

Alternative Sources of Finance: Evidence from Micro, Small and Medium Scale Enterprises (MSMEs) in Dala Local Government Area-Kano State of Nigeria



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ABSTRACT: This study assesses the alternative sources of financing of MSMEs in Dala local government area. The major objectives of the study is to determine the level of access and usage of alternative sources of finance, and to assess the effectiveness of MSMEs in securing financing as well as the constraints faced by MSMEs in applying for and securing funding from the lending agencies. The study employs the survey research design, data were collected via questionnaire, and analysed using descriptive statistics. The findings of the study revealed that MSMEs in Dala local government are accessing and using all the available alternative sources of financing, although many of which are on a limited scale. And the best external sources of finance for MSMEs are trade credits and borrowing from family and friends. The findings also indicate that, except for trade credits and loans from family and friends, most MSMEs were not applying for loans from the external sources or are largely not wholly successful in their application for loan from the lending agencies. The study has identified the problems limiting the ability of MSMEs to obtain funds from the lending agencies to include information asymmetry, lack of collateral, high cost of capital etc. Furthermore, the study recommends that, Government should educate and enlighten owners of MSMEs on its various programmes and schemes aimed at providing finance, and to reduce the conditions and requirements for collecting loans and credits from formal sources to ease access to finance.

KEYWORDS: Formal, Finance, Alternative, Funding, Enterprise

1. INTRODUCTION

Micro, Small and Medium Scale Enterprises (MSMEs) play a tremendous role in developing economies. They provide employment opportunities to the greater proportion of the workforce and contribute greater proportion of economic activities in the countries. Not only do they make up the vast majority of firms, but they dominate many sectors of economic activity and have been a reliable source of new products and of technological innovation more generally.

Finance has been a major problem bedeviling the progress of MSMEs in less developed countries, and access to it plays a greater role in ensuring the development of the industry and in generating the distribution of the firm sizes with efficiency and effectiveness thereby enabling full exploitation of market. That is, access to finance play an important role in enabling firms to be formed at various scales that were efficient for the industries and market segments, and in enabling them to grow and take advantage of new technological developments and of increases in the size and scope of markets (Salami, 2003).

Micro, small and medium enterprises are undoubtedly the backbone of the Nigerian economy, and by extension the economy of Kano. They act as major job providers, produce a significant part of the total value added, feed the larger industries with their needed inputs, as well as acting as distributors/buyers of their products. Small firms provide a large segment of the lower and middle-income population with low priced consumption of goods and services. Small firms also represent a channel through which small savings are being translated into investments. Small enterprises could become major sources of constant innovation and experimentation and could thereby in some cases change the market structure. SMEs have been viewed as a source of technological progress, especially in new industries (CBN, 2011; Sanusi, 2004).

Despite their enormous potentials for long term growth and development, Nigerian MSMEs are faced with a number of constraints which limit their capacity to operate efficiently and effectively, and therefore the roles they are expected to play in the Nigerian economy is hitched. Of all these constraints, access to funds is the most critical factor stunting their growth and development

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(UNCTAD 2017; World Bank, 2014). Thus, this makes financing SMEs a major catalyst and a key success factor for the development, growth and sustenance of any economy. Having access to finance gives MSMEs the chance to develop their businesses and to acquire better technologies for production, therefore ensuring their competitiveness. However, there is a huge challenge for SMEs globally when it comes to sourcing for initial and expansion capital funds from lending institutions. This necessitate the firms to find many alternative sources of finance.

Although various studies have been conducted to determine the alternative sources of financing available to MSMEs in Nigeria and Kano in particular, there is no known study, to the best of our knowledge that assesses the financing possibilities of MSMEs in Dala Local Government Area. This study attempts to fill this gap by exploring the financing possibilities of the MSMEs operating in Dala. This study therefore sets out to, among others, examine the various financing possibilities of MSMEs in Dala Local Government area, as well as to assess the problems these MSMEs face in the formal and informal financing of their activities.

