Bank Credit and SMEs Financing in Nigeria

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Abstract
This study examined the extent SMEs are funded by deposit money banks in Nigeria. This was done through extensive descriptive, graphical and empirical analysis of Bank credit to SMEs data. The study generated and analyzed Bank credit to SMEs gap. It further explored Nigeria's "financing gap" which measures the need of external funds for the corporate sector. Bank credit to SMEs was found to be decreasing over the period covered (i.e. 1992 – 2020). Bank Loans to SMEs as percent of Total Bank Loans reached a maximum of 47.7% in 2003 from where it had continued to decline to 0.56% in 2019 ended. Loans to Small Scale Enterprises as a percentage of Total Credit to the Private sector had been on the decline from a maximum of 27.04 % in 1992 to 0 0.54% in 2019. The analyzed SMEs Credit Gap shows that by 1992, SMEs Credit Gap was N113.664 million but by 2009, the SMEs Credit Gap has grown to N4261.46 billion and N7725.51 billion in 2016. The SMEs Credit Gap as at 2019 ended stood at N7565.51 billion. For the corporate sector, the financing gap is alarming as results reveal a financing gap of N3, 176,147,942,428.47 trillion in 2019. Thus, policies and actions aimed at reversing the downward trend in credit to SMEs as well as closing the financing gap should be intensified. Deposit money banks not just Microfinance banks should be encouraged to lend more to SMEs and remove all obstacles (hidden charges that increase the interest rate) while providing more technical assistance to SMEs.
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1. Introduction

Small and medium enterprises (SMEs) have long become the toast of nations seeking recovery and accelerated economic development. Several strategies and models have been used by respective countries to boost the contribution of small and medium enterprises to economic growth and employment. However, as in 1994 (Ernest, Amoah, Tamara, Hemamala & William, 1994) so it is in the year 2020 that lack of access to finance is consistently mentioned as a principal constraint to the development of SMEs in African countries, Nigeria inclusive. According to the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN, 2013), one of the main challenges confronting the operations of SMEs in Nigeria is access to finance. The World Bank notes that in 2011, very few (9.5%) SMEs in Nigeria obtained a loan or had a line of credit. Access to finance was so low that lending to SMEs was only 5% of total commercial bank lending in Nigeria (World Bank, 2014). The World Bank (2014) press release further asserts that "Limited access to finance is a key obstacle to enterprise growth and entrepreneurship … and it is a major obstacle faced by SMEs". The 'cry' of 'lack of access to finance' seems to have become a constant constraint to SMEs development. According to the World Bank (2015) brief on SMEs Finance, "…more than 50% of SMEs lack access to finance, which hinders their growth".

Ironically, SMEs are eulogized as veritable engines of economic growth. "Most formal jobs in emerging markets are with SMEs which also create 4 out of 5 new positions", (see World Bank, 2015). Saleem (2010), a senior International Financial Corporation (IFC) SME banking specialist in the Middle East and North Africa (MENA) notes in a paper "overcoming constraints to SMEs development in MENA countries and enhancing access to finance" that SMEs contribute about 45 per cent of employment and up to 33% of GDP in developing economies. That is not all. Saleem indicate that 80 – 90% of all businesses in most countries are SMEs but "access to finance is one of the greatest challenges facing SMEs across the globe".

The World Bank (2020) declares that:

"Small and Medium Enterprises (SMEs) play a major role in most economies, particularly in developing countries. SMEs account for the majority of businesses worldwide and are important contributors to job creation and global economic development. They represent about 90% of businesses and more than 50% of employment worldwide. Formal SMEs contribute up to 40% of national income (GDP) in emerging economies. These numbers are significantly higher when informal SMEs are included. According to our estimates, 600 million jobs will be needed by 2030 to absorb the growing global workforce, which makes SME development a high priority for many governments around the world. In emerging markets, most formal jobs are generated by SMEs, which create 7 out of 10 jobs. However, access to finance is a key constraint to SME growth. It is the second most cited obstacle facing SMEs to grow their businesses in emerging markets and developing countries".

Add that there is about $5.2 trillion unmet financing gap yearly suffered by about 65 million micro, small and medium enterprises (MSMEs) in developing countries (IFC, 2017; World Bank, 2020). In 2019, SMEs in

Nigeria contributed 48% of the country's gross domestic product (GDP), accounted for 96% of businesses and 84% of employment (Onyinyechukwu, 2020). Even in developed economies, Arnold (2019) report that according to the World Trade Organization, SMEs represent over 90 per cent of the business population, 60-70% of employment and 55% of GDP in developed economies. Arnold (2019) therefore concluded that "SMEs therefore do not just significantly contribute to the economy – they ARE the economy".

