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# Small scale industries and financing challenges in the rural areas

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## ABSTRACT

Small Scale Enterprises have been recognized to be the main engine of economic growth and a major factor in promoting private sector development and partnership in the developing economies of the world. The enterprises in this category have not only brought about substantial local capital formation, it has really increased the level of productivity and capabilities of the dwellers of the rural commodities thereby redistributing the nations income and curbing rural-urban drift of citizens. However, despite the benefit accruable from the development of Small Scale Industries (SSI), little attention has been paid to its improvement by various tiers of government because of the distance between the government and the local dwellers. Also, lack of infrastructural facilities like power supply, provision of water, accessible roads to link the rural communities to the commercial centers, and non – availability of formal financial institutions have negatively affected the optimum performance of the various Small Scale Enterprises in Nigeria. Therefore the thrust of this paper is to assess how far the Small Scale Industries have been thriving in the face of various problems ranging from infrastructural to financial, confronting the entrepreneurs in the local communities and the effects of such constraints and problems on their business and how the problems can be ameliorated in order to improve the welfare and enhance the social economic development of the citizens at the grassroots. The population for the study comprises the small scale entrepreneur in Osun State of Nigeria. The sample consists of Iwo Local Government Area and Ola Oluwa Local Government Area. The two local councils are predominantly of villages and towns which can be regarded as real grass root communities and the major enterprises being practiced is the small scale type. Out of this population, 200 respondents randomly chosen were served questionnaires, in which 153 respondents returned their questionnaire filled. The researcher also made use of oral interview with the officials of the Ministry of Commerce and Industry in Iwo Zonal office serving the two local councils as well as using some relevant data from the internal Revenue Board of Osun State. For the analysis of the data, simple percentages were used to classify the responses of the respondents and Chi-square ( $\chi^2$ ) was used to test the various hypotheses proposed. The findings of the study indicate that Small Scale business entrepreneurs have no access to funds from the formal financial institutions (Banks) due to non-availability of banks in these rural areas and where there are few of the banks, the formality of processing loans and the interest on such loans have been very discouraging. Due to this, majority of the respondents make use of non-bank financial institution like thrift and cooperative societies, and also get financial assistance through Revolving Loan Scheme (ESUSU) and Daily Contributions Arrangement (AJO). However, in spite of all these challenges, it was found out by the researcher that investing in small scale business in these areas has great prospect and thus profitable to the owners. Small scale businesses have really served as a very charitable linkage between the source of raw materials and the usage of such materials by the large scale counterparts in the state. Also, of small scale business have thrived greatly by helping the rural dwellers to have access to the finished products of large corporations through buying and selling.

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## Introduction

Small Scale Industries (SSIs) occupy a place of pride in virtually every country throughout the world. They have been recognized to be the main engine of economic growth and a major factor in promoting private sector development and partnership in the developing economies of the world. Small Scale Industries (SSI) represent a vehicle for the achievement of natural economic objective of employment generation and poverty reduction at low investment cost as well as the

development of entrepreneurial capabilities including indigenous technology (Ojo, 2009).

It is thus recommended among others that: Government should create conducive environment like provision of some basic amenities like feeder roads, rural electricity etc. to encourage the local settlers in these areas and thereby enhancing production and sales. Financial wise, entrepreneurs are advised to form themselves into cooperative societies or partners in order to pool their funds together and these cooperatives can be

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assisted by government to get loans from banks by standing as guarantors. Lastly, the entrepreneurs in these communities are advised to regularly attend workshops, seminars and conferences in order to update their managerial skills,

Despite the benefit accruable from the development of small scale industries (SSI), little attention has been paid to its improvement by various tiers of government because of the distance between the government and the local dwellers. Also, lack of infrastructural facilities like power supply, provision of water, accessible roads to link the rural communities to the commercial centers, and non-availability of formal financial institutions have negatively affected the optimum performance of the various small scale enterprises in Nigeria. This sector has remained stagnated and remains relatively small in terms of its contribution to the Nigerian GDP or to gainful employment. Activity mix in the sector is also quite limited (dominated by import dependent processes and factors).

It is in light of this that the main thrust of this research work focuses on the effect of financial constraints confronting entrepreneurs of small scale businesses in the local communities and how they have been coping in order to improve the welfare and social economic development of rural dwellers. The study also examines the operations of small scale industries amidst their financial and infrastructural predicament and suggests how they can improve on their performance using other alternative sources of funds.