2. LITERATURE REVIEW

Defining MSMEs have been a challenging task given that there is no universally accepted operational definition for the concept(s). Different countries, people and institutions use different criteria such as size of workforce, size of capital, annual turnover, size of profits, etc, to classify business firms as either large-scale enterprises or Micro, Small and Medium Enterprises (MSMEs). However, for the purpose of this study, Micro Enterprises are defined as those employing 10 or less individuals having a capital of less than ₦5 million; Small Enterprises are those employing more than but fewer than 50 workforce with operation capital above ₦5 million, and Medium enterprises are the businesses employing fewer than 150 individuals.

SMEs financing has always become of interest to researchers and policymakers in Nigeria. Although MSMEs are generally considered to be the backbone of the economy, stimulating the development of the business sub-sector is hampered by several factors, with the most critical one being poor access to finance. As rightly put by Fatai (2009): "In Nigeria, one of the major challenges faced by MSMEs is that of capital to finance their operations". A World Bank report showed that 39% of small scale firms and 37% of medium scale firms in Nigeria are financially constrained. (World Bank report, 2001). Many MSMEs in Nigeria lack the capital to continue their business and they are forced to close shop because they are unable to access the required funds. Every enterprise is financed either through debt or equity or a combination of both. Both types of financing are usually sourced from either the informal finance sector (IFS) or the formal finance sector (FFS). The two fundamental financing concepts of MSMEs, have been identified by previous researchers, scholars and practitioners (Gelinas, 1998; Aruwa, 2004). The researchers identified commercial banks and development banks in the formal sector as the most popular source of finance for enterprises. The informal sector which consists of borrowing from friends, relatives and cooperatives are also important source of financing of especially MSMEs. Another source of enterprise financing is through personal savings.

The informal finance sector consists of informal finance institutions like money lenders, landlords, friends, relatives, credit and savings associations (co-operative societies), esusu, also known as ayo among the Yorubas, isusu or atu among the Ibos, osusu among the Edos, adashi among the Hausas, dashi among the Nupes and etibe among the Ibibios. (Okorie & Miller, 1976). The formal finance sector is made up of formal finance institutions such as commercial banks, microfinance banks, international development agencies etc. (Aruwa, 2004).

According to Baadom (2004), the common sources of financing, including equity financing and debt financing for SMEs in Nigeria include mostly personal savings, informal sources and to a lesser extend loans and advances from the lending institutions and the informal money lenders. Hire purchase is also another important source of financing for Micro, Small and Medium enterprises in Nigeria.

A 2014 World Bank survey on Nigeria's firms showed that although 85 percent of the firms had relationships with banks, not all of them had access to external credit. The larger a firm, the more likely it is to have access to external sources of credit. Almost 100 percent of firms with more than 250 employees have access to credit compared to only 52 percent of micro-enterprises and 80 percent of small firms. Interestingly, over 90 percent of foreign firms have access while just over 70 percent of indigenous firms do (World Bank, 2014).

Secondary financing sources are another alternative. Unfortunately, there are few domestic equity sources, as well as limited sources of export finance, and SMEs' participation in the stock market (Second-tier Security market) is minimal. This is due to their inability to meet the listing requirements as well as their persistent tendency to operate as much as possible in the informal sector. They are also unaware of the advantages of using the stock market as a source of financing. The newly incorporated Bank of Industry is expected to play a very important role in addressing SME financing, monitoring and advisory issues (Baadom, 2004).

The commercial banks remain the formal source of finance for enterprises. Banks have three (3) social and economic functions: to collect and secure savings and other deposits; to finance the economy by handing out credits; and to facilitate payments and

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to transfer funds. Their role is to reduce the gap between supply (the money deposited and potentially available) and demand (the money needed for investment) that exists between idle money and productive investment.

The financial intermediation role of financial institutions has been faulty for a number of reasons (Gelinas, 1998): Inadequacy in building up and securing national savings; bureaucratic obstacles to the financing of small and medium-sized enterprises, inability to establish positive relationships between lenders and borrowers; and absence of risk sharing. Otherwise, the banks offer loans, either by way of term loan or an overdraft. An overdraft is essentially a short-term finance to meet working capital requirement over a few months and cannot be used for long-term investment purposes.

