Small and medium enterprises (SMEs) play an important role in the development of a country: they form the backbone of modern economies and are crucial engines for development in their role as seedbeds of innovation, efficient producers and employers of labour. SMEs have a propensity to employ more labour-intensive production processes than large enterprises; consequently, they contribute significantly to the provision of productive employment opportunities, the generation of income and the reduction of poverty. Economists believe that economic development is advanced through the increase of SMEs because such proliferation increases employment opportunities. According to an OECD\(^1\) report, SMEs account for more than 95 percent of manufacturing enterprises and an even higher share of many service industries in OECD countries. In most of these countries, SMEs generate two-thirds of private sector employment and are the principal creator of new jobs. This is, however, not the case in most developing countries: developing countries have a large number of microenterprises and some large firms, but far fewer small and medium enterprises. In high-income countries, SMEs account for over 50 percent of GDP and over 60 percent of employment, but in low-income countries they account for less than half of that: 30 percent of employment and 17 percent of GDP. This SME gap between the numbers in the high and low income countries is called “The Missing Middle”.

Source: OECD

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\(^1\) Organisation for Economic Co-operation and Development
To have a firm understanding of “The Missing Middle” it is essential for one to be familiar with the definitions of and differences between microenterprises, small enterprises, medium enterprises and large enterprises. The definition of the aforementioned enterprises differs from country to country, although they can be defined along the following lines: number of employees, assets and annual sales.

<table>
<thead>
<tr>
<th>Employees</th>
<th>Assets</th>
<th>Annual Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microenterprises</td>
<td>&lt;10</td>
<td>$10,000</td>
</tr>
<tr>
<td>Small Enterprises</td>
<td>&lt;50</td>
<td>$3m</td>
</tr>
<tr>
<td>Medium Enterprises</td>
<td>&lt;300</td>
<td>$15m</td>
</tr>
<tr>
<td>Large Enterprises</td>
<td>&gt;300</td>
<td>&gt;$15m</td>
</tr>
</tbody>
</table>

Source: The World Bank

‘The Missing Middle’

A number of reasons have been identified to be responsible for the low number of SMEs in low income countries, some of which include: poor infrastructure, small local markets and underdeveloped regional integration, weak legal and regulatory environments for businesses, low business acumen and limited access to financing. Access to financing remains one of the key contributors to ‘The Missing Middle’ in developing countries. According to the World Bank's "World Business Environment Survey" (WBES) which involved more than 10,000 firms from 80 countries, SMEs worldwide on average named financing constraints as the second most severe obstacle to their growth; however firms in Central and Eastern Europe, the former Soviet Union, and Africa were most likely to cite finance as their most severe constraint.

‘The Missing Middle’ can be said to be the financing gap in emerging markets that lies above micro-finance and below traditional institutional financing. This occurs because SMEs are too large to secure funds from micro-finance institutions and too small for mainstream private equity or commercial banks. Commercial banks in emerging markets typically view SMEs as high-risk investments which make it a challenge to get loans. Banks find it difficult to adequately assess the risks involved in transacting with
SMEs because most of them lack track records, credit history or tangible assets which can serve as collateral in securing needed loans.

The finance requirement for enterprises in ‘The Missing Middle’ is usually between fifty thousand dollars to two million dollars. Funds requirement for the majority of SMEs in ‘The Missing Middle’ are towards lower limit of the funds requirement – between fifty thousand dollars and two hundred and fifty thousand dollars.

*The Missing Middle’ in Africa*

‘The Missing Middle’ phenomenon is experienced in most African countries with exception of a few countries such as South Africa, Mauritius and some North African countries which have fairly modern financial systems and clear government policies in favour of private enterprise. The SMEs sector in Africa is weak because of small local markets, undeveloped regional integration and very difficult business conditions, which include: burdensome official procedures, poor infrastructure, weak legal systems, inadequate financial systems and unattractive tax regimes. Like SMEs in other developing countries, the main challenge for SMEs in African countries is the access to funds. In an investment climate surveys of entrepreneurs conducted in a few African countries, access to and cost of finance were identified as the leading constraints in private sector operations and growth. The financial sector of most African countries is characterized by very low levels of financial intervention and weak capital markets, which cannot effectively supply the financial resources and other products required by the private sector, in particular in the SME sector which generally lacks the scale, collateral and relationships for formal financing.
SMEs in Africa suffer from inadequate access to funds due to a high risk of default, inadequate financial facilities, poor securities and lack of information about their ability to repay loans. As a result, the main sources of capital for SMEs in Africa are retained earnings and informal savings and loan associations (tontines), which are quite unpredictable and unsecure. Banks avoid lending to SMEs for some of the following reasons: lack of knowledge of the sector, high transaction costs, limited staffing capacity in financial institutions, poor credit culture among some target SMEs as well as underdeveloped tools to identify and mitigate risks associated with lending to SMEs.