SME's are highly priced to the extent that the United Nations, the International Federation of Accountants-IFAC, and the International Council for Small Business celebrate SMEs on June 27 as part of the UN Micro-, Small and Medium-sized Enterprises Day (#MSMEDay19). The UN believes that SMEs are an important part of achieving its Sustainable Development Goals especially goal 8 and 9 which are to 'promote inclusive and sustainable economic growth, employment and decent work for all' and to 'build resilient infrastructure, promote sustainable industrialization and foster innovation' respectively (see Arnold, 2019).

In Nigeria, on the part of government and its agencies like the Central Bank of Nigeria (CBN), several intervention programs have been initiated (for instance the CBN N200 billion SMEs credit guarantee scheme (SMECGS), Creative Industry Financing Initiative (CIFI) and others - see appendix 1). Policy directives have also been given to deposit money banks (DMBs) and other development financial institutions (DFIs) in Nigeria with respect to SMEs financing. Deposit money banks especially are at the center of every government effort to support SMEs financing through their crucial position in the intermediation process. Nelson and Ayawei (2018) assert that DMBs should be a "major source of funding to small and medium sized businesses" but reports a widespread concern about the poor funding of SMEs by DMBs which limits "the potentials that could be taped from the subsector". Several other studies have examined the extend bank credit affect SMEs output with varying results (see Akingunola, 2011; Iloh and Chioke, 2015; Okey 2016; Richard, 2016; Omonigho 2017; Hedwigis, 2017; Benson, 2017; Oluwarotimi and Adamu, 2017). Thus, there is need to continuously and critically examine the extent DMBs lending has accommodated SMEs in Nigeria. Like Thorsten, Demirgüç-Kunt & Soledad, (2009), this research focuses on banks as opposed to other financial institutions because studies have shown that banks are the main source of external finance for SMEs across countries. This paper is a contribution to the growing literature on DMBs credit to SMEs given the important position they (DMBs) occupy in the financial ecosystem. It empirically examines the extent SMEs are funded by deposit money banks in Nigeria for the period 1992 to 2020. With the above introduction, the rest of the paper is structured as follows: section two examines related literature on bank credit and SMEs financing, section three details the methodology while section four takes care of data exposition and analysis. Section five brings the paper to a logical conclusion.

2. Review of Related Literature

2.1 Small and Medium Scale Enterprises

So much has been written about SMEs and definitions abound. However, as observed by Ardic, Mylenko and Saltane (2011) attempts have been made to have a common definition of SMEs (see OECD, 2004), but "the heterogeneity of SMEs themselves and the nature of the economy they operate in might mean that establishing a global definition is not feasible".

Several criteria are in use by different countries, institutions and organizations. These include; number of employees, sales and/or loan size. In this paper we restrict ourselves to the definitions provided in the revised Micro, Small and Medium Enterprises (MSME) policy for Nigeria for 2015–2025.

Table1. Definition of SMEs

S/N	Size Category	Staff Count	Assets (N‟Million) (Excluding Land and Buildings)
1	Micro enterprises	Less than 10	Less than 10
2	Small enterprises	10 – 49	10 - less than 100
3	Medium enterprises	50 – 199	100 - less than 1,000

Source: revised MSME policy for Nigeria for 2015 – 2025

Table 1 above presents the definition of SMEs in Nigeria as articulated in the revised MSME policy. The MSME policy adopts a dual criteria definition. SMEs were defined either by number of staff employed or value of assets (excluding Land and Buildings). However, the revised MSME policy instructs that, "where there exists a conflict in classification between employment and assets criteria (for example, if an enterprise has assets worth twelve million naira (N12m) but employs 7 persons), the employment-based classification will take precedence and the enterprise would be regarded as micro".

The value of SMEs to the Nigerian economy has been reiterated time and time again. Okufolami (2003) asserts that "the development of Small Scale Enterprises (SMEs) in Nigeria is an essential element in the growth strategy. And further states that SMEs not only contribute significantly to improved living standards, they also bring substantial local capital formation and achieve high level of productivity". According to the International Organization of Securities Commissions (OICU/OISCO 2015), SMEs are important actors in economic growth and transformation, creating positive value for the economy and contributing towards sustainable and balanced economic growth, employment and social stability. Organization for Economic Co-Operation and Development (OECD, 2018) asserts that, "enabling SMEs to scale up can help countries address low productivity growth and widening income gaps". To this end several efforts has been made by the Nigerian government at developing the MSMEs sub-sector (see CBN, 2003, Olaitan, 2006, SMEDAN, 2017).

