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Patterns and Dynamics in Business Financing in a Depressed Economy: The Nigerian Example

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Abstract *Nigeria's depressed economic state has continued over the years, raising serious concern among entrepreneurs as they struggle to raise capital to finance their businesses. Remarkably, new self-run businesses open up daily in Nigeria due to graduate unemployment and high population growth rate. Unfortunately, businesses die faster than their birth rate owing to financial problems. To address this problem, the search for fund raising strategies and financial resilience among businesses have gathered serious pace. The present work explores patterns and dynamics in business financing in a depressed economy. The work lays the foundation to understand the depressed nature of the Nigerian economy. It showcases some traditional patterns of business financing in Nigeria. It also takes note of the problems facing these traditional methods, in terms of the dynamics for business financing. It concludes with some funding suggestions in Nigeria's unsteady economic scene.*

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Introduction

The business atmosphere in Nigeria in the last decade has been increasingly challenging due to difficulties in accessing funds for startups and running initiatives. There has been a steady downturn in business outlook as lenders and borrowers struggle to find common ground to operate profitably. The effect has been dire on the Nigerian economy, which recently has been slowing continuously. Remarkably, research indicates that due to rising graduate unemployment, and high population growth rate, Nigerians continue to open private, small businesses. Unfortunately, there is poor profitability, which reduces the contributions of small businesses to Nigeria's economy (Ademola, Olaeye, Olusuyi & Edun, 2013; AlayeOgan, 2012). In less than a decade, Nigeria twice (2015 and 2017) slumped into the worst economic recession in 50 years (Ngwu, 2017).

Adisa, Abduraheem and Mordi (2014) found that there have been more cases of closure of small businesses in Nigeria than their birth in the last 30 years. The Organization for Economic Co-operation and Development (OECD) states that of every 100 business started each year, less than 100 reach the second year (Adisa, Aduraheem & Mordi, 2014). This failure rate also affect medium and large scale companies, which depend on the small businesses to reach the final consumer (Ebo, 2016).

Government and individuals have continued the search for the best options for business survival and thriving in Nigeria, especially through sustainable and profitable financing. While there are individual and small group self-help financing avenues, government also attempts to help businesses through policies, agencies and laws. For instance, there is the Small and Medium Scale Enterprise Development Agency of Nigeria Act (as amended, SMEDAN Acts, 2003), the National Poverty Eradication Programme (NAPEP, 2001), the Bank of Agriculture (BoA, 2013); and the National Economic Empowerment Development Scheme (NEEDS, 2003). These initiatives have contributed to the development and growth of businesses in Nigeria. Without doubt too, the process of implementing government's monetary policies has recorded some successes and challenges. In view of this, the present work focuses on the patterns and dynamics of business financing in a depressed economy like Nigeria.

Purpose of the study

The main purpose of this study is to determine how Nigerian economy has been in view of its

economic quagmire. Specifically, the study determined:

1. The nature of the depressed Nigeria economy
2. The patterns of business finance in the depressed Nigerian economy.

Literature review

Nigeria's Economy

Nigeria's economy is typically underdeveloped, and in a continual depressed state. Though agriculture is playing an important role, the oil and gas sector is the primary driver, accounting for more than 95% of export earnings and about 85% of government revenue (Chete, Adeoti, Adeyinka, & Ogundele, 2014; Mbamalu, 2023). Chete et al (2014) also note that in contrast, the industrial sector in Nigeria (comprising manufacturing, mining, and utilities) accounts for a tiny proportion of economic activity (6 per cent) while the manufacturing sector has contributed only 4 per cent to GDP since 2011. This is despite policy efforts, over the last 50 years, and, in particular, more recently, that have attempted to facilitate the industrialization process.

Nigeria's first and second development plans (1962 to 1968 and 1970 to 1974) attempted to use import substitution and production of local goods and capital goods for export to boost the economy. There was an attempt to link economic activity and growth to agriculture, transport, mining, and the local industries. However, this lofty plan was disrupted because Nigeria had also attained the status as a major oil exporter. Government took centre stage as the major investor in high calibre economic projects that would drive the economy especially because individual investors lacked the capital to invest in areas such as iron and steel, cement, salt, sugar, fertilizer, pulp and paper, among others. Poor implementation and management of these ventures stalled their growth and running at full capacity added to Nigeria's limited industrial and technological capacity (Chete, Adeoti, Adeyinka, & Ogundele, 2014).