In her comparison of bank financing to SMEs in Africa to other developing countries, Maria Soledad Martinez Peria, a Senior Economist at the World Bank concluded that bank financing to SMEs in Africa is significantly less and more short-term in nature than in other developing countries. In most developing non-African countries, bank loans devoted to financing small businesses average 13.1 percent, while only 5.4 percent of loans are allocated to such businesses by banks in Africa. Similarly, bank approvals for loan applications by small firms in non-African developing countries average 81.4 percent, whereas only 68.7 percent of such applications are approved by banks in Africa. Furthermore, while an average of 47 percent of small business loans are used to finance investments (as opposed to working capital) in non-African developing countries, only 28 percent of small business loans are used to finance investment in Africa.

SME finance from banks in Africa is costlier than in other developing countries. Fees charged on SME loans in Africa are almost twice as high as loan charges in other non-African developing countries, an average of 1.97 percent of the loan value for small firms and 1.79 percent for medium-sized firms are charged as loan fees. Interest rates on SME loans are also 5 to 6 percentage points higher on average in Africa than elsewhere in the developing world. The root cause of the high interest rate is because SME loans in Africa are generally of higher risk than those in other developing countries. The share of nonperforming loans (NPLs) among small firm loans in Africa averages 14.5 percent compared to 5.5 percent in other developing countries. The NPL ratio for medium-sized firms is also higher in Africa; it averages 6.8 percent compared to 5.1 percent in other non-African developing countries.

### Table: Share of all Firms and Share of Employment

<table>
<thead>
<tr>
<th></th>
<th>Share of all Firms</th>
<th>Share of Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microenterprise</td>
<td>90percent</td>
<td>30percent</td>
</tr>
<tr>
<td>Small and Medium Enterprise</td>
<td>9.5percent</td>
<td>30percent</td>
</tr>
<tr>
<td>Large Enterprise</td>
<td>0.5percent</td>
<td>40percent</td>
</tr>
</tbody>
</table>

Source: MENON Business Economics

'The Missing Middle' in Nigeria

Like the rest of Sub-Saharan Africa, ‘The Missing Middle' phenomenon also exists in Nigeria. According to the National Bureau of Statistics (NBS) and Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) 2010 collaborative MSME survey, the total number of micro, small and medium enterprises in Nigeria is 17,284, 671. Microenterprises account for about
99.8 percent of the total number of enterprises in Nigeria – 17,261,753, while small and medium enterprises account for 0.12 percent and 0.009 percent respectively – 21,264 and 1,654.

Micro, Small and Medium Enterprises Distribution in Nigeria

SME Definition in Nigeria

<table>
<thead>
<tr>
<th>Enterprise Type</th>
<th>Employment</th>
<th>Asset</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro enterprises</td>
<td>&lt;10</td>
<td>&lt;N5m (~$30,000)</td>
</tr>
<tr>
<td>Small enterprises</td>
<td>&lt;50</td>
<td>&lt;N50m (~$300,000)</td>
</tr>
<tr>
<td>Medium enterprises</td>
<td>&lt;200</td>
<td>&lt;N500m (~$3m)</td>
</tr>
<tr>
<td>Large enterprises</td>
<td>&gt;200</td>
<td>&gt;N500m (~$3m)</td>
</tr>
</tbody>
</table>

Source: National Policy on MSMEs

Similar to what is obtainable in most developing countries, the main constraints of SMEs in Nigeria are low access to finance, weak infrastructure, inconsistency of government police, weak tax regime and obsolete technology. Of the aforementioned constraints, access to finance is considered one of the most major constraints. According to the 2010 World Bank Climate Investment Assessment report, out of the 10 percent of Nigerian SMEs that applied for loan facility, about 70 percent of them were denied financing. Owing to this the main source of finance for SMEs in Nigeria are personal savings and family sources. Personal savings account for about 54.4 percent of capital sources for SMEs, while family sources and loans account for 29.8 percent and 9.2 percent respectively.