On the contribution of SMEs in Nigeria, a 2010 National MSME Collaborative Survey (SMEDAN and Bureau of Statistics) shows that 17,284,678 MSMEs employed a total 32,414,884 persons as at December, 2010. A similar survey in 2013 indicates that 37,067,416 MSMEs employed 59,741,211 persons representing 84.02% of the total labour force. MSMEs also contributed 48.47% and 7.27% to the Nation's Gross Domestic Product and export earnings respectively in 2013. By December 2017, the total number of MSMEs stood at 41,543,028, with a total employment contribution of 59,647,954 persons, (about 86.3% of national workforce), MSMEs also contributed 49.78% of Gross Domestic Product and 7.64% of export earnings in 2017 (SMEDAN/NBS, 2017). Despite the contributions of small and medium enterprises as recounted above, survey reports show that lack of access to finance limit their growth and ability to expand to meet the growing demands of the over 200million Nigerians.

2.2 Deposit money banks (DMBs)

Following the desire to close the financing gap militating against SMEs growth, DMBs are called upon to play a role in providing credit to SMEs. Intermediation of funds between the surplus units and the deficit units of an economy and the channeling of such resources to profitable investments has been the business of banks since 'Lombardy'. Also, DMBs are an important channel for transmission of Central Bank of Nigeria's monetary policies. This is because of the intermediation role which banks play in resource mobilization and allocation. Thus, DMBs engage in savings mobilization and investment promotion. An efficient banking sector according to Alper and Anbar (2011) in Ogunbiyi and Ihejirika (2014) "can promote economic growth, while credit insolvencies could result in systematic crisis".

Several studies have shown concern why DMBs shy away from lending to SMEs. Ellé (2012) assert that "most micro entrepreneurs are excluded from traditional sources of financing because they cannot provide required collaterals needed for financing". Akaeze and Akaeze (2018) agree with Ellé (2012) on inability of SMEs to provide collaterals and add that corruption by bank officials in credit application process hinders SMEs from access to finance. Nelson and Ayawei (2018) attribute lack of access to credit as emanating from the nature of SMEs, their inability to provide the requirements demanded by banks. For Banks, "banks perceive macroeconomic instability in developing countries and competition in developed countries as the main obstacles impeding SME finance" (see Thorsten, Demirgüç-Kunt & Soledad, 2009).

Earlier, Torre, Soledad and Schmukler (2008) referred to what they called "the "conventional wisdom" which "argues that the inadequate financing of SMEs is to a significant extent rooted in "supply-side" features". Explaining, Torre, Soledad and Schmukler (2008) wrote that "the way in which financial institutions operate is biased against offering financing to SMEs; as a consequence, many banks and other financial institutions become uninterested in being involved with SMEs". Torre, Soledad and Schmukler (2008) further showed that "Opaqueness" of SMEs (lack of transparency, inadequate information and informal nature of SMEs) hinder banks from giving credit to SMEs. Previous studies that point to opacity includes Berger and Udell (1998); Cole, Goldberg, and White (2004); Kano, Uchida, Udell and Watanabe (2006) as well as Gatti and Honorati (2007).

Notwithstanding the observed constraints, Nigerian banks have made some efforts in the past to accumulate funds solely for lending to SMEs. According to Okufolami (2003) "the concept of SMIEIS in Nigeria was the initiative of the Central Bank of Nigeria with the voluntary support and efforts of the Bankers' Committee. The Scheme requires that all banks in Nigeria set aside 10 percent of their profit before tax annually for equity investments in small and medium industries. The CBN reports that by July 31, 2007, that SMIEIS fund had grown to N37.4 billion out of which only N18.9 billion or 49.5 percent had been invested. Perhaps SMEs are not forthcoming in accessing the fund or "the fund managers are too lethargic in their portfolio management".

2.3 Theoretical approaches to SME financing by deposit money banks

2.3.1 Relationship lending VS Arm's Length Technology

Relationship Lending is a concept that has been investigated by several scholars. According to Berger and Udell (1995), "Relationship Lending is a type of loan contract in which the bank-borrower relationship is likely to be an important mechanism for solving the asymmetric information problems associated with financing small enterprises. In their study, Berger and Udell (1995) find that "borrowers with longer banking relationships pay lower interest rates and are less likely to pledge collateral". Theory indicates that "relationship lending generates valuable information about borrower quality" and thus alleviates the asymmetric problem. Sageworks (2013) defined Relationship-based banking "as the provision of financial services by a financial intermediary on the basis of long-term investment in obtaining firm-specific information or borrower-specific information through multiple interactions with the customer". Similarly, Beck, Degryse, De Haas and Neeltje (2014) posit that "relationship lending alleviates credit constraints" especially "during a cyclical downturn but not during a boom period". Relationship lending therefore, is the practice of lending to businesses (SMEs in particular) based on established relationship that help banks evaluate the customer dispositions more accurately rather than following conventional arm's length lending principles and demand for collateral (see Udell, 2008; Hachem, 2011; Antwi & Ohene-Yankyira, 2017).

