

## DEALING WITH THE FINANCING PROBLEMS OF ENTREPRENEURS IN NIGERIA

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### **ABSTRACT**

*Entrepreneurs' most herculean task is that of financing their new or existing business/businesses. The sources, relevant questions and mode of assessing these funds are usually unknown and where they are known, desiring entrepreneurs are scared of applying because of 'fear' of being turned down. This paper has therefore articulated various sources of funds available both locally and internationally and identified some skills required for his business. This is with a view to providing answers to relevant questions asked.*

### **INTRODUCTION**

An entrepreneur has no doubt been defined and explained by earlier papers presented in this conference but it is important, for flow of discussion, to bring in one definition by Okereke (2006). According to him, an entrepreneur is a person who has business or managerial ability to identify and evaluate profitable business opportunities, mobilizes necessary resources and initiates appropriate action plan (s) very consistent as to ensure the realization of enterprise objective(s). Given this, an entrepreneur is an innovator, risk bearer, promoter, a generalist, an economic leader, very courageous and profit oriented person. He is an independent boss; self accounted and always faced with challenges, tasks or problems including financing problem.

Financing investment opportunities is a very difficult task facing investors/entrepreneurs, especially in the face of high cost of funds occasioned by global economic depression. Essentially, once a viable investment niche is carved out- it is immediately followed by the sources of raising capital to effectively carry on operation. Thus, the first question that must occupy an entrepreneur/investor's mind is the sources of financing his 'new' business. This informed the place of capital in any business. Neo-

classics described it as the engine of growth of any business. In fact, it is not only business lubricant but also the 'back-borne' holding the going-concept of the business. It can also be described as a pivot upon which all business activities revolve. This is because a well-packaged proposal or highly feasible and viable project can never see the light of the day if the necessary funds are not fully mobilized. So, not until an entrepreneur/investor can identify the means of raising funds for a new project or for expansion modernization or replacement of obsolete equipment and the availability of such funds, his efforts in this direction can best be described as wishful thinking, in fact, an illusion! Finance, as a factor of production (the Accountants' view) and the hub of business activity, can get a business in a sound footing and can also diminish a feasible and viable project. It is one of the factors that determines the actualization or concretization of an investment opportunity. It is required by an entrepreneur or investor at the various stages of a project's cycle and he can only cope if he is able to avail himself with feasible sources of raising the required capital. Again, the issues of utilization, control and return of funds from their various sources demand serious attention.

Essentially, two main sources of financing are available for an entrepreneur/investor. They are internal sources and external sources. *Internal sources* are those arising from an entrepreneur's/investor's immediate environment and are characterized by quick access to the fund with less difficulty and conditions, little or no cost implications, and closer contact between him and the lending party. *External sources* are those arising from the entrepreneur's/investor's outside environment and are characterized by less accessibility to the fund, high cost implication, complexities and lack of close contact between the entrepreneur/investor and the lender. The third category is *other sources*, which are not captured in internal or external sources discussed below but belong to either of them.

For proper articulation and perceptive writing, the paper is divided into four parts namely introduction, sources of financing a business enterprise, guiding questions in business financing and finally concluding remarks.

### **Sources of Financing a Business Enterprise**

#### **Internal Sources**

This source constitutes the main source of financing among Nigerian entrepreneurs. According to Saha (1983) this source contributed 94.6% of all sources of financing small furniture businesses in Nigeria. Basically, the major internal sources of funds for an entrepreneur/investor include:-

- (a) Better management of funds to improve earnings. This involves monitoring cash flows, monitoring debtors (reduce the time it takes debtors to pay; incentives like cash discount are recommended), monitoring inventory, maintaining machinery and equipment, monitoring personal income and fixed assets and retaining earnings.
- (b) Personal Resources: This involves the entrepreneurs starting the business from home and making use of his personal facilities like telephones, furniture, computer, cars and his free time.
- (c) Other entrepreneurs or business promoters who may render 'free' service or work at a significantly less and/or deferred monetary compensation.
- d) Personal savings and income
- e) Family sources
- f) Friends, relations and close associates
- g) Isusu or "Mitri Onu-Eku" as it is called in some parts of Imo State of Nigeria like Mbano.
- h) Age Groups
- i) Social Clubs (Okereke, 2007)
- j) Successful professionals who have some money to invest. Such professionals like lawyers, Sportsmen and women physicians, etc. However, this group of people must know the potentials of the investor(s) and the commercial viability of the project.
- k) Past and present employees who know something about the potentials of the company and have confidence in the entrepreneur/investor(s) (Nwachukwu, 1990)
- l) Retained Profit: If the Company is a public company, this becomes an external source

