



Crowdfunding as Financial Option for Small and Medium Enterprises (SMEs) in Nigeria

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Abstract – Small and medium scale enterprises (SMEs) act as a promoter of economic development of the developed and under developed nations. Developing countries like Nigeria that, require sustainable economic growth and development must pay attention to the SMEs sectors in order to reduce unemployment, poverty and improve the standard living of its society. Unfortunately, in Nigeria, SMEs have underperformed despite that, 90% of the Nigerian businesses are small scales but their contribution to the Nigerian GDP is below 10%. The main reason for this low contribution of SMEs to Nigerian GDP could be attribute to poor funding, lack of management expertise and lack of access to modern technology among others, with proper finance the SMEs can acquire modern technology and employed qualified staff. Thus, this paper focuses on crowdfunding as financial option for Nigerian SMEs. However, the paper is a conceptual framework.

Keywords: SMEs, financial option, crowdfunding, crowdfunding framework

Introduction

Small and medium enterprises (SMEs) play important role in economic growth and development of any nation especially the developing countries. SMEs has contributed to the development of many Asian countries such as China, Malaysia and India respectably. For example in India, SMEs account for 39 percent of manufacturing output and 33 percent of the country total exports (Gbandi and Amissah 2014). Additionally, SMEs reduce unemployment, increase local competition, improvement of local technology as well as developing local entrepreneurs (CBN 2011). Nevertheless, in Nigeria the story is different, SMEs in Nigeria is underperformed it's accounted to only 1percent to the Nigerian GDP. The main problem affecting SMEs performance in Nigeria can be group into four main parts, Firstly lack of access to credit, secondly poor business environment, thirdly lack of access to modern technology and fourthly low managerial skills. The problem can be minimize if the SMEs fully funded. Financing of SMEs in Nigeria is very important if they are to perform the role of economic growth and development of Nigeria. The question here is that, what are the financial options of SMEs in Nigeria.

Small and Medium Enterprises (SMEs) in Nigeria

In Nigeria and worldwide, it appears to be no specific definition of small and medium enterprises. Different scholars, authors, schools and countries have different ideas about the definition of small and medium business. Some they base their definition in terms of capital outlay, sales turnover, fixed capital investment, number of employees, machinery and plant, market share and the area of operation. Stills these features are vary from country to country.

In Nigeria, third National Development Plan, defined a small and medium scales business as any manufacturing firm employing less than 10 people or whose investment in equipment and machinery

does not exceed N600,000 thousand naira. Moreover, federal government small scale industry development plan of 1980 defined small and medium scale business as any manufacturing establishment or services industry with a total capital not exceeding N150,000 thousand naira excluding cost of land (Ayozie et al 2013).

The central bank’s monetary and credit guidelines, stated that, small scale industry were regarded as any business whose total turnover is less than N6,000,000 and capital not exceeding N10,000,000 (Muritala et al 2012). Further, Small and Medium Enterprises Equity Investment Scheme (SMEEIS) defined small business as any businesses with total turnover of less than N100 million naira and employed not less than 10 people and not more than 300 people. Nevertheless, National Bureau for Statistics (2015) defined SMEs based on the following criteria as tabulated in the Table 1 below

Table 1: SMEs definition (National Bureau for Statistics (2015))

S/N	Size Category	Employment	Assets (=N= Million) (excl. land and buildings)
1	Micro enterprises	Less than 10	Less than 5
2	Small enterprises	10 to 49	5 to less than 50
3	Medium enterprises	50 to 199	50 to less than 500

However, in United Kingdom (UK), a small and medium enterprise were regarded as any businesses with total turnover of less than GBP 200 million and employed not more than 200 people, while in Japan is a business with total turnover not exceeded 100 million Yen and employed not more than 300 people (Gbandi and Amissah 2014). But, in United State of America (USA) the small business administration define a small business as businesses that is independently owned, operated and finance by a small number of people, employed up to 1500 peoples depending on the industries (Ayozie et al 2013).