On the other hand, an arm's length lending describes a financial transaction consisting of parties (lender and borrower) that have no relationship or contact with one another aside from the transaction at hand. Arm's length lending goes a long way in determining fair market values for assets. The transactions that take place in arm's length markets are known as arm's length transactions, in which the buyers and sellers act independently and do not have any relationship to each other. Attention though has most often been on 'relationship lending' as the prime lending tool for SMEs. However, studies have shown that arms-length lending (applying hard information to screen firms and hard assets as collateral) can be more cost-effective (Berger and Udell 2006). Arms-length lending also allows larger and non-local banks to lend to SMEs (Beck et al. 2011).

2.3.2 Centralized organizational structures

Centralized lending describes a situation "where all loans are filtered through a central lending department/location so as to take advantage of economies of scale". It is "a hierarchy decision-making structure where all decisions and processes are handled strictly at the top or the executive level". The advantage of centralized lending is that it enables standardization of procedures and systems. However, it smirks of bureaucracy and lack flexibility. Centralized decisions and control especially in big and foreign banks has its benefits no doubt, but the remoteness and unique nature of SMEs, make it difficult for them to access credit from such centralized institutions (Berger & Udell 2006, Beck et al. 2011).

2.4 Empirical literature review

Bello and Mohammed (2015) investigated the extent banking sector credit affect small and medium enterprises in Nigeria. The study which covered the period 1985 to 2010 used descriptive statistics, correlation matrix and error correction model to analyze data. Their results show that banking sector credit significantly affects the growth of small and medium enterprises in Nigeria. The relationship between commercial banks' credit and the growth of small and medium scale enterprises in Nigeria was the concern of Okey (2016). The study modeled Small and medium enterprises as a function of commercial bank credit, lending rate, inflation rate, exchange rate and bank density. The method of analysis was the ordinary least square regression which indicated that commercial bank credit had no significant relationship with growth of small and medium enterprises in Nigeria.

Ibrahim (2017) examined "the role of commercial banks in financing small and medium scale enterprises in Nigeria" for the period 1991 to 2012. Using Paired sample test, Ibrahim (2017) found that "commercial banks' loans do not affect small and medium enterprises positively".

Ezeaku, Anidiobu and Okolie (2017) particularly focused on the effect of small and medium enterprises financing on the growth of the manufacturing sector in Nigeria and cover the period 1981 to 2014. Regression analysis was used by Ezeaku, et al (2017) to analyze data collected on Manufacturing output as the dependent variable, credit to small and medium enterprises, inflation rate and exchange rate as predictor variables. Their findings revealed a positive effect of small and medium enterprises financing on manufacturing output. On the other hand, inflation rate and interest rate exerted negative effects on manufacturing output.

Closely related to the present study, Veiga and McCahery (2019) writing on the "Financing of Small and Medium-Sized Enterprises: An Analysis of the Financing Gap in Brazil" reviewed "developments in the availability of financing for SMEs in Brazil". Their study among other concerns examined "the changes in the availability of bank loans between 2014 and 2016" and estimated the SME loan gap in Brazil "based on Central Bank and publicly available data". Veiga and McCahery (2019) "results show that the loan gap in Brazil was substantial".

3.0 Methodology

First we examined the extent SMEs are funded by deposit money banks in Nigeria. This we did by extensive descriptive and empirical analysis of Bank credit to SMEs data. The study further generated and analyzed Bank credit to SMEs gap. We also explored Nigeria's "financing gap" which measures the need of external funds for the corporate sector as the difference between Gross fixed capital formation and Savings for a broader understanding of the financing deficit in the country.

3.1 Data

Bank credit to SMEs, credit to the private sector and total bank credit to the economy are reported by the Central Bank of Nigeria in conjunction with the National Bureau of Statistics and can be accessed from the latest CBN statistical bulletin or CBN statistical data base. Gross fixed capital formation and Savings data were sourced from the World Bank data. Bank credit to SMEs gap and SMEs contribution to GDP was generated based on official information and reports.