### **Theoretical Framework and Literature Review**

#### **The Concept of Small Scale Industries**

There is no universal definition of small scale industry. Each country tends to derive its own definition based on the role the small scale industries are expected to play in that economy and the programme of assistance designed to achieve that goal. Varying definitions among countries may arise from differences in industrial organization at different level of economic development and differences in economic development in parts of the same country (Sule, 1986).

In Nigeria, at the 13<sup>th</sup> Council meeting of the National Council of Industry held in July 2001, Micro, Small and Medium Enterprises (MSMEs) were defined by the council as follows.

#### **Micro Cottage Industry**

An industry with a labour size of not more than 10 workers, or total cost of not more than ₦1.5million, including working capital but excluding cost of land.

#### **Small Scale Industry**

An Industry with a labour size of 11-1100 workers or a total cost of not more than ₦50 million, including working capital but excluding cost of land.

#### **Medium Scale Industry**

An industry with a labour size of between 101-300 workers or a total cost of over ₦50 million but not more than ₦200 million, including working capital but excluding cost of land.

Nigeria Banker's Committee based on the Small and Medium Enterprises Equity Investment Scheme (SMEEIS) defined small and medium industry as any enterprise with a maximum asset base of ₦200million, excluding land and working capital, and the number of staff employed by the enterprise not less than 10 and not more than 300. This is subject to review by the Banker's Committee from time to time (CBN, 2009).

#### **The Benefits of Small Scale Industries to Nigerian Economy**

According to Udechukwu (2003), the development of small scale industries is an essential element in the growth strategy of most economies and holds particular significance for Nigeria.

He maintained that small scale enterprises do not only contribute significantly to improve living standards, they bring about substantial local capital formation and achieve high levels of productivity and capability.

Anyanwu (2003), in his own view, acknowledged small scale industries as the bedrock of the industrial development of many countries. He said that apart from the numerous goods produced by them, they also provide veritable means of large scale employment, as they are usually, labour intensive. This was corroborated by Green, et al (2003), when they stated that small scale enterprises compared with large enterprises are invariably more labour intensive and often more efficient. Indeed, labour intensive production tends to be more efficient where labour is plentiful and capital scarce, which is frequently the case in developing countries like Nigeria.

Also, in the opinion of Salami (2003), the experience of many countries indicates that small scale industries (SSIs) can meaningfully contribute to the attainment of many economic development objectives. These include output expansion, employment generation, even location of industries among regions in a country, income redistribution promotion of indigenous entrepreneurship and technology, as well as production of intermediate goods to strengthen inter industrial linkages. These among others, explain the increased interest, which many countries including Nigeria have shown in the promotion of small scale industries in recent time.

#### **The Problems of Small Scale Enterprises Financing**

Access to institutional finance has always constituted a pandemic problem for small scale industries development in Nigeria (Olutunla, 2001). In Nigeria, this financing gap probably informed the establishment of a number of Development Financial Institutions (DFIs) such as the Nigeria Industrial Development Bank (NIDB) (1964), Nigeria Bank for Commerce and Industry (NBC) (1973), and Nigeria Agricultural and Cooperative Bank (NACB) (1973), other attempts made to bridge the funding gap include the establishment of specialized banks (Peoples Bank and Community Banks in 1989 and 1992 respectively), World Bank Assisted Small and Medium Scale enterprises Apex Units Loan Scheme (1989), the National Economic Reconstruction Fund (NERFUND) (1986), and African Development Bank Export Stimulation loan scheme (ADB-ESL).

In 2001, The NIDB, NBCI and the NERFUND were merged under a new name known as the Bank of Industry (BOI). All these initiatives however, have made minimal impacts on the development of small scale industries in Nigeria. The failure of the above efforts prompted the new initiative of Bankers Committee /CBN to establish the Small and Medium Industries Equity Investment Scheme (SMIEIS) in 2001, requiring all commercial and merchant banks to commit 10 percent of their pre-tax profit to the funding of the equity of small and medium scale enterprises.

However the conventional banks have continued to regard the small scale enterprises (SSEs) sub-sector as a high risk sector. This is not surprising as SSIs lack continuity and many collapse with the death of their owners. Similarly, there is low educational status and lack of skills among SSI promoters, many with poor management practices, high loan repayment defaulters and inefficient credit administration. Therefore small scale industrialists with no collateral securities are usually not reckoned with by banking institutions rather, a great percentage of banks subsidized credit goes to the few economically and politically powerful ones in the urban economy.