The period of the third development plan (1975 to 1980) also occurred as Nigeria swum in oil money. Government continued in capital investments while individual investors took to investments in the light, low technology consumer industries which were heavily dependent on imported machinery and raw materials (Chete, Adeoti, Adeyinka, & Ogundele, 2014). As in the case of the first and second development plans, Nigeria's technological capacity failed to carry the plans laid out by government. Local

industries could also not compete with all sorts of foreign goods that were easily imported by large scale retailers who had access to foreign exchange with relative ease.

The fourth National Development Plan of 1981 to 1985 met an evolving global economic recession with the attendant dwindling foreign exchange earnings, balance of payment disequilibrium and unemployment in the Nigerian economy. With a national industrial layout based on import, industries struggled, leading to mass retrenchments and economic distress. This forced the government to introduce the structural adjustment programme (SAP) as an alternative economic response. According to Chete, Adeoti, Adeyinka, & Ogundele (2014), the objectives of SAP included promoting investment, stimulating non-oil exports and providing a base for private sector-led development; promoting the efficiency of Nigeria's industrial sector; privatizing and commercializing state-owned enterprises to promote industrial efficiency; developing and utilizing domestic technology by encouraging accelerated development and use of local raw materials and intermediate inputs rather than imported ones.

Overall, the major problems witnessed in the Nigerian economy over the years include:

1. Little linkage between the public and private sector, especially because of the lack of clear-cut economic ideology in the country. The country is neither capitalist nor socialist, and the lack of distinction leads government to overstep bounds and create monopolies or inequalities that hamper progress in the private sector. That was what happened in the telephone industry until the GSM revolution. It is also happening in the power sector. The private sector and the small businesses must begin to take some pivotal role in the process of economic development.
2. Corruption and national insecurity have combine to kill the spirit of enterprise and foreign direct investment (FDI). There is need to fight corruption and totally redress the ongoing social tensions in order to reduce the risks to investment in Nigeria.

The problem of poor or near absent electricity supply, a flailing democratic process, bad roads, crime, religious bigotry and ethnicity are working effectively in Nigeria to hamper efforts to grow the economy. The continued importation of refined fuel since 1999, heavy import dependence and a weak local currency cause run-away inflation and a continually depressed

economy, which have severely affected business financing in Nigeria.

Patterns in Business Financing in Nigeria

Access to funds is inevitable for businesses to acquire the latest technology, human resources and to fully utilize production capacity. In addition to any other source of capital, businesses are expected to be able to access loans from banks at an interest rate on the borrowed sum. Such rates are expected to be comfortable to the borrowers and the lenders, for both to operate at a profit without causing inflation. The following as sources of finance for businesses in Nigeria,

i. Personal Financing: Ordinarily, Nigerians are known to self-finance their businesses through personal savings or small group cooperatives (Isusu), where individuals pool funds, and take turns to harvest the pool by members of a given informal contributory scheme. This practice similar with many cooperative schemes, which pool resources to lend to members at low interest rates.

However, the inadequacies of personal savings, and the risks they face in the event of business failure make business owners to seek other sources of funding. Wealthy individuals can also lend money and financial advice to startups and existing businesses.

ii. Bank Loans: This is a means through which businesses apply for bank loans repayable at an agreed date at an interest rate. Unfortunately, interest rates have been rising steadily in Nigeria, making bank lending difficult for small and medium scale businesses in Nigeria. Even where businesses indicate interest to borrow at high rates, banks are still unwilling if businesses cannot produce requisite collateral securities. That is, assets the banks can liquidate to recover their money if a loan is not repaid as agreed.

iii. Government grants: The Nigerian government grants incentives to businesses from time to time. For example, the 2018 *trader monie* of the Nigerian government in which petty traders and artisans received interest-free loan on an incremental level from ten thousand naira (N10, 000) to one hundred thousand naira (N100,000) depending on how well borrowers are able to repay initial loans. Through established contractual agreements, businesses, especially agricultural ones apply for existing agricultural grants or soft loans. In the Nigerian contexts, however, tedious processes may be involved to get such grants, and in the process, corruption and nepotism often interfere.