### **External Sources**

The major external sources can be categorized into two:

- (a) Debt Financing
- (b) Equity Financing

- (c) **Debt Financing** is fund provided by borrowing and includes all legally binding obligations of a firm to pay a fixed amount of principal and interest for a specific period of time (Okereke, 1994). It is most times cheaper than equity finance in the long run and it is easier and quicker to source especially in an excess-liquidity-prone economy. Debt financing is most appropriate for companies with limited capital needs, stable cashflow and substantial tangible asset

base and the decision to use this type of financing must be guided by, among others, the amount required, firm's size, current capital structure and financial health of the company. It has the singular advantage of not diluting ownership of the firm. Generally, debt financing are classified based on maturity periods of such debts. Hence, we have;

- i) Short Term Debt e.g Trade credit for example, local purchase order (LPO) financing, contract financing, commodity (inventory) financing, brokerage arrangement, account receivables financing, deferred credit or Accounts Payable(Suppliers);, etc, Bank loans (usually from Money Deposit Banks, Merchant, Development, Mortgage Banks, Finance Companies, Community or Microfinance Banks and such loans do not exceed one calendar year), unsecured loans, usually from project promoters as a bridge finance; factoring; management buy-out.; Commercial Papers; Promissory Notes; Commercial Drafts, Bankers Acceptances and Negotiable Certificate of Deposit (NCD). These last items are called money market instruments.
  - ii) Intermediate Term Debt e.g. Bank Term Loan (loan from banks and other lending institutions for a period of more than one year but usually less than ten years), syndicated loans, equipment leasing; conditional sales, hire purchase, etc
  - iii) Long term debts: These are debts whose maturities are ten years and above. Examples are loans, bonds and variations thereof.
- b) **Equity Financing:** This source of financing involves funds generated through public participation. Example, ordinary shares or common shares, preference shares and retained earnings. Raising equity funds may be by Private Placement, Initial Public Offer (IPO), Asset Stripping, Offer by Introduction, Deferred Public Offer, and Employee Buy-Out. The providers of this type of fund are willing to gamble on the success of the firm, as their expectation on return on capital is not at the early stage of the business but in the second or third year of operation with mouth watering success. They may be active or passive depending on their level of participation in running the business.

This source of capital has advantages of limited exposure to financial risk, access to funds market and business contacts, stable financial structure, access to new ideas which provides strategic value, etc.

**Other Sources of Financing** an investment opportunity include angel investors ( <http://www.springboardenterprises.org> ), venture capital firms, leverage buyout firms, ethical investors, Strategic individuals, institutions and corporations with strategic interest in entrepreneurs' success; Government or individual grants, Donations, sources from Government and her Agencies e.g one hundred percent currency retention scheme, Export Credit Guarantee Insurance Scheme, The Refinancing and Rediscounting Facility (RRF) and Foreign Input Facility (FIF), Nigerian Export-Import Bank (NEXIM), National and State Directorates of Employment ((NDE and SDE) in Nigeria, Government credit and other schemes and international sources like International Finance Co-operation (IFC), African Project Development Facility (APDF), African Enterprise Fund (AEF), etc. APDF and AEF are clearly distinct from each other. The former is a United Nation Development Programme (UNDP) project funded by United Nation Development Programme (UNDP), the African Development Bank (ADB), a number of bilateral donors and the IFC who is also the executing agency which started operation in Nigeria in July, 1986. The latter is a special fund established by IFC in July 1988 but started operation in March. 1989 (Erhiyoja, 1989). They also differ in their mode of operation. APDF only advice entrepreneurs on the preparation of viable projects, working with them until project financing has been secured and provides partial funding for market, technical or other feasibility studies that may be needed. But AEF is involved in direct investment. Regrettably, these two ready options are grossly underutilized in Nigeria either because of ignorance or mere negligence. Entrepreneurs with strong investment background are, therefore, advised to avail themselves these viable and reliable sources of financing including other World Bank Group by visiting their offices most times attached to Government House of states of the federation of Nigeria. This third group of financing sources is characterized by a number of incentives (e.g free land allocation) either to empower entrepreneurs or prospective ones, help promoters of projects to meet targets, attract investors in certain location or for general economic development.

