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**Microenterprise in Nigeria: Policy Issues and recommendations**

Problem Domains and Policy Issues

Of the 493 small-scale industrialists surveyed, 465 faced considerable problems in their day-to-day business activities such as scarcity of finance, low demand, lack of materials etc. The degree of uncertainty depends on (macro-economic) factors mainly external to the influence sphere of individual craftsmen. The fact that the craftsmen survived economically, despite environmental constraints and severe national problems, underlines their productivity potential as well as their flexibility, initiative and creativity.

Proposals made by craftsmen to solve business problems were often addressed to the government (e.g. 'the government should lift import loan'). Some of the suggestions have been implemented in the context of the 1987 SAP measures. But the situation has become even worse for certain segments of the informal sector.

There are conflicting views regarding the 'development progress' of Nigeria's informal sector during the Structural Adjustment Programme'. According to NISER (1989), the progress has mainly been in the area of new product development, improvement in the quality of the existing output, increased local value added, increased employment generation, and training.

Zdunnek (1990:68) in contrast has pointed out that the entry of a new group of small entrepreneurs into all sections of the informal sector, chiefly young unemployed male (university) graduates with comparatively much capital who were previously absorbed by the formal sector, has increased intra-sectoral competition. Certain subsectors are encountered by price fluctuations resulting from the unstable exchange rate of the Naira.

Meagher/Yunusa (1991) have argued that Nigeria's informal sector has been squeezed from both the supply and demand sides during SAP. Raw materials are costly and scarce, due to the recent drive by formal industrial producers to recycle waste products which have been a major source of supply for the inputs of informal producers. Foreign inputs are costly and hardly accessible. Technical capacity is still low. Goods produced are not suitable for use in industry. Due to increasing unemployment and the sharp fall in real wages there is a substantial contraction in demand, especially among low income wage earners who normally purchase goods and services from informal sector producers.

In 1985, when this study was conducted, the government was frequently requested by interviewed craftsmen to improve raw material supply, capacity utilization and so forth. Statements such as 'austerity must be overcome' indicate that promotion programmes aimed at improving the active problem-solving capacity of informal

sector entrepreneurs could be more effective if they were paralleled by sound monetary and economic policies as well as a change of the general policy framework for the small business sector.

Inappropriate economic policies can not be compensated by external aid.

In the past, most of the development activities of Nigeria's government have been directed towards the formal sector, neglecting the informal sector:

„Employment has been generated and incomes have been increasing in the formal sector. The employment generation and income increases experienced in the informal sector have always been indirect, coming as a result of the multiplier effect of investment in the formal sector. Considering its possible size and the range of economic activities that take place in it, the informal sector can make a significant contribution to the economic growth of Lagos" (Fapohundo/Lubell 1978:60).

Today there is ample information available as to its size, the different activities that are taking place in it, the level of technology it uses, its needs in terms of credit, and the kinds of contract linkage arrangements that exist. Theoretically, Nigeria's informal sector could contribute to the quest for 'self-reliance' due to its potential for higher employment generation per unit of investment, skill transfer, extensive utilization of local resources, supply of intermediate goods for bigger industries, as well as grassroots development. But there is a big gap between theory and practice:

„While most governments in sub-Saharan Africa have stated that they favor and support the growth of small producers, there are only few policies that might be considered as directly supportive... In large measure, the central impact of these policies is negative, operating in ways which discriminate against them rather than encouraging their development" (Liedholm/Mead 1986:317).

Until recently, most small enterprise development projects have not focused on policy reforms or the overall policies that affect small businesses, but on targeted projects or programs that involve some form of patron-client relationship with individual establishments (Liedholm/Mead 1986:320).

Measures which have been introduced by Nigeria's government and the National Directorate of Employment since 1986 to assist small businesses to develop and grow, include the *National Economic Recovery Fund*, the *Graduate Job Creation Scheme* or the *Small Scale Industries Loan Scheme*. They chiefly favour the private and intermediate sector. Applicants can obtain credits up to a sum of Naira 150,000 provided that they provide at least 50% collateral and that they employ two university graduates per Naira 25,000. Neither the microenterprises constituting the informal sector nor members of the Nigerian Association of Small-Scale Industrialists are qualified to apply for that loan (NISER 1990:104).

The analysis of two institutional projects (promoted by the National Directorate of Employment and the People's Bank), recently launched by the Nigerian government, shows that both institutions have not been effective in developing the growth

potential of the informal sector. Operations are hampered by lack of sufficient funds, problems of patronage and high rates of default (Meagher/Yunusa 1991).