iv. Crowdfunding: In this case, an intending business owner can launch an online or offline campaign to raise funds. If the terms (dividends and shares) are attractive to investors, people can pool resources to finance a business. This also highlights the importance of the internet and networking in this type of business financing as well as the financial, legal and other internet regulatory requirements to launch such a fund drive. There are three types of crowdfunding as explained underneath by Oyelami (2023):

a. Equity Crowdfunding: In exchange for their money, investors in equity crowdfunding get shares in a company or the right to a part of the sales or profits from a certain product.

b. Crowdfunding through donations and rewards: Where a company sets a goal for raising money and asks for donations in exchange for a token or receipt for the product or service that will be made.

c. Debt crowd funding: Where investors lend their money to a company at relatively high interest rates. By spreading a large amount of money out in small amounts over a large number of loans, they lower their overall risk of lending.

v. Business incubators: These are asset based business supporters. They provide resource support to startups by allowing them to use existing human resources and other assets. As explained by Oyelami (2023):

“Incubators will typically allow fledgling firms and other types of startups to use their space and provide access to their administrative, logistical, and technological capabilities. For instance, a business incubator can allow a startup company to use its labs so that the company can develop and test its products for a lower cost prior to beginning production of those products. The incubation period typically lasts anything from one year to two years in length. When the product is ready, the company will often leave the incubator and begin creating it on its own out in the real world once it has graduated. Companies that receive this type of assistance typically operate in forwardthinking industries such as biotechnology, information technology, multimedia, or industrial technology. There is a greater possibility of success over the

next five years for companies that received assistance from an incubator.”

vi. Money Lenders: These are private lending operators, who grant credit at an interest. Some private online and offline schemes such as one popular *Lapo scheme* lend money to businesses at relatively short repayment notices and high interest rates. Businesses in Nigeria are known to often default on such loans and loose valuable property.

Dynamics of Business Financing in Nigeria's Depressed Economy

Businesses exist mainly to make a return on investment, either in the form of monetary profit or goodwill. Unfortunately, Nigeria's depressed business atmosphere means that many small businesses are struggling to survive due to a harsh operating climate. Yet, it is in this kind of toxic atmosphere that businesses require the most careful devotion to sources of financing. This is not only because of the need to track and maximize funding sources, but also to exhibit the necessary characteristics such as resilience and profitability, which investors use as bases to lend money or to invest in a business. Institutional lenders such as banks as well as private lenders and investors want to be sure that businesses are credit worthy prior to lending or investing in a business.

Over the past decade, however, the manufacturing sector in Nigeria has not received a significant amount of loans to finance their business. The manufacturing sector accounts for about 10% of economic activity or 7% of government revenue. Interest rates, tough bank requirements, inflation and the volatility of the exchange rate in the official and unofficial markets make it hard for manufacturers to receive credit from the banks and other sources. Earlier in the year, the Manufacturing Association of Nigeria (MAN) decried the action of banks in mainly offering short term loans, which do not meet the requirements of medium and long-term investments. This adds to the burden of high cost of erratic electricity supply, high cost of fuel, high exchange rates and reducing consumer demands for products. Unemployment hovered around 41% by 2023, while inflation remained a doubledigit affair, standing at 22.04% (Mbamalu, 2023).

Data from the CBN indicate that the inflation rate in Nigeria rose from 11.8 percent in 2010 to 11.98 percent in 2015 (Adofu, Ilemona, & Tijani, 2015). In the same vein, exchange rate rose from 150.4 percent in 2010 to 360.25 percent in