4.0 Analysis and results

Table 2: Descriptive analysis of Bank credit to SMEs 1992 – 2019 Nm

Statistic	Mean	Median	Maximum	Minimum	Std. Dev.	Skewness	Kurtosis
DMBLSMES	34636.46	29044.10	90176.50	10747.89	23560.95	1.019652	3.217774

Statistic	Jarque-Bera	Probability	Sum	Sum Sq. Dev.	Observations
Value	4.907217	0.085983	969820.8	1.50E+10	28

From table 2 above, the average Bank credit to SMEs for the period was N34636.46 million.

Observe that the maximum annual Bank credit to SMEs stood at N90176.5million and occurred in the year 2003. On the other hand, a minimum of N10747.89 million was extended to SMEs as at 2016 by Banks in Nigeria. In total, Bank credit to SMEs for 28years amounted to N969820.8 million only. The degree of paucity of finance and the stochastic nature of Bank credit to SMEs is graphically shown below in figure 1.

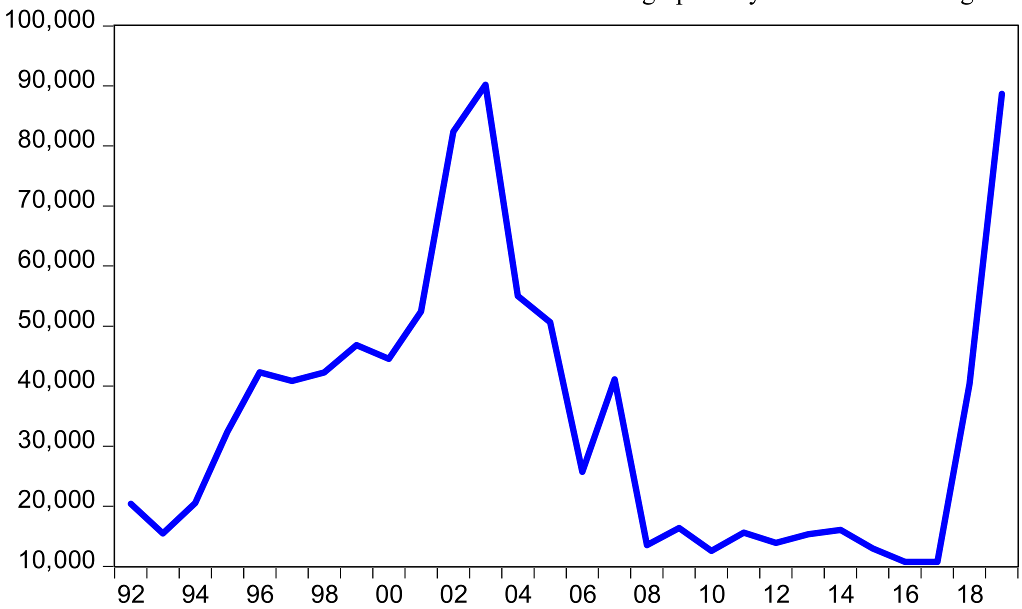

Figure 1: Graph of Banks Loans To SMEs (Nm) 1992 - 2019

Next is presented the distribution of Bank credit to SMEs as a percentage of total bank loans to all sectors.

Table 3: descriptive statistics Bank Loans to SMES to Total Bank Loans %

Statistic	Mean	Median	Max	Min	Std.dev	Skewness	Kurtosis
BankLoanstoSMEs toTotalBankLoans%	8.0	1.8	47.7	0.07	11.4	1.8	6.4
Global statistic	Jarque-Bera	Prob.	Sum	Sum Sq.Dev.		OBS	
Value	28.88773	0.0000	222.77	3496.37		28	

Table 3 above showcase the summary statistics of Bank Loans to SMEs as a percentage of Total Bank Loans. Bank Loans to SMEs as percent of Total Bank Loans reached a maximum of 47.7% in 2003 from where it had continued to decline to a minimum of 0.067% in 2016. As at 2019 ended, Bank Loans to SMEs as a percentage of Total Bank Loans stood at 0.56% with an average of 8.0% from 1992 to 2019. A pictorial view of the movement of Bank Loans to SMEs as percent of total Bank Loans is presented in figure 2 below.

Similarly we examined Loans to Small Scale Enterprises as a percentage of Total Credit to Private sector. The graph shown in figure 3 below indicate that Loans to Small Scale Enterprises as a percentage of Total Credit to the Private sector had been on the decline from a maximum of 27.04 % in 1992 to 0.07% and 0.54 in 2017and 2019 respectively.