### Specific Policy and Project Recommendations

How should specific policies for target group oriented craft projects and interventions aimed at improving and fully utilising the growth potentials of wood and metal crafts in the informal sector be designed (Fapohundo/Lubell 1978:60; Schneider-Barthold 1984:79-88; Frenz 1984:11-18; Förster 1984:45-50; Seibel/Holloh 1988:162-180)? Any intervention has to consider that the dynamic of these small and microenterprises in the secondary sector is largely determined by macro-economic factors and changes.

### Policy Dialogue

One bottleneck for the development of crafts in the informal sector is the policy framework. **Policy dialogue measures** should be aimed at

- drawing the attention of the government to the fact that crafts in the informal sector play a significant role for Nigeria's socio-economic development, and that appropriate policies are necessary to encourage its development;
- ensuring that the promotion of crafts in the informal sector is taken into account within national and regional economic policies;
- drawing attention to the fact that existing credit projects are chiefly oriented toward the top end of the small enterprise sector, leaving smaller producers with limited access to institutional credit;
- improving access to finance through linkages between banks and self-help groups of microentrepreneurs, possibly in cooperation with the African Regional Agricultural Credit Association (AFRACA) and GTZ (Seibel, Bassele & Michell-Auh 1994);
- promoting local financial institutions owned by microentrepreneurs and their self-help organizations, particularly through Community Banks as they have been evolving in Nigeria since 1990 (Seibel 1994), possibly in cooperation with the two associations of savings and cooperative banks in Germany, DSGV and DGRV
- convincing national decision-makers that interest associations of local craftsmen are far from exhausting their self-help potential and that they should be assisted in building up an efficient system of services for their members, possibly in cooperation with chambers of crafts;
- drawing attention to the fact that demand-oriented support is necessary to fully utilize the production potentials of wood and metal crafts;
- improving the dwindling purchasing power of the population through the implementation of sound economic, fiscal and employment policies;
- drawing attention to the fact that supply-oriented support is necessary to ease problems such as rising cost and scarcity of raw materials;
- guaranteeing equal treatment of small and large firms with regard to import licenses, tariffs etc. and equal access to basic business inputs (tools and machines, spare parts etc.) as well as foreign exchange;

- the revision of restrictive rules and regulations in terms of business location.

## Problem Analysis and Promotion Needs

About two-thirds of the sampled enterprises operated in economies characterized by scarcity of finance (credit), low demand, lack of (cheap) raw material supply, insufficient working space, lack of (imported, power-driven) equipment goods such as machines, tools or spare parts as well as unreliable or absent supply of water and electricity. These problem domains in combination with the unused potential of local craft associations represent the major promotion needs of wood and metal crafts in Lagos and Ibadan.

The number of craftsmen in Lagos and Ibadan who have joined local self-help organisations such as craft associations in order to solve business problems is quite low (15 %). Indigenous autonomous self-help organizations solve many problems for their members, but many others remain that could be tackled if some outside technical aid or other form of assistance were provided (Seibell/Damachi 1982:80).

The craftsmen surveyed expected more and better assistance from self-help associations such as craft unions or savings and credit clubs with regard to financial services (Seibel 1984), technical advice, lending of tools and machines as well as protection and representation of their interests. The capacity of local self-help organizations to solve small entrepreneurs' business problem No. 1 'lack of capital' is low, due to insufficient inputs, facilities and hampering structural conditions.

Business organizations of small businessmen in other developing countries have demonstrated that they are capable of building up an efficient system of services for their members. Under certain conditions local associations may become powerful instruments of organized self-help among small entrepreneurs:

„Yet for the large majority of them, this is an unused potential. Governments have usually ignored this potential by establishing their own financial or other services, often without any measureable impact. By imposing organizations of their own making, governments have frequently alienated small entrepreneurs and their business organizations. There are a few successful examples of promoting and upgrading existing business organizations of small entrepreneurs and their financial activities. Wherever they exist and function properly, they should be given due consideration for linkages of the formal financial sector with small entrepreneurs" (Kropp et al. 1989:48/49).

## Objectives Analysis

### **Overall Goal**

The overall goal of promotion measures is the provision of Nigeria's population with craft products and services.

### **Project Purpose**

Project Purpose is to strengthen the self-help capacity of craft unions and their members.

Promotion measures should be aimed at improving the quality of services provided by craft unions and at strengthening the active problem-solving capacity of craftsmen (Seibel/Holloh 1988:163). With proper assistance unions of craftsmen can learn to offer their members consultancy services, training facilities, and technical services. They may help them to organize supply and sales; and they may assist in securing finance (the most important obstacle). The latter may include support to self-help financial institutions as intermediaries.