## Methodology

The population of the study comprises the Small Scale Entrepreneurs in Osun State. The study was carried out in two local government areas of the state, which were selected through judgmental sampling. The local government areas are Iwo and Ola Oluwa Local Government Areas.

Data used for the study were collected from both primary and secondary source through the use of well structured questionnaire and personal interview. 200 respondent were served questionnaire but only 153 of them returned their questionnaire filled. So our analysis is based on the returned ones. For the analysis of the data, simple percentages were used to classify the responses of the respondents and Chi-square ( $\chi^2$ ) was used to test the various hypotheses proposed.

## Presentation And Analysis Of Data

### The data for the study are as analyzed below

From the table above, majority of the respondents (i.e. 116 out of total of 153) source their funds from outside the banking industry. Their initial capital are sourced from Cooperative Societies, Revolving Loan Scheme (ESUSU) and Daily contributions (Ajo). This is 75.82% of the total respondents. The remaining 24.18% get their capital from other sources.

We can deduce from table 2 that about half of the respondents (78 out of 153) have no access to banking facilities. The reason cannot be for fetched since few banks in the two local government areas surveyed are concentrated in Iwo town and Bode Osi town which serve as the headquarters of Iwo local council and Ola Oluwa local council respectively. No bank exists in other surrounding villages 14 respondents claimed that banks condition for giving loan is too stringent while 20 people submitted that they could not provide collateral security. Ten people had their loan application denied.

Analysis from table 3 shows that 116 respondents forming 75.82% of total 153 people have been accessing their loans to run their businesses. 37 respondents responded negatively to the question because some of them are yet to join the financial institution in their localities.

From table 4, it can be found out that 84 out of the 153 respondent (i.e. 54.9%) used their secured loan on their small scale businesses while 42 respondents used their secured loans to pay their children school fees.

Exposition from table 5 shows that 122 out of 153 respondents forming 79.74% of the total agreed that small scale industries have really contributed positively to the development of the hosting communities. 11 respondents disagreed while 20 respondents claimed ignorant of the whole scenario.

It can be derived from table 6 above that 136 respondent out of 153 agreed that insufficient fund has been a major limitation to the growth of small scale businesses in the two local government areas. This amounts to 88.89% of the total respondents. One claimed ignorant while 16 respondents disagree with the statement.

### Test Of Hypothesis

Three hypotheses were tested using the chi-square ( $\chi^2$ ) analytical method allowing 5% level of significance

The formula is given as:

$$\chi^2 = \frac{\sum (O-E)^2}{E}$$

Where E= Expected frequencies

O= Observed frequencies

The decision rule is that when  $\chi^2_c < \chi^2_t$ , the null hypothesis is accepted thereby rejecting the alternative hypothesis, but when

$\chi^2_c > \chi^2_t$ , the reverse is the case. Degree of freedom = (r-1) (c-1).

### Hypothesis I

Ho: Traditional Financial Institutions have not been good sources of funds to rural entrepreneurs.

Hi: Traditional Financial Institution have been good sources of fund to rural entrepreneurs

$$DF = (r-1) (C-1) = (2-1) (2-1) = 1 \times 1$$

From the statistical table  $\chi^2_{df} (0.05) = 3.84$

Since  $\chi^2_c < \chi^2_t$ , (i.e. 80.80 > 3.84), we accept the alternative hypothesis and reject the null hypothesis meaning that traditional financial institutions have been good sources of funds to rural entrepreneurs.

### Hypothesis Ii

Ho: Small Scale Industries have not contributed significantly to the growth of rural economy.

Hi: Small Scale Industries have contributed significantly to the growth of rural economy.

$$Df = (r-1) (c-1) = (3-1) (2-1) = 2 \times 1 = 2$$

$$\chi^2_{2df} (0.05) = 5.99$$

Since  $\chi^2_c > \chi^2_t$  (i.e. 149.05 > 5.99), we accept the alternative hypothesis and reject the null hypothesis meaning that small scale industries have contributed positively to the hosting communities.

### Hypothesis Iii

Ho: Insufficient capital has not been a major constraint to the growth of small scale industries.