In Nigeria, to improve on the rate at which the formal financial institutions, extend loans to MSMEs, the formal financial institutions have been organized to finance MSMEs through venture capital financing in the form of a Small and Medium Enterprises Equity Investment Scheme (SMEEIS) fund. Venture capital financing supplements or takes the place of credit facilities that the conventional banks are unwilling to give. The provider of the funds may initially part with the funds as a loan, but specifically with the idea of converting the debt capital into equity at some future period in the enterprise. The return from such investment should be high to compensate for the high risk. Venture capital may be regarded as an equity investment where investors expect significant capital gains in return for accepting the risk they may lose all their equity (Golis, 1998).

The Nigerian government's version of venture capital financing of SMEs – SMEEIS, requires all licensed banks in Nigeria to set aside 10 percent of their pre-tax profit for equity investment and to promotion of small and medium-scale enterprises. The goal is to reduce interest rate burden and other financial service charges imposed under normal bank lending. However, SMEEIS's fund has been reported to have attained 20 billion naira but only 8 billion naira disbursed. The reason for the inability of the SMEs to avail themselves of this fund is yet unconfirmed. The apparent lack of investment in the micro-enterprises sub-sector could be informed by the absence of approved guidelines which is still being finalized (Osagie, 2004).

According to Sanusi (2004), a breakdown of the SMEEIS fund investment by sectoral distribution, 68.82 percent went to the real sector while service related investment accounted for only 31.18 percent. This he noted is a sharp reversal from the initial trend recorded under the scheme. The Bankers Committee have allocated the investment of banks with respect to the fund as 60, 30, and 10 percent of their fund in core real sector, service-related and micro-enterprises respectively. Analyzing the geographical spread of the SMEEIS fund, Sanusi (2004) reports that Lagos-based investments have gulped 56.63 percent of the fund, and Abuja and 18 states received the balance 43.47 percent.

Since the banks have demonstrated their inability to assume and manage the interest of Small and Medium-scale Enterprises (SMEs), the informal savings not only do they fill the vacuum created by the official financing system's failure to adapt to the SMEs needs, but they also prepare for new forms of capital accumulation based on solidarity and co-operation.

2.1 Synthesis of the Study Gap Identified

The literature surveyed in the preceding section has detailed numerous sources of financing for SMEs in Nigeria, both private and public sources. But none of the literature surveyed has detailed the sources of financing for the SMEs in Kano, not to talk of the SMEs in Dala local government area. This study will fill this gap of information by focusing on the financing sources or possibilities of SMEs operating within the Dala local government area of Kano State.

3. METHODOLOGY

In order to be able to answer the research questions, this study uses the quantitative research approach and a survey research design for the analysis. One hundred and twenty (120) survey questionnaires were distributed to a sample of (120) SMEs selected from six wards in Dala Local government of Kano State, Nigeria. The selected wards are those with high concentration of both formal and informal small businesses in the local government area. The questionnaire was designed to collect information about the existing financing sources accessed by the MSMEs in recent times. The questionnaire also collects information to speculate on the effectiveness with which MSMEs applied for and secure funding from the existing alternative sources. The last part of questionnaire collects information on the major constraints to the ability of MSMEs to secure funding the existing external sources. The questionnaire is structured to obtain observations that would help answer the research questions. Simple descriptive statistical methods, including tables and charts were employed for the analysis of the data generated from the questionnaires.

4. RESULTS AND DISCUSSIONS

The responses from questionnaires administered to formal and informal MSMEs are presented and analyzed. Out of the one hundred and twenty (120) questionnaires administered to the Micro, Small and Medium Enterprises (MSMEs) in DALA, one

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hundred and seven (107) were returned and usable for the study, and this marked a response rate of 89 percent. The completed questionnaire were processed and the data is presented in tabular form and the percentage.

4.1 Business Characteristics

From the results of the analysis, it is found that 64 (60%) are micro enterprises; 35 (33%) were Small-sized enterprises; and 8 (7%) were medium enterprises. From this result, it is obvious that majority of the sampled SMEs are micro enterprise and this is in line with the general distribution of business firms in the study area.