## Outputs

The following outputs have to be obtained and carried out to achieve these goals:

### **(1) Viable financial services are available to self-help groups of craftsmen**

Small entrepreneurs in the informal sector of Lagos and Ibadan chiefly utilize informal credit sources (family, friends, *esusu*) to ease their main problem: obtaining capital. Informal credit sources are insufficient. Although 65.8% of the firms surveyed already do have linkages with banks through savings or current accounts, very few have access to bank loans. Lack of access to formal channels of credit has negative effects with regard to the firm's operational efficiency. Survey findings indicate that craft enterprises need credit for start-up capital, working capital, investments and business expansion.

Existing credit projects are chiefly oriented toward the top end of the small enterprise sector. This leaves smaller producers with limited access to institutional credit:

„These programmes are often based on a tranche of funds from outside donors lent to a certain category of borrowers at subsidized rates. These below-costs interest rates also raise the danger of spreading to small producers the same perverse excessive capital intensity which has often characterized the larger firms. They also make it unlikely that local funding agencies will step in to continue this credit flow when external assistance is no longer needed" (Liedholm/Mead 1986:321).

Nigeria's crafts sector represents a big potential market for banks. The savings mobilization and loan absorption capacity of craftsmen is far from being fully exhausted. Appropriate strategies are necessary to utilize this potential, to satisfy the need for credit and to make profits from these loans and associated investments (Marx 1992:9).

Part of the problem of small enterprise financing is the lack of a financial intermediation system, i.e. the insufficient linkages between formal and informal financial institutions. There are considerable transaction costs involved for both sides. For small entrepreneurs it is often impossible to provide sufficient collateral and to cope with high interest rates. For banks it is difficult to deal with small customers such as microentrepreneurs individually, especially if they operate their businesses in rural areas or in the informal sector. Potential creditors demand repayment guarantees which many applicants in the informal sector can not provide:

„Both sectors (modern financial institutions and indigenous saving and credit associations/craft unions with their secondary financial functions, H.D.S. + T.M.) may benefit from one another. Further development may, therefore, not only be a question of modernizing *esusu*, *cheetu* (craft associations, H.D.S. + T.M.) and other indigenous forms of saving and credit, but also of traditionalizing modern financial institutions" (Seibel/Damachi 1982:109).

Whether the urgency of the latter is the greater, as stated by Bouman (1978:209), has to be answered by further empirical studies.

The following measures should be initiated to overcome problems of small enterprise financing:

- Provision of funds for the development of crafts based on existing grassroots organizations;
- savings mobilization;
- linking banks and informal financial institutions such as craft associations or *esusu* to ease access to formal financial institutions in collaboration with the Central Bank or other institutions (along the lines of the model outlined below);
- encouraging microentrepreneurs to participate in the establishment and ownership of Community Banks (Seibel 1994);
- linking credit to savings;
- elimination of interest rate ceilings as a move toward ensuring that interest rates more closely approximate the opportunity costs of capital for small borrowers;
- **no** provision of subsidized loans to encourage craftsmen to use capital productively and to work against the prevailing defaulting mentality;
- granting loans in small amounts for short periods to ensure high repayment rates;
- technical assistance to formal financial institutions such as the Nigerian Bank for Commerce and Industry or the Nigerian Industrial Development Bank to develop low-cost screening mechanisms for lending to groups of very small producers (Liedholm/Mead 1986:322);
- assisting organizations at the federal and regional level such as the Division of Small-Scale Industries to develop programmes for informal sector crafts and craft unions (Liedholm/Mead 1986:321,326; Seibel/Parhusip 1990; Marx 1992:5).

### **Linking Banks and Informal Financial Institutions - A Financing Instrument for Crafts and Small Industries**

Linked formal and informal financial institutions could provide a major instrument for financing small-scale enterprises, following a model developed by Seibel (1984) in Nigeria.

Since 1990 the Central Bank of Nigeria has established a linkage banking project, with support from GTZ and AFRACA, to initiate linkages between banks and existing

self-help groups of small farmers. It has been proposed to extend this program to microentrepreneurs and their associations (Marx 1992:8; Seibel et al. 1994).

To cut down transaction costs, banks could establish business ties with suitable intermediaries: savings and credit associations or craft associations (unions). Members who have joined such associations have proved that they are able to save. They trust each other. Otherwise members would not put their scarce funds into the association's hands. The selection of suitable craft associations should be based on sound eligibility criteria and the premise that lending for onlending to members is based on savings (Marx 1992:8).