Therefore, this paper adopts the definition given by the central Bank of Nigeria (CBN) that, small scale business are businesses with total assets (excluding cost of Land) of less than One million naira and employing less than 50 people as a full time workers. While medium businesses are those with total assets (excluding cost of Land) less than Fifty million and employing not more than 100 people as a full time workers. Going by these definition 90 per cent of the Nigerian businesses are SMEs (Adeyigal 2016).

The Need for Financial Assistance among SMEs in the World

SMEs access to finance tends to be a common problem facing both developed and under developed countries. The finding indicates that, despite dominant of SMEs in private sector; they are more constrained in their access to finance compare to large businesses. For example, in 2012 in United Kingdom, there was an estimated gap between the demand and supply of SMEs loan between 26 billion pound and 59 billion pound. Similarly, in United State of America the bank denied roughly 590 billion dollar of SMEs loan in 2014. Additionally, in 2013, European Central Bank projected that, SMEs loan application will not honored by a financial institution; the rate is 17.9 percent for micro businesses, 13.5 percent for small businesses and 5.7 percent for medium businesses (Perkmezovic and Walker 2016). Consequently, SMEs access to finance is changing because of the 2007-2008 world financial crises; in 2013 access to finance was the second most persistent problem mention by different SMEs managers in most of the countries. For example, 15 percent of EU managers, 40 percent Cyprus, 32 percent from Greece, 22 percent from Netherland, Ireland, and Italy, similarly, in Austria, Luxembourg and Germany were 7, 6, and 8 percent respectively (Ramona and Danovi 2015).

Financial Needs of SMEs in Nigeria

Both practitioners and scholars generally accept that, a small and medium enterprise serves as engines of economic growth and development of any nation. Despite their contribution to the economic development, SMEs are face with many challenges such as finance (Gbandi and Amissah 2014). In

Nigeria, one of the major challenges faced by SMEs is lack of access to finance (Munkaila 2011). Empirical research shows that finance contributes about 25% to the success of SMEs (Ogujuiba et al 2004).

However, a report from World Bank showed that 39% of small-scale businesses and 37% of medium scales, businesses in Nigeria lack the access to finance to continue their operation and these lead to close their business. However, every enterprise, weather big or small is financed either through Debt or Equity or the combination of the both two (Gbandi and Amissah 2014). Nevertheless, both types of financing are generally source from formal financial sector (FFS) or the informal financial sector (IFS). Most of the researchers identified commercial banks and development banks in the formal financial sector as the most common source of finance for enterprises. The informal sector consists of borrowing from family and friends (F&F), cooperatives and personal serving.

Formal Finance Sector (FFS)

Commercial banks remain the popular source of finance for SMEs all over the globe. In Nigeria, most of the commercial banks are reluctant in financing because of perceived risks and uncertainties. In 2010, CBN released a statistics that shows that, commercial banks loan to SMEs have been on the decline over the years. The total credits decreased from 48.79 percent in 1992 to 0.15 percent in 2010 (Liuper 2012). Additionally, merchant banks advances to SMEs as a percentage of total credit has reduce from 31.2 per cent in 1992 to 9.0 per cent in 2000 (Achua 2008).

In recognizing the SMEs financial constraints, the Nigerian government established credit institutions in order to improve SMEs access to finance. The institution includes: National economic reconstruction fund (NERFUND), Nigerian bank for commerce and industry (NBCI), peoples bank of Nigeria (PBN), Microfinance banks, Nigerian agricultural credit guarantee scheme (NACB). Other institution includes small and medium equity investment scheme (SMEEIS) and Small and medium enterprises credit guarantee scheme (SMECGS) (Soludo 2008).