It must be stressed and most importantly too, that the choice of any of the sources identified above depends significantly on the type of business (Sole Proprietorship, Partnership, Limited Liability Company, etc), the nature of financing, etc.

### **Guiding Questions**

The decision to raise funds internally, externally or others must be guided by the following questions, among others.

1. What is the type and nature of project or business and its operations?
2. What is the entrepreneur's/investor's net worth and the amount required?
3. Is the loan for working capital or fixed assets?
4. How much is required?
5. Which institution(s) or individual or agency to use?
6. What are their lending condition(s)?
7. What is the repayment period? Does the bank or individuals provide you with grace period on principals, amortization or a longer period for the financing of capital requirement?
8. What are the interest rate and the financing charge(s)? Do you find this too high or reasonable enough?
9. How is the fund released?
10. Does the lending institution or individual require a counterpart amount of money or property (Assets) already acquired by owners equity?
11. How is the loan paid back? Monthly, quarterly, semi-annually or annually.
12. What are the restrictions imposed by law, the financing institution or individual? Is it within your reach?
13. What are the collateral requirements of the bank or individual? Is it within your reach?
13. Would the loan transaction lead to the establishment of long term relationship?

These and others are important questions that must guide the entrepreneur(s)/investor(s) while deciding to utilize a particular source(s) of funds for his investment opportunity. These questions will provide such decision information like cost of fund, inherent risk, adaptability, control, accessibility, the financing mix, etc which will make the sourcing easier and most convenient and management very efficient. It is expected that the entrepreneur must have the *skill* and *ability* to religiously and sequentially provide answers to the above questions. But where this is lacking, an expert should be employed to do it.

Let us also state here that funds so sourced must be properly managed to ensure the sustenance of the going-concept in business. This call for *financial management*, which according to Pandey (1981) is the managerial activity concerned with the planning and control of the firm's resources. It is not only the use of financial statements that reflect the financial condition of a business to identify its relative strengths and weaknesses but also involve the entire planning, sourcing, utilization and control of the firm's financial resources. Although it is outside the scope of this paper, it is important to highlight some tools of financial planning and management that can enable the entrepreneur to plan in order to maximize his return on investment. According to Linda, (1986) they include

1. Basic Financial Statement
  - i. Balance sheet
  - ii. Income statements
- 2 Ratio Analysis- a means by which individual business performance is compared to similar businesses in the same category
- 3 Pro-forma statement of income
- 4 Break-even Analysis
- 5 Pricing formulas and policies
- 6 Cash flow statement
- 7 Types and sources of funds
- 8 Short-term and long – term planning Considerations

An entrepreneur who understands and effectively utilizes these concepts appropriately is practicing sound financial management and it is a confirmed indicator of the right path to success in his business. Thus, one singular reason for the knowledge, understanding and inculcation of financial planning and management is to avoid business failure which is very common among entrepreneurs globally and particularly in third world countries including Nigeria. According to Linda (1986) eight in every ten new businesses fail due to lack of good financial planning in United States of America. Nwachukwu (1990) found that 50% of small and medium size enterprises have gone out of business while 65.4% of manufacturing enterprises operate below average installed production capacity in Nigeria.

**CONCLUDING REMARKS**

Entrepreneurs are always comforted when the source(s) of raising short-term, medium-term and long-term funds is sure. The sources identified in this paper provide the assurance. However, caution must be taken when chosen any particular source. The benefits of any one source must always outweigh its associated drawbacks/cost. Efforts should be made by entrepreneurs to establish a lasting relationship with lending institutions beyond the loan agreement. This will pave way for the benefits inherent in such relationships to accrue to them in the long run. Beyond sourcing funds for the business, the place of application or managing the sourced funds is very critical and must be taken with all seriousness it deserves. Entrepreneurs must as a matter of priority embrace at least the basic financial management and accounting principles as well as ethics of their business. For lending institutions / agencies, they should as a matter of necessity reduce some of their lending conditions, processes and procedures. This, no doubt, will go a long way in ameliorating the Entrepreneurs' suffering and 'fear' of accessing funds for their business enterprise.



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