The associations are formed into joint and several liability credit groups, depositing their savings (regular or irregular contributions) or part of their savings with a partner bank. Loans could be provided on the basis of **regular group savings paid into blocked savings accounts** for a certain period, e.g.

6-12 months. The savings capacity determines the loan amount. On the basis of their savings they obtain group credit for on-lending to their members. Details are fixed in an arrangement between bank and the informal financial association to suit both partners. Groups can get bank loans (for on-lending to their members), provided that they demonstrate their seriousness and capability through their own savings. Since they do not want to loose their savings, borrowers are more likely to repay their loans (Marx 1992:2,3).

The core of the model is the definition of an appropriate ratio between savings and bans to stimulate savings mobilization and assure reimbursement at the same time, with a double incentive to save: (1) the amount of loan depends on the amount of savings; (2) the loan is a multiple of the amount of savings, the factor of multiplication depending on the number of satisfactory cycles of reimbursement. E.g., starting with a factor of 3, the association will obtain a loan of \$ 3,000 on savings of \$1 ,000 which remain with the bank as security. The association uses the money for on-lending to the members, charging higher interest rates than it pays to the bank. The association's savings grow from continued savings and income from interest. Assuming that savings have increased to \$ 5,000, then credit ceiling after 5 successful cycles of reimbursement would be \$ 40,000.

This model is one of slow and steady growth in moderate steps, where the amount of ban does not exceed the investment capacity of the participants.

The model can be adjusted to quite different financial and investment capacities. It is recommended to start with a low factor of multiplication and short-term loans to small and unsophisticated enterprises. Associations of entrepreneurs with larger, more sophisticated and more promising enterprises may start with a higher factor of multiplication and/or with a higher rate of growth of that factor according to successful cycles of reimbursement.

Essential is the existence of a low-cost and rapid **loan appraisal** system to assess the group and individual entrepreneur, the business and the feasibility of the project. Screening of loans should be based on the character of the applicant, his willingness to repay a loan and to make proper investments and -most important - the regularity

of his own savings in his esusu or group. Savings deposits and joint and several liability replace the conventional types of collateral.

There is an increasing number of viable and sustainable systems of banking with microentrepreneurs and small farmers, such as the Grameen Bank in Bangladesh (Marx 1992:6), Bank Rakyat Indonesia (Patten & Rosengard 1991) and Northern Mindanao Development Bank in the Philippines and presumably also the new community banking system in Nigeria (Seibel 1994). These systems commit none of the two cardinal sins of development banking: subsidizing and targeting.

## **(2) Institutional development of self-help organizations of craftsmen is initiated**

To promote interest associations of craftsmen following measures should be adopted:

- Encouraging craftsmen to join local interest associations;
- provision of advisory services and training for institutional development;
- assisting them in providing training and consultancy services for their members such as technical, administrative or management courses;
- assisting self-help and business organizations of small entrepreneurs in raising funds of their own by mobilizing members' savings so that they can build up their own credit system, utilizing their own internally generated funds;
- assisting them in linking up with formal institutions or in establishing financial institutions of their own (see above).

## **(3) Demand increases**

Survey findings indicate that demand side problems are somewhat more pressing for informal sector entrepreneurs in Lagos and Ibadan than supply-side problems. The informal sector is adversely affected by increasing unemployment and the contraction in demand among low income wage earners who normally purchase goods and services from informal sector producers.

This has several implications for the design of possible promotion measures aimed at increasing demand for craft products:

- Assistance should be given to small craftsmen and their interest associations in product management and marketing to ensure that products are of suitable quality for end-users and for use in industry and to establish more effective links to outside markets, e.g. through sub-contracting arrangements with larger manufacturers or with merchants in the formal sector;
- assistance should be given to modern and traditional crafts if they satisfy (latent or manifest) consumer needs and demand for services (Engelbrecht 1987:199);
- it is necessary to examine possible side-effects of designed craft projects (impact assessment) with regard to the question in how far they create competitors for other craftsmen.

Such measures will have no noticeable effects unless resolute macroeconomic policies are implemented consistent with a sustainable market-determined exchange rate system. This implies:

- Increasing per-capita income and consumption;
- a higher labor productivity associated with a steady increase in the capital-labor ratio;
- appropriate taxation and financial sector framework for ensuring adequate resource mobilization (domestic savings) to finance the required increases;
- articulation and implementation of an appropriate foreign debt and aid strategy to mobilize other sources (foreign savings);
- appropriate public investments and incentives for private sector development with regard to investment, health care, education etc.;
- encouraging inflows of foreign investment so as to increase the availability of foreign exchange and technology to the economy as well as
- the implementation of appropriate trade, agricultural and industrial policies (World Bank 1989:332).