Small and Medium Enterprises Credit Guarantee Scheme (SMECGS)

In order to improve access to credit by SMEs, the Central Banks of Nigeria (CBN) established the small and medium enterprises credit guarantee scheme (SMECGS). The CBN injected two hundred billion naira to the scheme. The main objectives of the scheme is to develop manufacturing sector by providing them guarantee for access to credit at lower interest rate. The scheme charge the interest rate of 7 per cent and the repayment period is 15 years (Gbandi and Amissah 2014).

Small and Medium Enterprises Equity Investment Scheme (SMEEIS)

The 246th bankers' meeting held in 1999 approved the scheme and made it mandatory for the all participating banks to set aside 10% of their after tax profit for investment and promoting the activities of Nigerian SMEs (CBN, 2012). The main aim of the scheme was to reduce the SMEs problem of finance. The maximum interest charges on any loan are 9 per cent (Oreoluwa, 2011). However, the participating banks remain equity partners in the enterprises for a minimum of three years after which they can exit (Gbandi and Amissah, 2014).

Agricultural Credit Guarantee Scheme Fund (ACGSF)

Agricultural Credit Guarantee Scheme Fund was establish in 1997 and started operation in 1978. Virtually all-farming business in Nigeria was categorize as small and medium business. The scheme guarantees credit allocation to the farmers by the participating bank without any collateral. The activities of the scheme are manage by the Central Bank of Nigeria (Gbandi and Amissah, 2014).

Microfinance Banks

The Central Bank of Nigeria (CBN) recognized the significant roles play by microfinance in poverty reduction through empowering the micro, small and medium enterprises (Olaitan, 2006). The main objectives of establishing the microfinance is to developed the agricultural sector of the economy, which was neglect due to the discovery of crude oil. Majority of Nigerian especially in the rural areas are engaged in agricultural activities (Gbandi and Amissah, 2014).

International Development Agencies

Nigeria as a member of the World Bank group and international finance corporation (IFC), this institution has made an important contribution in financing SMEs in Nigeria. For example in 2000, the IFC injected almost \$ 400 million in some selected Nigerian bank (first bank of Nigeria, first city monument and guarantee trust bank) with the aims of increasing credit facilities to the SMEs (Omorogbe 2011). Similarly, African development bank (AFDB) is another international agency that plays a significant role in financing of SMEs in Nigeria and other African countries. In 2010, AFDB has approved a total of \$700 million worth of credit facilities for Small and Medium sized Enterprises in Nigeria. (Mungcal, 2011).

Venture Capital and Business Angels

Venture capital involves the provision of investment finance to small and medium enterprises in the form of equity or quasi-equity instrument not traded on the capital market (Gbandi and Amisshah 2014). A venture capitalist provides financing for a new enterprises, expansion of existing company or bailout for ailing firm (Oreoluwa 2011). It provides the capital to firms that have difficulty in sourcing finance in capital market (Gompers and Lerner, 2001). Most of the Venture capital primary focuses on high growth businesses in their early stage of growth. The major stages of Venture capital are seed capital, start-ups and early stage capital.

Sources of Financial Resources for SMEs

The main source of equity finance for SMEs in Nigeria is personal saving, moneylenders, family, and friend. Previous researchers such as Ojo (1984) confirmed this. The author stated that, 96.4 per cent of Nigerian SMEs investment come from personal serving, 3 per cent from informal sector and 0.21 per cent came from formal sector. Further, a recent study by National Bureau for statistics (2015) shows some improvement in funding of SMEs by the formal sector. The report shows that personal saving account to 62 per cent, while 17 per cent for loan, 11 per cent, 5 per cent for cooperatives, 3 per cent for grant and others account for 2 per cent respectively.

