is defined as ability to be able to borrow from a particular source. This is often measured by the amount that it can be

borrowed. If the amount is positive, the sector is said to have a positive access. If the amount is negative, the sector is said to have a negative access. A sector is credit constrained when it lacks access to credit or cannot borrow as much as it wants. (Diagne and Zeller, 2001). SMEs in Nigeria have different sources of finance but they lack access to this credit because they cannot borrow as much as they desire to carry out their operations. Thus, they are credit constrained because of formal financial institutions lending conditions.

SMEs sources of finance include informal and formal sources. According to Gbandi and Amissah (2014), the informal finance sources consist of money lenders, landlords, friends, relations, credit and savings associations (co-operative societies), *esusu*, also known as *ajo* among the Yorubas, *isusu* or *atu* among the Ibos, *osusu* among the Edos, among the Hausas, *dashi* among the Nupes and *etibe* among the Ibibios (Okorie & Miller, 1976; Ijaiya & Afolabi, 2017). The formal finance sector is made up of formal finance institutions such as the deposit money banks, microfinance banks, international development agencies, etc. Ekpenyong and Nyong (1992) hypothesised that in Nigeria, financing of firms is skewed towards large firms rather than SMEs probably because they are more inclined to the funds of the informal sector. The major gap in Nigeria's industrial development process is inadequate long term fund and in some cases short term finance for the SMEs (Olorunshola, 2001).

The financial system in Nigeria is not in short supply of liquidity, but banks have been very reluctant to grant loans to SMEs, because SMEs are regarded as high-risk due to their informal nature; inability to prepare bankable business plans; poor record keeping; lack of security required for conventional collateral based bank lending; and discriminatory cultural practices which hinder transparency (Segun, 2012). Thus, the inability of SMEs to raise sufficient funds are usually linked to their lack of collateral, poor financing report, no feasibility report, the risk associated with such business and also the inability to raise the required equity contribution (Ojo, 2006). Ango (2011) rightly noted that due to poor funding by formal financial institutions that SMEs usually raise their finance through informal sources which includes: personal resources through savings, borrowing from families and friends, partners or business associates, informal financial markets comprising of individuals and group, including pool fund groups and co-operative societies.

The state of financing of SMEs in Nigeria is so pathetic that SMEs' access to finance sources need to be improved to enable them to borrow to improve their operations and contributions to Nigeria's GDP.

6. Government Policy on Small and Medium Scale Enterprises Financing in Nigeria

Over the years, several initiatives and credit institutions have been established by the government and its agencies at various levels to address this funding challenge and promote the development of SMEs in Nigeria. Some of these initiatives include the execution of a comprehensive national SME policy through the establishment of special intervention funds like setting up of industrial estates to reduce overhead costs and schemes for SMEs. Other initiatives are Bank of Industry (BoI),

Intervention fund/schemes for SMEs; the Small Scale Industry Credit Scheme (SSICS), the Community Banks (CB) now Microfinance Banks, development of SME national database by the National Bureau of Statistics and a host of others (Segun, 2012). Government also facilitates and guarantees external finance by the World Bank, African Development Bank and other international financial institutions (Sanusi, 2003). It also includes Small and Medium Equity Investment Scheme (SMEEIS), the Small and Medium Enterprises Credit Guarantee Scheme (SMECGS), etc. In the 1980s, banks were mandated to set up branches in the rural areas. The objective of this policy was to improve SMEs access to financial services (Soludo, 2008).

7. Roles of Small and Medium Enterprises in Economic Growth

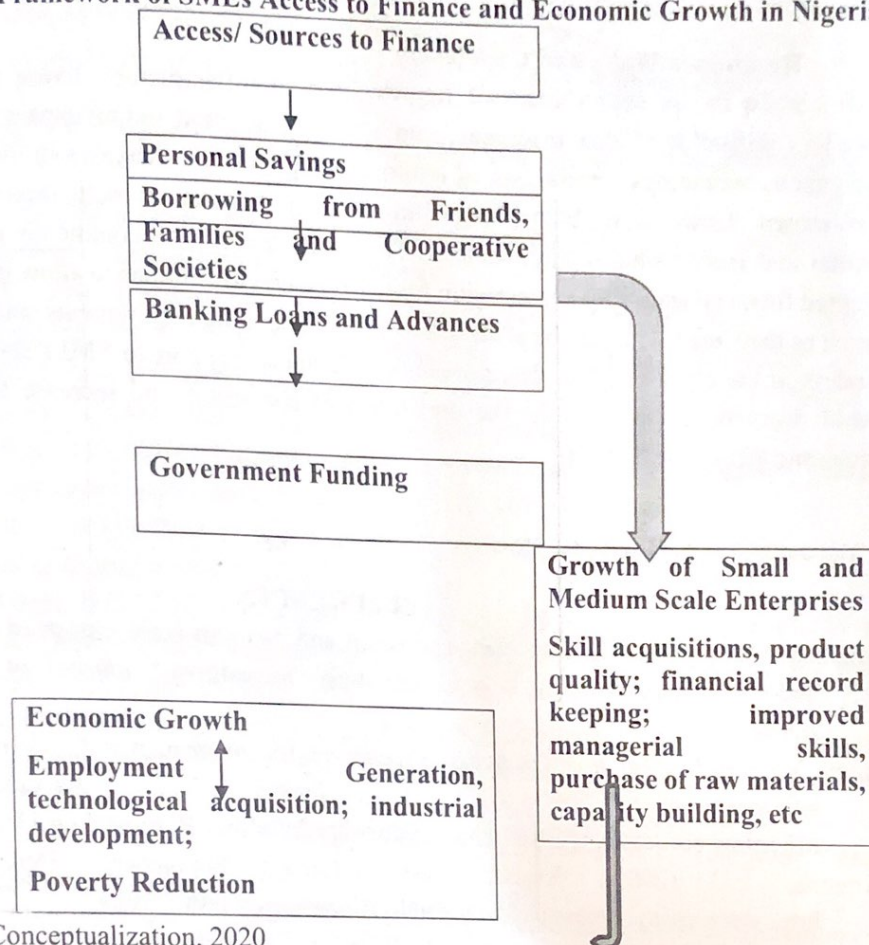
Usman (2001) observes that small scale industries are recognised worldwide as catalyst to economic development, while Essien (2001) also posits that small scale industries are useful in mobilising small savings for productive investment and enhancement of the industrial capital formation. In a country with low level of savings such as Nigeria, small and medium scale industries are ideal for the mobilisation of resources for economic development. Besides, Odubanjo (2000) and Nnanna (2001) assert that SMEs assist in the achievement of improving rural infrastructure, living standard of the rural dwellers, utilisation of local resources, employment generation, output expansion, transformation of indigenous technology, production of intermediate goods, increases the revenue base of the government and so on. Therefore, SMEs impact on the development of any economy range from employment generation, technological acquisition, capacity building, technological industrial development, growth promoting, structural transformation of rural areas, increase in standard of living, serving of large -scale industries and export promotion. Thus, SMEs can promote industrial and economic development through the utilisation of local resources technology (Carpenter, 2003; Adelaja, 2013).