The main activity of SMEs surveyed in DALA were: Construction (14.0%), manufacturing (4.7%), whole sale and retail (38.3%), transportation (27.1%), handcraft (4.7%), artisan (6.5%), and other services (4.7%). Whole sale and retail which include provision stores, medicine stores, gift shops, grain stores (i.e rice, beans, maize etc) take (38.3%) which is the highest percentage of the SMEs in DALA.

About 36% of the participating SMEs were not registered, the remaining 64% were registered as at the time of the study. This shows that majority of the MSMEs in the study area are registered with relevant government authorities and institutions.

The ownership structure of the participating SMEs is as follows: one male owner take the high percentage of (33.6%) then followed by Owners/shareholders with percentage of (27.1%) then, Family/friends (20.6%), then, one female owner with (11.2%) and other businesses take (7.5%). Most of the businesses of the area surveyed are one male owner which has (33.6%)

4.2 Access to or Usage of Alternative Sources of Funds

In this section the rate of usage and access to several sources of financing by the MSMEs in Dala Local Government were reported. The results from of the analysis was presented in table 1 below.

Table 1: Usage of Internal Funds

Use of Funds	Frequency	Percent	Valid Percent
Valid Used	53	49.5	49.5
Valid Did not use	54	50.5	50.5
Total	107	100.0	100.0

Field Survey, 2023

Table 1 present the level of usage of internal sources of financing by the small businesses owners surveyed. The result revealed that, 53 small business owners representing 49.5% of the respondents have raised additional funding from internal sources during the past 12 months. As can be observed from the table, a slightly higher number of the small businesses surveyed, 54 representing 50.5% have reported not using internal sources of funds during the same period. This finding is in line with prior expectation regarding the means by which small businesses raise funds to finance their operations. Most SMEs reinvest some part of the profit they made during previous financial period to expand their activities or acquire certain desirable assets for the business. The main reason for this is that it is very difficult to raise funds from external sources, especially from commercial banks, thus many small businesses have to rely on the internal sources. The greater proportion of the participating businesses that have not used funds from internal sources might fall under the micro enterprises category because their earning capacity is low and could be just enough to keep the operators going. This finding may point to a strong evidence that internal financing is an important source for SMEs.

Table 2: Public Grants or Subsidized Loan

	Frequency	Percent	Valid Percent
Valid Used	25	23.4	23.4
Valid Did not use	82	76.6	76.6
Total	107	100.0	100.0

Field Survey, 2023

Table 2 above shows the number of MSMEs that have raised fund from the government's SMEs financing schemes. Only 25% of the MSMEs surveyed reported accessing funds from the SMEs financing schemes of the government organizations. Majority of the SMEs representing 76.6% have not obtained government grants or subsidized loan in the last twelve months. This is in spite of the fact that the government have been advertising for SMEs to apply for funding under its various SMEs financing schemes.

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Table 3: Bank Overdraft or Credit Card

	Frequency	Percent	Valid Percent
Valid Used	31	29.0	29.0
Valid Did not use	42	67.3	67.3
Valid Source not applicable to my firm	34	3.7	3.7
Valid Total	107	100.0	100.0

Field Survey, 2023

Table 3 shows the number of surveyed MSMEs that have obtained funds from the commercial banks in form of bank overdraft. 31 SMEs representing 29% reported obtaining bank overdraft from the commercial banks. 42 SMEs or 67.3% did not use bank overdraft in the last twelve months. While 34 SMEs reported that bank overdraft is not applicable to their businesses which means they do not operate current account.

Table 4: Bank Loan

	Frequency	Percent	Valid Percent
Valid Used	16	15.0	15.0
Valid Did not use	51	47.7	47.7
Valid Source not applicable to my firm	40	37.4	37.4
Valid Total	107	100.0	100.0

Field Survey, 2023

Table 4 shows the number of surveyed MSMEs that have obtained loan from banks. 16 MSMEs representing 15% have access to bank loan while 51 respondents representing 47.7% reported that they have not used bank loan in the last 12 months, and 40 MSMEs representing 37.4% reported that, bank loan is not applicable to their businesses.