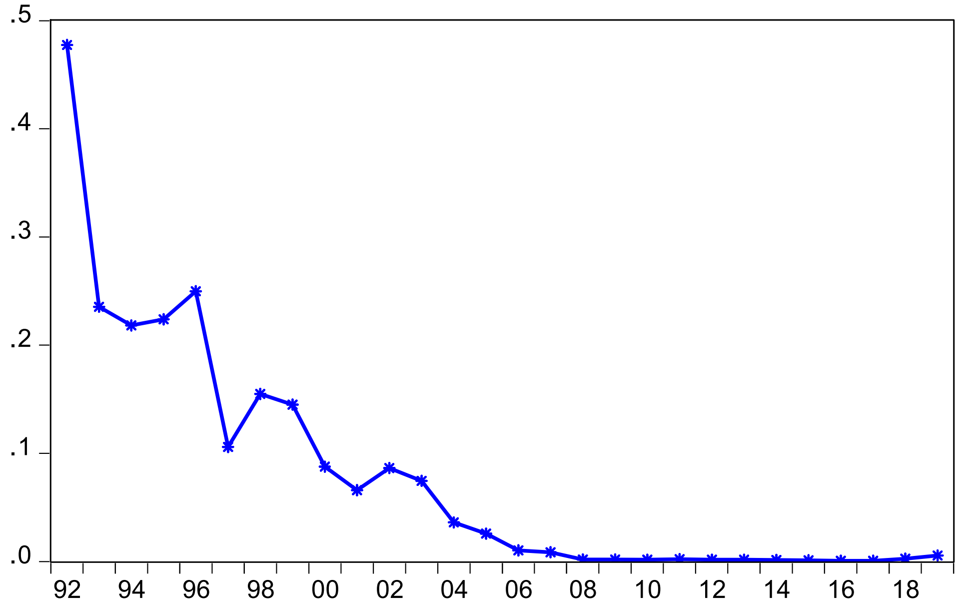

Figure 2: Trend of Bank loans to SMEs to total bank loans %

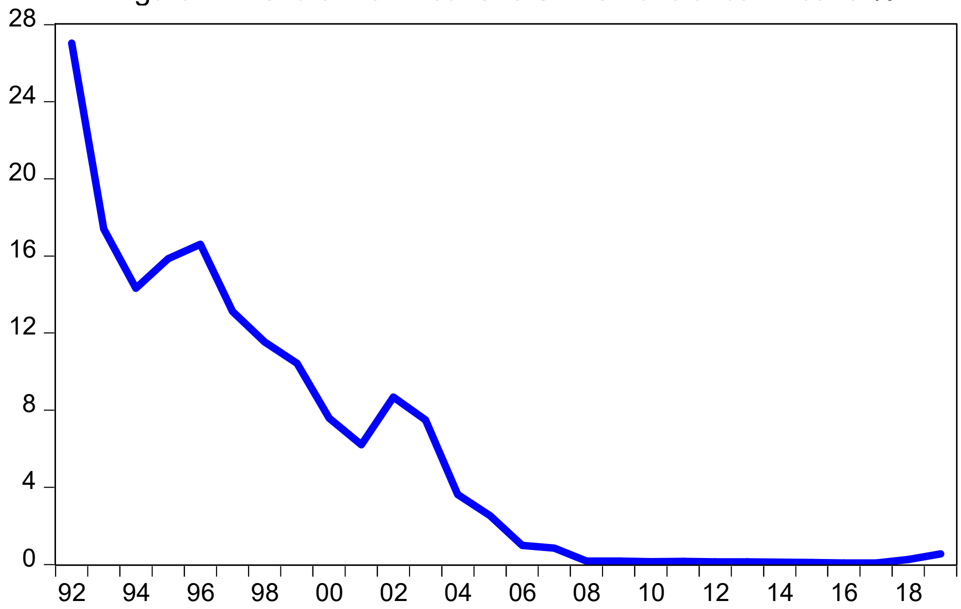

Figure 3: Loans To Small Scale Enterprises to Total Credit to Private sector

4.1: SMEs Credit Gap Analysis

We define SMEs Credit Gap as the unmet amount of credit required by SMEs for maximum output in the economy. Elsewhere, it has been described as “Potential demand – Existing supply” but Veiga and McCahery (2019) propose that the percentage contribution of SMEs to the economy (GDP) should reflect the amount of credit to SMEs as a percent of total credit. We call this the expected or ideal credit to SMEs. Veiga and McCahery (2019) to arrive at total credit add “other credit raised in capital markets from the Central Bank of Brazil”. Thus, they estimate SME credit gap in Brazil as the difference between the expected or ideal credit to SMEs and actual credit to SMEs. In this study, we implement Veiga and McCahery (2019) idea though we do not include “other credit raised in capital markets from the Central Bank of” Nigeria (the patronage of the Growth Board segment formerly Alternative Securities Market dedicated to SMEs is very low. Out of 45 million SMEs in the country, only 9 are listed on the Board). As indicated in Bukola (2017) the Nigeria Bureau of Statistics in its report on small and medium scale enterprises (SMEs) in Nigeria asserts that SMEs have contributed about 48% of the national GDP in the last five years (2012 -2017). SMEDAN in several surveys also reports on the contribution of SMEs to GDP. SMEs contribution to GDP has hovered between 48.5% in 2016, 48% in 2017, 48.7 in 2018, 48% in 2019 and 49% in 2020 (see Premium Times, 201;, The Nation, 2017; Olowookere, 2018; SME360 2020 and PricewaterhouseCoopers MSME Survey 2020), We use 48% threshold (i.e. if SMEs contribute 48% of GDP, they should at least get 48% of total bank credit (Veiga & McCahery, 2019) to determine the expected or ideal credit required by SMEs in Nigeria and subtract the actual credit to SMEs to arrive at SMEs Credit Gap shown below in figure 4.

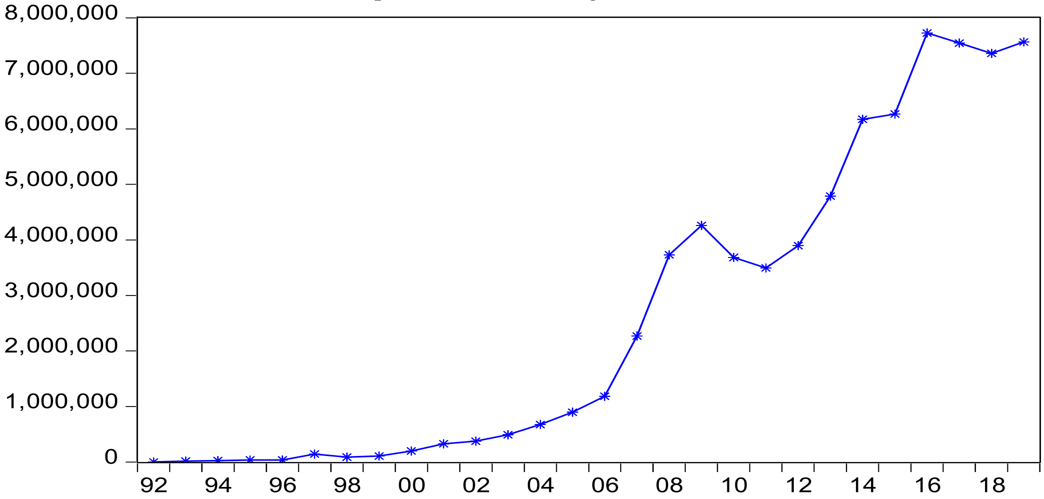

Figure 4: SME CREDIT GAP

The analyzed SMEs Credit Gap shows that by 1992, SMEs Credit Gap was N113.664 million. By 2009, the SMEs Credit Gap has grown to N4261.46billion and N7725.51 billion in 2016. The SMEs Credit Gap decreased to N7544.5 billion and N7359.99 Billion in 2017 and 2018 respectively but rose again to N7565.51 billion in 2019. SMEs Credit Gap as a percentage of total bank credit is presented in figure 5 below.