In another submission, Oduntan (2014) itemises the role of SMEs in economic development as follows:

- i. **Capacity building:** SMEs provide platform for training of indigenous entrepreneurs which drives the wealth creation process at all levels. It has even been established that SMEs are nursery of entrepreneurship where individual creativity and innovation are the driving force. Therefore, they may be the university where vast majority of entrepreneurs receive training.
- ii. **Employment generation:** SMEs have the capacity to generate employment as their mode of operations is more labour intensive. Their labour intensive nature is much higher than that of large enterprises. It has also been observed that more jobs per unit of investment capital and per unit energy consumed are created worldwide by SMEs than large scale enterprises. They therefore helped in solving the problem of unemployment in many countries.
- iii. **Promoting growth:** In like manner, SMEs by its nature are such that they are involved in primary and secondary economic activities that depend heavily on locally sourced materials. As such they achieve high value added operations which is a key role in the growth and development of any economy.

- iv. **Industrial dispersal:** SMEs could easily be located in rural areas because they can survive on rudimentary industrial infrastructure. Consequently, they serve as major facilitators for industrial dispersal and rural development and thus have the capacity to stem rural-urban conurbation.
- v. **Backward and forward linkages:** Most SMEs output serves as intermediate or semi-processed goods of large scale firms. By this, they generate mutual industrial linkages between local producers of raw materials and large industrial concerns.
- vi. **Technological/industrial development:** SMEs have short-term gestation period and high potentials for quick yield on investment. They provide promising alternatives for countries that desire the fast option of industrial development. This is possible in most cases because the technology used is less complex and can be handled and manipulated by the entrepreneurs.
- vii. **Technological acquisition:** Small-scale industries provide opportunities for the development of local skills and technology acquisition through adaptation. The Aba made goods syndrome, a concept adopted by a part of Nigerians, is a clear manifestation of such technological acquisition and this gives impetus to rapid development in the economy.
- viii. **Poverty alleviation:** SMEs play a vital role in reducing poverty and inequality among the citizenry. This is not unconnected to the affordable and relatively low capital requirement for its establishment. It also engages both skilled and unskilled workforce thereby creating a means of livelihood.

8. Conceptual Framework of SMEs Access to Finance and Economic Growth in Nigeria



Source: Authors' Conceptualization, 2020

The above diagram shows a schematic flow of finance from both the informal sources (personal savings, borrowing from friends, families and cooperatives societies) and formal sources (banks and government funding) to the SMEs that will impact on their skills acquisition, product quality; improved financial recording, capacity training, purchase of raw materials, etc. which will lead to increase in their contribution to economic growth of the country in areas of job opportunities, industrial development, poverty reduction, etc.

However, the achievement of the improved contribution of SMEs to economic growth of Nigeria is based on the following assumptions:

- i) improved access to formal sources of finance;
- ii) adoption of a subsidised interest rates;
- iii) improvement in infrastructural facilities that will reduce cost of production;
- iv) relaxation of laws and regulations that inhibit development of SMEs in Nigeria; and
- v) the credit must not be diverted to other uses than their business.

9. Recommendation and Conclusion

SMEs assist in the achievement of improving rural infrastructure, living standard of the rural dwellers, utilisation of local resources, employment generation, output expansion, transformation of indigenous technology, production of intermediate goods and increases in the revenue base of the government. However, problems bedevilling SMEs in Nigeria are multi-faceted such as inadequate capital and inaccessible credit facilities. This study therefore recommends that SMEs should be granted financial access by encouraging formal financial institutions to allow the sector to borrow as much as they need. This can be achieved by relaxing lending requirements since they are the largest lenders in the economy. Besides, government financial support to SMEs should be monitored to avoid diversion so as to boost the operations of the sector and increase their contributions to economic growth of Nigeria.

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