Table 5: Trade Credit

	Frequency	Percent	Valid Percent
Valid Used	82	76.6	76.6
Valid Did not use	25	23.4	23.4
Valid Total	107	100.0	100.0

Field Survey, 2023

Table 5 shows the level of usage of trade credit of the MSMEs in DALA. 82 respondents representing 76.6% used trade credit to finance their businesses, while 25 MSMEs owners representing 23.4%, did not use trade credit in the process of financing their businesses. The result of the analysis revealed that, most of the businesses in DALA have used trade credit as an essential tool for financing their businesses.

Table 6: Microfinance

	Frequency	Percent	Valid Percent
Valid Used	22	20.6	20.6
Valid Did not use	85	79.4	79.4
Valid Total	107	100.0	100.0

Field Survey, 2023

Table 6 shows the surveyed MSMEs that have obtained funds from the micro finance banks. 22 SMEs (or 20.6%) reported obtaining microfinance loan. 85 SMEs representing 79.4% did not used microfinance loan in the 12months. The data sows most SMEs did used microfinance loan due to lack of awareness.

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Table 7: Family/Friends/Other company loan

	Frequency	Percent	Valid Percent
Valid Used	70	65.4	65.4
Valid Did not use	37	34.6	34.6
Total	107	100.0	100.0

Field Survey, 2023

Table 7 shows the participating MSMEs that have obtained loan from family, friends or relatives. 70 SMEs representing about 65.4% used or collect loan from family, relatives and friends, while 37 (or 34.6%) did not used or collect loan from family, friends or relatives. Which means that, most of the MSMEs in DALA used or collect loan from family, friends or relatives because this is common to the SMEs to finance their businesses.

4.3 Effectiveness of MSMEs in securing funding from the lending agencies

Table 9: SMEs Securing Bank Loan in the Last One Year

	Frequency	Percent	Valid Percent
Valid Applied and got everything	14	13.1	13.1
Valid Applied but got part of it	17	15.9	15.9
Valid Applied but refused because cost is too high	12	11.2	11.2
Valid Applied but was rejected	9	8.4	8.4
Valid Did not applied	55	51.4	51.4
Total	107	100.0	100.0

Field Survey, 2023

Table 9 shows that only 14 out of the 107 MSMEs surveyed were fully successful when they applied for a bank loan during the past twelve months. 17 MSMEs applied but only got a part of it; 12 MSMEs applied but refused because of high interest rate; and 9 MSMEs were unsuccessful. The greatest number of the MSMEs, 55, representing about 51% did not apply at all.

Table 10: MSMEs accessing Trade credit in the last one year

	Frequency	Percent	Valid Percent
Valid Applied and got everything	10	9.3	9.3
Valid Applied but got part of it	18	16.8	16.8
Valid Applied but refused because cost too high	15	14.0	14.0
Valid Applied but was rejected	3	2.8	2.8
Valid Did not applied	61	57.0	57.0
Total	107	100.0	100.0

Field Survey, 2023

Table 10 shows the number of MSMEs that used trade credit in financing their businesses were 10 (or 9.3%) applied and got everything. 18 representing 16.8% applied but got part of it. Also 15 (or 14.0%) applied but refused because the cost is too high. While 3 representing 2.8% applied but was rejected. And 61 representing 57.0% did not applied for trade credit to finance their businesses.

Table 11: SMEs access of Microfinance loan in the last one year

	Frequency	Percent	Valid Percent
Valid Applied and got everything	9	8.4	8.4
Valid Applied but got part of it	11	10.3	10.3
Valid Applied but refused because cost too high	17	15.9	15.9

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Applied but was rejected	5	4.7	4.7
Did not apply	65	60.7	60.7
Total	107	100.0	100.0

Field Survey, 2023

Table 11 shows that 9 MSMEs have applied for microfinance and got everything, 11 applied but got a part of it; 17 applied but refused because of high charges; 5 applied but rejected and 65 MSMEs did not apply.