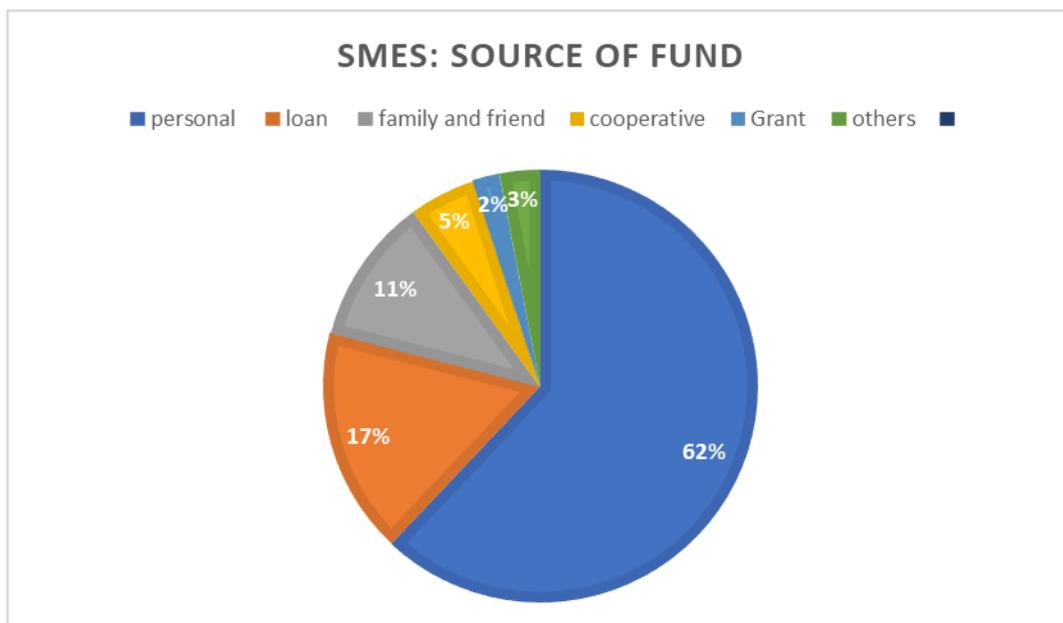


Figure 1: SMEs sources of Fund in Nigeria NBS (2015)

Crowdsourcing as a financial option for SMEs in selected countries

Crowdfunding has recently emerged as a new way of financing new projects. It is the financing of a venture or a new project by a group of people instead of traditional institution, allowing the creators of for-profit, cultural or social projects to request funding from crowd, often in return for future goods or equity (Puspa 2016). Today, crowdfunding is an innovative phenomenon internet based means of financing a new project that is fast growing in terms of popularity (Suhaili and Rizal 2016). Further, it

enable individuals to solicit small funds, donations, or loans through Internet from a wide variety of investors; they have emerged as a novel and potentially significant source of funds for entrepreneurial and charitable creativities (Yu et al 2017).

Technological development has helped the rapid growth of crowdfunding market. The fact that, the technological developments has the ability to construct a free online connectivity, accurate credit scores that can be used by many different backers as well as secure online money transferring services and e-commerce that can be employed to engage geographically dispersed large number of people (Eniola & Entebang 2015).

Crowdfunding started in America since 1885, when the New York world newspaper announced a campaign to raise \$100,000 in order to purchase a pedestal for the statue of liberty (the statue of liberty and America's crowdfunding pioneer 2013). Golic (2013) undertakes his research on the advantages of crowdfunding as an alternative source of financing of small and medium size enterprises. Author concluded that, crowdfunding serves as the best alternative means of financing the SMEs start-up capital, which in turn create more jobs and increase the country GDP. Further, Barbi and Bigelli (2017) stated that, Crowdfunding is rapidly growing and it is likely to become one of the main sources of financing new and existing business in the near future. This is in line with Paschen 2017 finding which reveal that, crowdfunding has significant role to play in establishing a financial resources base of company start-ups capital. Similarly, Riley-Huff et al (2016) find that, crowdfunding can play important roles in organizational fund raising strategy. Online crowdfunding campaign is a strong mechanism in promoting investment funding in a country (Mossialos 2017; Yu et al 2017; Suhaili and Rizal 2016; Callaghan 2014).