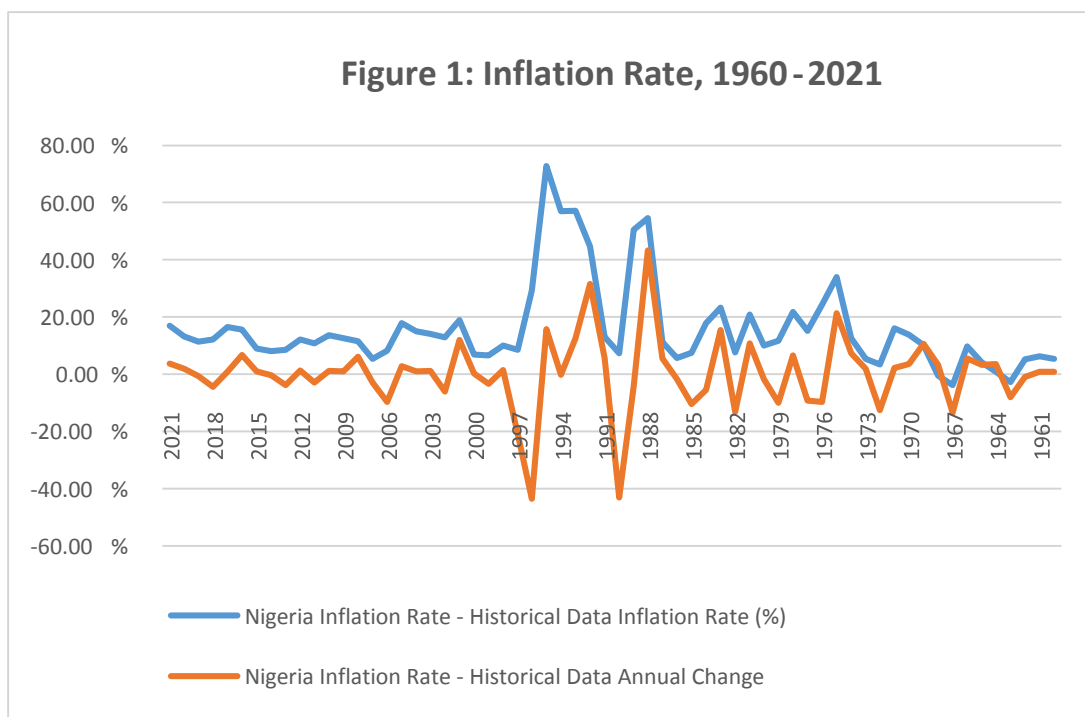
2019; this also caused the lending rate to rise from 22 percent in 2011 to 30.72 percent in 2019.

Between 1960 and 2019, inflation in Nigeria rose from just above 5% to 16%, having peaked to 44% as of 1992 (Figure 1). At its current stage, Nigeria's inflation rate, as of 2023, was the 4th highest in Africa after Zambia (22.02%), Angola (25.75) and Sudan (382.82%)(Mbamalu, 2023).

The situation has produced poverty in the land. In February 2023, the National Bureau of Statistics estimated that 83 million Nigerians were in abject poverty, living below \$1.9 a day, while 133

million Nigerians lived in multidimensional poverty. For example, about 37% of qualified youth were unemployed. Some estimates have shown that as many as 45% of Nigerians plan to relocate to other countries as a result of hardship and hopelessness. That's according to a 2022 PEW Research Survey.

Over 12000 Nigerians migrated to the UK alone in 2022, where at least 13000 Nigerian health workers operate. Why not? The dollar to naira exchange rate at times exceeded 1000 naira. This is a raw description of the economy of Nigeria, where businesses operate.



Experience has shown, therefore, that the vacillation between fixed interest rate (by the FBN) and a deregulated interest rate (determined by market forces) between 1986 and 2019 has not brought down the interest rate below 20%. According to Adofu, Ilemona, & Tijani (2015), given the interest rate of 22%, for instance, a producer of tomato paste who requested a five-year loan of ₦1 million, is expected to pay back with the total sum of ₦1.22 million, and with the interest rate of 30%, the manufacturer is

expected to pay back with the total sum of ₦1.3 million.

The Central Bank of Nigeria (CBN) in March 2023 raised interest rates to 21.91% (a 17.5 year high), up from 21.82% in February, even beating market expectations of 21.85%. The CBN cited exchange rate pressures and an expected removal of fuel subsidy as its reasons for the hike. Despite the situation, Nigeria's economy recorded a growth of more than 3.52% in 2022 relative to the 2.25% rise in the third quarter of 2021. The growth was noticed

mainly in the services sector rather than the manufacturing sector. By implication, while the main operators in the services sector such as banks are declaring profits, the manufacturing sector that banks should primarily support are lagging.