Table 12: MSMEs accessing other external financing in the last one year

	Frequency	Percent	Valid Percent
Applied and got everything	13	12.1	12.1
Applied but got part of it	12	11.2	11.2
Applied but refused because cost too high	9	8.4	8.4
Applied but was rejected	15	14.0	14.0
Did not applied	58	54.2	54.2
Total	107	100.0	100.0

Field Survey, 2023

Table 12 shows the number of MSMEs that applied for external financing were 13 representing 12.1% applied and got everything. 12 representing 11.2% and applied but got part of it. 9 (or 8.4%) applied but refuse because cost is too high. While 15 (or 14.0%) applied but it was rejected, and 58 representing 54.2% did not applied for external source of finance.

4.4 Constraints to securing external financing

Table 13: Factors constraining ability to get external funding

	Frequency	Percent	Valid Percent
Inadequate information	22	20.6	20.6
Insufficient collateral or guarantee	22	20.6	20.6
Interest rate	29	27.1	27.1
Interest rate or cost too high	8	7.5	7.5
Reduced control over the firm	6	5.6	5.6
Financing not available at all	20	18.7	18.7
Total	107	100.0	100.0

Field Survey, 2023

The result in table 13 shows that MSMEs in Dala local government face a number of constraints to accessing external funds. The major of which is interest rate, inadequate information and insufficient collateral. Others include non-availability of the finance, high cost and reduced control over the firm.

4.5 DISCUSSION OF FINDINGS

The characteristics of the participating MSMEs reveal some interesting findings. The results obtained from the analysis of the survey data reveal that the small businesses in Dala are dominated by the micro enterprises which make up about 60% of the participating MSMEs. This finding sufficiently fits the economic characteristics of the area as the intensity and prevalence of industrial activities is low, and thus most businesses (including the registered ones) are either owned by individual proprietors or individual families, implying low capacity to operate in large scale. The results also revealed that Dala MSMEs are engaging in virtually all the major categories of business activities including manufacturing, wholesale and retail, artisanal jobs, construction, manufacturing, whole sale & retail, transportation, handcraft and other services to business or persons such as consulting firms, business centers, etc.

The results from the analysis of data indicate that certain proportions of the participating MSMEs have used the listed alternative sources of financing in the last one year. Internal sources were used the most within the period under consideration, with 53 SMEs

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out of 107 reported using the source. The external sources have also been utilized, but on a much lower scale. The best sources of financing for the surveyed MSMEs include Trade credit with 82 (76.6%) of the businesses reported using the source; loan from family and friends (65.4%). Less than 30% of the surveyed MSMEs have reported accessing funds from all other sources. This indicate that small businesses in Dala Local Government area have low usage rate of the available sources of finance.

The results of the analysis also shows that a greater proportion of the MSMEs who applied for external funding from both public and private agencies have been less successful in their application. For instance, only 14 (13.1%) MSMEs have applied for bank loan and got everything they wanted in the last one year. Others, seventeen (or 15.1) have applied but got only a part of it; twelve found the cost too high and refused; and nine MSMEs application for a bank loan were out rightly rejected. Similar situations were observed in the MSMEs application for funding from all other external sources including the public grants and subsidized loans.

From the results of the study, it is found that the following affecting the ability of MSMEs to secure funding from the external sources include inadequate information, insufficient collateral or guarantee, interest rate or cost too high, financing not available at all. These factors fall within the broader list of factors constraining the ability of MSMEs to raise funds in Nigeria.

5. CONCLUSION AND RECOMMENDATIONS

The findings of this study revealed that the best alternative sources of finance for MSMEs in Dala include trade credits, loans from family and friends and the internal sources. The findings also revealed that fewer MSMEs are wholly successful in their application for financing from both public and private sources. Lastly, the study has identified some of the major problems affecting the ability of MSMEs to finance their operations from external sources, including information asymmetry, lack of collateral facilities and high interest rate.

Base on the findings of the study, the following recommendations were drawn:

- i. Financial institutions should reduce interest rate to enable the MSMEs to access the loans at an affordable rate.
- ii. Government should intensify effort to educate and enlighten owners of MSMEs on its various programmes and schemes aimed at providing finance.
- iii. Conditions and requirements for collecting loans and credits from formal sources should be reduced by the government and financial institutions in order to ease access to finance.

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