Further, the concept truly exploded in popularity though when the platform like kickstarter and indiegogo gave entrepreneurs an open opportunity to finance their business ideas through donation from the crowd. As at February 2017, Kickstarter has succeeded in funding over 117,000 projects with over 2.8 billion USD. Similarly, in 2014, 3,846 film and video funded after their project shows in Kickstarter web site. However, evidences from the literature and report from the crowdfunding industry indicate that, SMEs all over the globe are using crowdfunding to finance their businesses. Indeed, the value of fund raised in crowdfunding reached about 16 billion dollar across the globe in 2014 and 35 billion dollar in 2015 (David 2016). North America is the largest region with crowdfunding market; Europe has also experienced the growth, similarly in Asian region the market is growing at high rate but the market in African region is not growing may be because of lack awareness and less development in terms of technology. See table 1.

Table 2: Crowdfunding Volume by Region (Massolution (2015), Industry Report)

Region/year	2012	2013	2014	2015
North America	\$1,610m	\$3,860m	\$9,470m	\$77.2b
Europe	\$945m	\$1,350	\$3,300m	\$6,48b
Asia	\$33m	\$810	\$3,400	\$10,54b
Oceania	\$76m	\$27	\$43	\$68.6m
South America	\$0.8m	\$21m	\$57m	\$85.74m
Africa	\$0.1m	\$6m	\$12	\$24.16m

Crowdsourcing in Nigeria and Factors Influencing the Applicability of Crowdsourcing for SMEs in Nigeria

Nigeria has 70.3 million internet users (Internet World stats, 2014; Vanguard 2016); this is a truly large number of people and potential entrepreneurs that can be reached via crowdfunding. Moreover, financial Development (2017) reported that, Nigeria has positive features in place making it potential to form an effective crowdfunding market in the West African country. These features are; a large and fast growing population; wide spread mobile users and internet connectivity; strong social media usage and a great network of family and friends and thriving entrepreneurial prospect. Nigeria the

largest leading economy of Africa and country with 90% of its businesses is small, crowdfunding could be a great source of financing this business organization and individuals.

Additionally, crowdfunding can increase Nigerian SMEs' access to finance and possibly remedy firm market failures such as; inadequate provision of funding for startups and early stage of firm formation. Its distinct strategy offers flexibility, cost-effectiveness and a high speed of raising funds. Similarly, entrepreneurs can gain project-testing devices that help them to estimate demand and gather feedback from potential users (Eniola & Entebang, 2015).

Nevertheless, Nigerian entrepreneurs has started using crowdfunding as their means of finance, in 2015 out of \$83.3 million USD raised by crowdfunding market in Africa, Nigeria accounted for \$7-\$8 million USD. Peer to peer or lending crowdfunding and equity based crowdfunding model are the main model used by Nigerian entrepreneurs, the two models accounted for 90% of the monies raised in the market while donation and reward based crowdfunding accounted to the remaining 10%. However, the online platform used in raising crowdfunding money in Nigeria are; gogoafrika.com, push and start, fundasolva, jumpstart Africa, 234give.com and start crunch.com (Eniola & Entebang 2015). However, the acceptance of the model is very low compare with the number of small and medium businesses in Nigeria with percentage of the money raised in the crowdfunding market in 2015.

However, the major problem facing crowdfunding in Nigeria is lack of legal backing as cited by Bolu (2015). For example, on 15 August 2016 Nigerian security and exchange commission (SEC) ban the activities of crowdfunding in Nigeria because of the legal implication. SEC stated that main reason for banning the activities of the crowdfunding is that, Nigerian capital market rules and regulations such as the “investment and securities Act (ISA, 2017) and the companies and Allied Matters Act (CAMA 1990)” did not capture crowdfunding activities and there is no provision for it.