**(4) Access to basic inputs, import licenses and equal treatment with regard to tariff rates is ensured**

**(5) Assistance in supplying spare parts, tools and machines is provided**

Many craftsmen in Lagos and Ibadan reported difficulties related to obtaining basic inputs for their businesses such as inexpensive raw materials or equipment goods of foreign origin. In 1985 Nigeria's government exercised extensive control over the distribution of industrial inputs as part of the austerity policy to regulate supplies of imported products. For larger firms it is easier to cope with a restrictive public sector distribution system. Small and microenterprises in the informal sector should have equal access to basic business inputs.

Survey findings with regard to the origin of tools and machines indicate that Nigeria's informal sector (especially metal crafts) is marked by a high level of dependence on foreign inputs.

In 1984, the authorities began to implement measures against external and fiscal imbalances. Budgetary expenditures were slashed, and administrative controls over imports - in the form of import licenses and prohibitions against imports of certain items - were tightened (World Bank 1989:329).

In contrast to large corporations small and microenterprises have no influence on the government with respect to obtaining import licenses and no bargaining power with regard to decision-making processes on tariff rates. Liedholm/Mead (1986:318) have pointed out that large garment producers in Sierra Leone were covered by the country's industrial incentive package and were able to import their machines duty-free. Small tailors, however, found that the sewing machine, their basic capital input, was classified as luxury consumer good and taxed accordingly with no duty relief.

When the SAP was introduced in Nigeria, import licensing was terminated and the import prohibition list was reduced. It is to be hoped that the new customs and excise tariff schedule as well as the new system for import duty assessment and collection has significantly improved import transactions and supply of informal producers with foreign inputs.

#### **(6) Space and suitable premises for crafts are available**

Another problem domain of informal sector entrepreneurs in Nigeria relates to restrictive government rules and regulations in terms of business location. Small producers are often subject to arbitrary and erratic interpretations of law which makes 'rational' business planning difficult.

Difficulties such as lack of space and suitable premises should be solved by the

- Revision of building laws and municipal regulations to reduce construction costs for housing;
- revision of municipal (tax) regulations aimed at reducing costs for obtaining space or premises and avoiding demolition of road-side shops and 'spontaneous settlements' as well as harassment by city councils (and bulldozers);
- improvement of water and electricity supply (NEPA).

It has to be examined whether the establishment of new industrial estates or the support of existing ones are appropriate measures in this context.

#### **(7) Technical skills and occupational training are improved**

Technological development (Tiffin/Osotimehin 1988) in Nigeria's informal sector is just incipient:

„Except for some areas like metal work, modern hair weaving, and motor car repair, informal sector businesses have not made much in-road into the development of technology for their own use. In the process of their normal working days most of the practitioners manage to repair their equipment (many of which are imported whole or assembled locally from completed knocked down parts). Hardly have entrepreneurs produced any major equipments made locally for their own use, but they utilize equipments made locally in other sectors" (NISER 1990:104).

Technical skills and occupational training should be improved by:

- Industry and task-specific technical assistance;
- the provision of curricula and training manuals;
- establishing and implementing training programs;
- improving conditions for technical problem solutions;

- advice in terms of technical equipment, new and second-hand tools as well as appropriate technologies;
- upgrading informal institutions such as the apprenticeship system aimed at training workers in traditional and modern crafts;
- rewarding graduates and masters (Liedholm/Mead 1986:323);
- establishing mechanical workshops and technical schools to intensify practical and theoretical training as well as ameliorating technical skills;
- promoting universities (Centre for Industrial Research and Development, University of Ife), Polytechnics and Industrial Development Centres aimed at providing technological advice and further education for craftsmen and craft unions.

### Project Holder

Assistance to unions and participating banks, designed to link formal and informal financial institutions - as an instrument for financing small and microenterprises - could be given by GTZ (Deutsche Gesellschaft für Technische Zusammenarbeit) or by one of the two associations of savings and of cooperative banks in Germany, DSGV and DGRV. This could be paralleled by assistance to unions designed to built up a system of consultancy, training and marketing services to its members by a German Chamber of Crafts. Further suggestions with regard to promotion measures for crafts in Nigeria are documented in Seibel/Holloh (1988:162-170).

According to the type of project, there are several alternatives with regard to the potential project holder such as the *Nigerian Association of Small-Scale Industrialists (NASSI)*, the *Nigerian Bank for Commerce and Industry*, the *Nigerian Industrial Development Bank* or the *Central Bank of Nigeria*.

Project holders must be capable, efficient and willing to cooperate with craftsmen in the informal sector and their interest associations.