Hi: Insufficient capital has been a major constraint to the growth of small scale industries.

$$Df = (r-1) (c-1) = (3-1) (2-1) = 2 \times 1 = 2$$

$$\chi^2_{2df} (0.05) = 5.99$$

Since  $\chi^2_c > \chi^2_t$  (i.e. 214.71 > 5.99), the alternative hypothesis is accepted while the null hypothesis is rejected i.e. insufficient capital has been a major constraint to the growth of small scale industries.

## Findings

From the forgoing, it is shown that, small scale industries have really served as a very charitable linkage between the source of raw materials and the usage of such materials by the larger scale counterparts in the state. They have in one way or the other assisted in transforming the rural areas in terms of capital formation and general development of the hosting communities.

It is also found out that most of the small scale entrepreneurs have no access to funds from the formal financial institution (Banking Institutions) due to non-availability of banks in the rural areas covered, and where there are few of the banks; the stringent conditions attached to their loans have been very discouraging.

Due to this, majority of the respondents make use of traditional financial institution like. Thrift and cooperative societies, revolving loan scheme (ESUSU) and Daily contributions (Ajo). However, inspite of all these challenges, it was discovered that investment in small scale businesses in these areas has great prospect and thus profitable to the owners.

## Recommendation

It is thus recommended among others that: Government should create conducive environment like provision of some basic amenities like feeder roads, rural electricity etc, to encourage the local settlers in these areas and thereby enhancing production and sales.

Entrepreneurs are also advised to organize themselves into cooperative societies or partners in order to pool their funds together so as to serve as a link between the government, banking institutions and the members, in terms of getting loans. Lastly, the entrepreneurs in these rural communities are advised to regularly attend workshops, seminars and conference in order to update their managerial skills.

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**Table 1:**  
**Means of Securing Start up Capital By Small Scale Entrepreneurs**

Means	No of respondents	Proportion (%)
Loan from friends/relatives	13	8.50
Personal savings	20	13.07
Loan from banks	04	2.61
Loan from traditional financial institutions	116	75.82
TOTAL	153	100.00

Source field survey, 2012

**Table 2: Reasons for Not Taking Loan From Banks**

Reason	No of respondent	Proportion (%)
Stringent condition	14	9.15
Lack of collateral security	20	13.07
Non availability of banks	78	50.98
Not being a bank customer	31	20.26
Application denial	10	6.54
TOTAL	153	100.00

Source field survey, 2012

**Table 3: Whether Loans from Traditional Financial Institutions Have Been Easy To Access**

Response	No respondent	Proportion (%)
Yes	116	75..82
No	37	24.18
TOTAL	153	100.00

Source: Field survey, 2012

**Table 4: Uses To Which Loans From Traditional Financial Institutions Were Put**

Uses	No of respondent	Proportion (%)
Business enterprises	84	54.90
Education of wards	42	27.45
Ceremony	10	6.54
Others	17	11.11
Total	153	100.00

Source: Field survey 2012

**Table 5: whether small scale industries have contributed positively to the hosting communities**

Response	No of respondent	Proportion (%)
Yes	122	79.74
No	11	7.19
Uncertain	20	13.07
Total	153	100.00

Source: Filed survey, 2012

**Table 6: Whether Insufficient Capital Has Been A Major Constraint To The Growth Of Small Scale Industries**

Response	No of respondent	Proportion (%)
Agree	136	88.89
Disagree	16	10.46
Uncertain	01	0.65
Total	153	100.00

Source: field survey, 2012

**Table 3 Replicated: Whether Loans from Traditional Financial Institutions have been easy to access.**

Response	O	E	O – E	$(O - E)^2$	$(O - E)^2 / E$
Yes	116	76.5	39.5	1560.25	20.40
No	37	76.5	-39.5	1560.25	20.40
Total	153				80.80

**Table 5 Replicated: Whether Small Scale Industries have contributed positively to the hosting communities.**

Response	O	E	O – E	$(O - E)^2$	$(O - E)^2 / E$
Yes	122	51	71	5041	98.84
No	11	51	-40	1600	31.37
Uncertain	20	51	-31	961	18.84
Total	153				149.05

**Table 6 replicated: Whether Insufficient Fund/Capital has been a major constraint to the growth of Small Scale Industries.**

Response	O	E	O – E	$(O - E)^2$	$(O - E)^2 / E$
Yes	136	51	85	7225	141.67
No	16	51	-35	1225	24.02
Uncertain	01	51	-50	2500	49.02
Total	153				214.71