Crowdfunding Conceptual Framework

The general crowdfunding conceptual framework based on the idea that, project seeking for funding must undergo some process by describing, advertising, promoting and marketing his idea using social networking via the Web platform (Suhaili and Palil 2016). The design style of the website permits the fundraiser to create a social networking access in promoting the needs fund by revealing project profile, pictures and description of how the fund raised should be use (Kirby and Worner 2014). Operationalization of the framework needs at least two parties participating; one is the project owner and second is the crowdfunding platform. The platforms serve as intermediaries in managing the transfer of the fund raised from the donors to the fundraiser (Abdullah 2016). The project donor received a reward in terms of gift, dividend, and interest or appreciated letter in return of his donation.

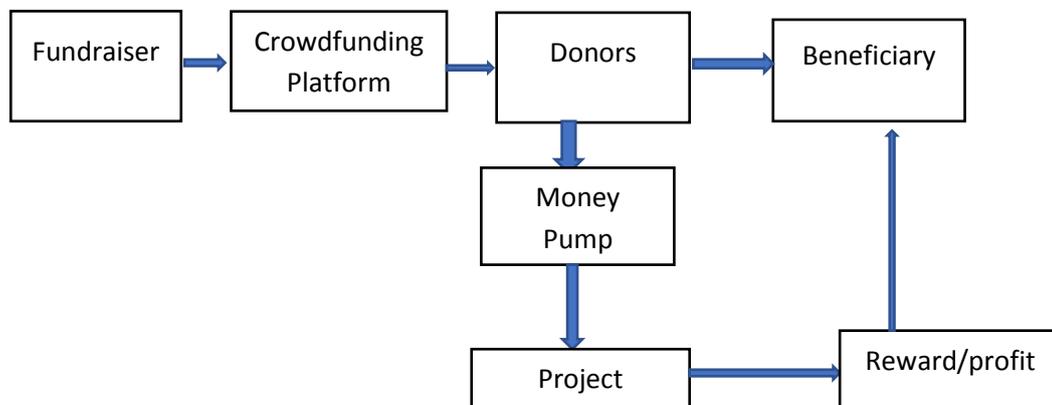


Figure 2: General conceptual framework of crowdfunding operationalization. Adopted from Suhaili and Pilil (2016) with modification.

However, in crowdfunding operationalization framework the platform facilitates as the third party of the campaign from donors to the fundraiser. The platform in turn, use banks to facilitate the process of deposits and withdrawals of fund raised from their various donors. However, the platform charges some amount of money as a service fee for the maintenance of the portals, the services fee varies from platform to platform. For example, Spacehive.com charge affordable cost (Hollow 2013) while JustGiving and Spot.us is free of charge (Kuppuswamy and Bayus 2013). The platforms manage the funding process and takes the responsibility of tracking the project progress based on the projects' funding campaign objectives.

Conclusion

In conclusion, SMEs in Nigeria dominated the Nigerian business environment, its account for over 90 percent of businesses in Nigeria. Moreover, African economic outlook 2004/2005 reported that, SMEs in Nigeria account for 95 percent of manufacturing sector and 70 percent of employment in industry sector done by SMEs. Despite the dominance of the Nigerian economy by the SMEs, still their contribution to the Nigerian GDP is only 1 percent. Nevertheless, the low contribution of SMEs to the growth and development of Nigerian economy can be attribute to many reasons such as lack of access to finance as cited by many authors (Unido 201; Adeyigal 2016; NBS 2016). However, access to finance is very important to the growth and survival of any businesses whether small or big. An empirical study shows that finance contributes 25% to the growth and success of the SMEs sector (Gbandi and Amissah 2014). Further, with proper funding SMEs can remedy their problems and positively contributed to the growth and development of Nigerian economy. Consequently, Federal government of Nigerian in collaboration with CBN has established many financial institutions with hope of reducing the financial problem faced by the Nigerian SMEs. However, this effort appears not yield any positive results as indicated by previous researchers (Obamuyi 2009; Gbandi and Amissah, 2014; Olaitan, 2006). Therefore, this paper tried to highlight the important of Crowdfunding as alternatives sources of finance to the SMEs. Crowdfunding can serves as the financial option to the Nigerian SMEs.

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