Banks in Nigeria recorded an aggregate 26% increase in their profits in 2022 compared to 2023 earnings. The increase is largely a result of the regularly increasing interest rates from lending. In monetary terms, the aggregate bank profits in Nigeria rose to ₦3.13 trillion (\$US 6.6 billion) up from ₦2.48 trillion in 2021. MAN, by contrast reported a 15% contribution of the manufacturing sector to Nigeria's GDP in 2022, implying a negative growth rate of -19% compared with the 2022 figures. However, the manufacturing sector's \$64.41 billion output for 2021 was a 17.65% increase from 2020. The negative growth has further been linked to brain drain, tying up of investments by multinationals, the war in Ukraine and cost of diesel. MAN reported a whopping ₦67.7 billion spent on diesel in the in the first half of 2022. Officially, the naira to dollar rate stands at ₦461 to the dollar, while the parallel market hovers around ₦752 to the dollar (Olalekan, 2023).

The way forward

The failure of interest rates to have a significant positive impact on the manufacturing sector means that some measures have become important. The first must be to redress what some have described as arbitrary multiple currency exchange systems, in which the so-called black market becomes the real currency exchange system rather than governments approved exchange rates.

The deregulation of the interest rate policy should be monitored to avoid interbank collusion to shortchange industrial borrowers. Such monitoring oversight can be made into a legal instrument mandating bank to devote a certain percentage of their deposits to financing the manufacturing sector. As it is, the CBN requires banks to lend it (CBN) money when they (banks) have excess cash. This is the same cash that other banks can borrow from the CBN to offset cash pressures, especially when borrowers call. Curiously, findings show that while the amount of cash lent to the CBN by banks continues to grow, the amount lent to the manufacturing sector by banks continues to decrease. As of March 2023, the CBN recorded a first quarter bank lending of N641.19 billion, while banks have only accessed ₦453.7 billion (Olalekan, 2023).

Exchange rate safety nets, improvements in the energy sector (electricity and local crude refining)

and subsidization of the importation of raw materials should be undertaken by the federal government to reduce manufacturing costs. Even banks incur costs from these areas, which are eventually transferred to borrowers, causing further rise in interest rates. Multiple taxations, reducing insecurity and supporting the local production of raw materials are other ways canvassed by MAN which the federal government needs to uphold in action. A situation where banks are declaring high aggregate profits, while the manufacturing sector is declining presents an inexplicable economic paradox.

Summary and conclusion

The foregoing discussion shows that Nigeria's depressed economic situation poses a lot of challenges to business financing. Luckily, there are still great opportunities for resilience and capital sourcing. It is the responsibility of government to institute financial policies to support businesses, for example, control of cash movement. As of September 2022, 80% of the cash in circulation was outside the banking system, meaning that out of the 3.2 trillion naira in circulation, 2.73 trillion naira circulated outside the banking system. So much of this money was trapped by politicians, business people in the informal financial sector, kidnappers and violent non-state actors (Mbamalu, 2023). Moreover, the recent cashless policy and naira redesign policy of the federal government compromised the viability of many lending schemes in addition to prevailing hardship and inflation.

Government must evolve measures to regulate and to ensure the safety status of the several, emerging unpopular online platforms offering financial assistance to businesses. The informal financial sector should be engrafted to the formal banking system to ensure that the groundnut seller does not die because of a cashless economy? Therefore, some kind of social economics, or enlightenment, needs to interface with the hard-faced micro and macroeconomic and fiscal policy. Nigeria's federal government should first make effort to give Nigeria a definable economy. An overborrowing, import dependent system is hardly an economy. A trading system filled with whole sellers and retailers of foreign products can barely be a serious financial system. An economy filled with job-seeking and frustrated self-financing entrepreneurs will find it difficult to work with a banking system that milks them further. The point is: Nigeria's economy needs to have a definable identity. Security, trust and adequate infrastructure are necessary conditions for

achieving a strong economy, and a seamless system of business financing. It was the absence of these essentials that almost snuffed the life out of over 26% of small and medium scale enterprises in Nigeria during the cash crunch.

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