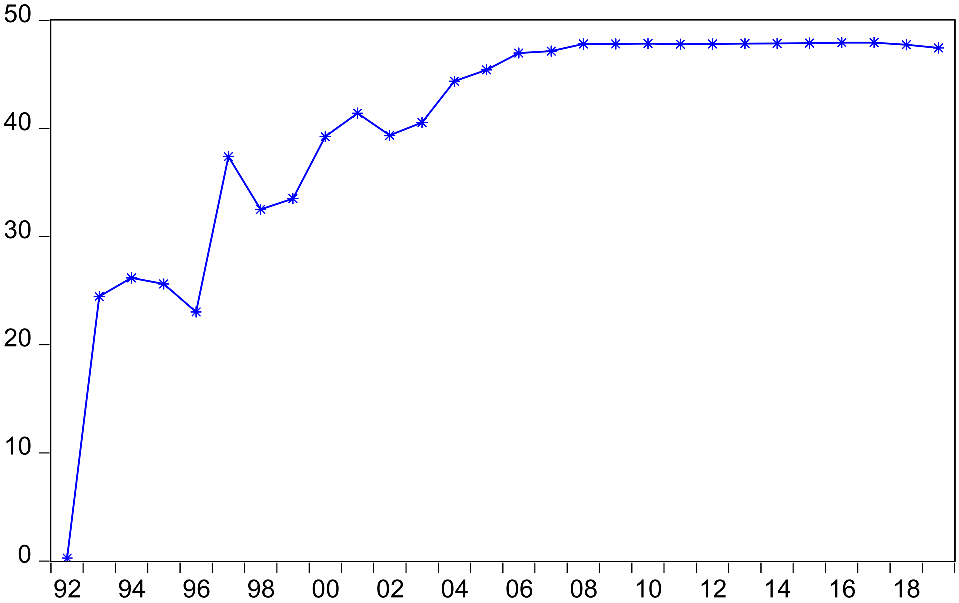

Figure 5: SME CREDIT GAP percent of total credit

4.2: Financing gap analysis in Nigeria

This measures the need of external funds for the corporate sector as the difference between Gross fixed capital formation and Savings. Figure 6 below show the graph of the difference between Gross fixed capital formation and Savings. This reveals a financing gap of N3, 176,147,942,428.47 trillion in 2019.formation and Savings. This reveals a financing gap of N3, 176,147,942,428.47 trillion in 2019.

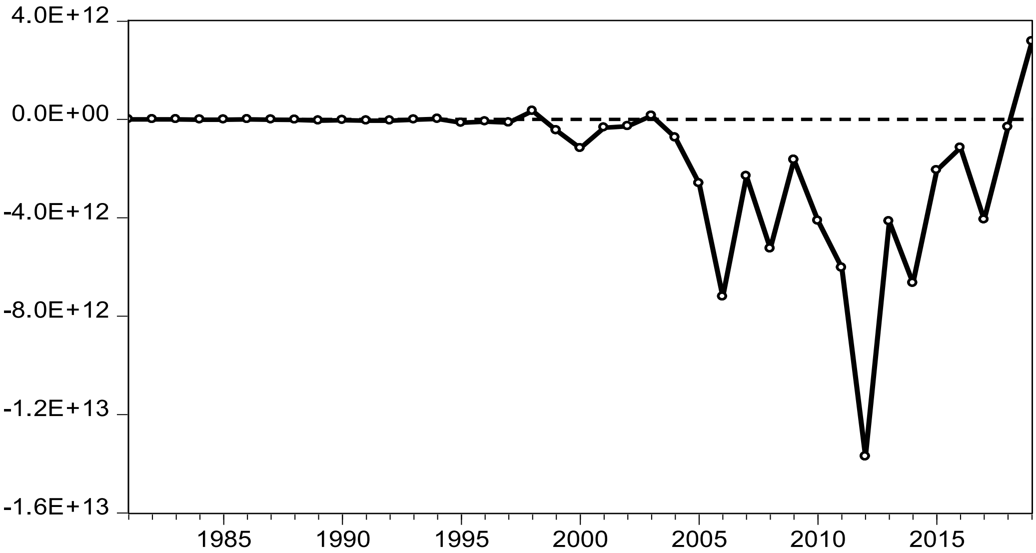

Figure 6: Nigeria Financing Gap

5.0 Conclusion

This study examined the extent SMEs are funded by deposit money banks in Nigeria. This we did by extensive descriptive, graphical and empirical analysis of Bank credit to SMEs data. The study generated and analyzed Bank credit to SMEs gap. We also explored Nigeria's "financing gap" which measures the need of external funds for the corporate sector. Bank credit to SMEs was found to be decreasing over the period covered (i.e. 1992 – 2019). Bank Loans to SMEs as percent of Total Bank Loans reached a maximum of 47.7% in 2003 from where it had continued to decline to 0.56% in 2019 ended. Loans to Small Scale Enterprises as a percentage of Total Credit to the Private sector had been on the decline from a maximum of 27.04 % in 1992 to 0 0.54% in 2019. The analyzed SMEs Credit Gap shows that by 1992, SMEs Credit Gap was N113.664 million but by 2009, the SMEs Credit Gap has grown to N4261.46 billion and N7725.51 billion in 2016. The SMEs Credit Gap as at 2019 ended stood at N7565.51 billion. For the corporate sector, the financing gap is alarming as results reveal a financing gap of N3, 176,147,942,428.47 trillion in 2019. Thus, policies and actions aimed at reversing the downward trend in credit to SMEs as well as closing the financing gap should be intensified. Deposit money banks not just Microfinance banks should be encouraged to lend more to SMEs and remove all obstacles (hidden charges that increase the interest rate) while providing more technical assistance to SMEs.

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