Interventions by the Nigerian Government

The Nigerian Government, understanding the importance of SMEs to the growth of the Nigerian economy, has made a conscious effort in recent times to improve the plight of SMEs in Nigeria. A number of schemes were established to help ensure SMEs adequate
access to finance. The first step taken by the Nigerian Government to stimulate the growth and development of the sector was the establishment of the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) in 2003. SMEDAN’s mandate is to facilitate the creation, resuscitation and stimulation of the growth and development of the micro, small and medium enterprises sector of the Nigerian economy. Other interventions by the Nigerian government include:

**The Small and Medium Enterprises Equity Investment Scheme (SMEEIS)**

The SMEEIS initiative of the Nigerian Government was established with the aim of providing adequate and cheaper funding. All the commercial banks operating in Nigeria were required to set aside 10 percent of their profit after tax (PAT) for equity investment in small and medium enterprises in Nigeria. The cumulative sum set aside by the banks under the scheme as of December 2009 was N42 billion. The funds were to be in the form of equity investments.

**The N200 Billion Small and Medium Scale Enterprises Guarantee Scheme (SMECGS)**

This scheme was established in 2010 by the Nigerian Government with the aim of stimulating growth in the SME sector by providing guarantees on loans by banks to the sector in order to absorb the risks that have previously inhibited banks from lending to this sector. The beneficiaries of the scheme are small and medium enterprises with total assets not exceeding N500 million and a labour force of 11 to 300 staff. A maximum amount of N100 million would be guaranteed which could be in the form of working capital, term loan for refurbishment or equipment upgrade or expansion and overdraft.

**The N2 Billion SME Restructuring/Refinancing Fund**

The scheme was established by the Nigerian Government through the Central with the aim of refinancing or re-structuring of bank’s existing loan portfolios to the SME sector. The main objective of the fund is to enhance access to credit by the small and medium enterprises and improve the financial position of the commercial banks. The fund was sourced from the N500 billion debenture stock issued by the Bank of Industry. The scheme is managed by the Bank of Industry who disburses the fund to the participating banks for restructuring of their loan portfolio.

**The N2 Billion NERFUND Facility**

The Nigerian Government in its effort to ensure SMEs easily have access to finance released N2 billion to the National Economic Reconstruction Fund (NERFUND) to enable direct lending to the MSME sub-sector. In disbursing the fund, NERFUND signed an MOU with SMEDAN and other principal stakeholders within the sector to channel application with a bankable business plan from their clients to ensure adequate outreach.

Though a number of schemes have been established by the Nigerian Government to ensure SMEs have easy access to finance, most SMEs still struggle to access funds. Limited access to funds still occurs because some of the requirements that enable the applicants eligible for the funds are hard to meet: most SMEs lack a proper bankable business plan, marketing strategy, have no sound accounting systems and do not run their transactions through the banking system. Another reason
why some of the schemes didn’t make the required impact was because there was a lack of alignment with interests: the SMEEIS was one such scheme. SME promoters were not interested in the equity participation for fear of losing control of their enterprises; they wanted low interest rate loans which were longer tenure and flexibility in the areas of the collateral banks seek for. As a result of this, some SME promoters were reluctant to apply for funds from the scheme.

Innovative Ways of Financing SMEs

Most financial institutions view SMEs as high risk investments that should be dealt with caution; as a result of this, financial institutions are usually reluctant to make funds available to SMEs. Due to this, innovative approaches to financing SMEs must be adopted if ‘The Missing Middle’ challenge must be tackled. A number of innovative financial instruments have been adopted by other countries to ensure SMEs get access to funds. Some of these instruments are being implemented in Nigeria: the Alternative Securities Market is one of such instruments.

**Alternative Securities Market (ASeM)**

ASeM is a specialized board of The Nigerian Stock Exchange (NSE) dedicated to listing SMEs with high growth potential. It provides a platform through which SMEs can access long term capital for growth and expansion. The ASeM was launched on the 23rd of April 2013 as part of NSE’s initiatives to develop entrepreneurship and provide a platform for SMEs in Nigeria to access capital market. ASeM is similar to the Alternative Investment Market (AIM) of the London Stock Exchange. Like ASeM, AIM allows small companies to float shares with flexible regulatory system than is applicable to the main market. AIM was launched in 1995 and has raised almost £24 billion for more than 2,200 companies. Flexibility is provided by less regulation and no requirements for capitalization or number of shares issued.

**Crowd Funding**

Crowd funding is an alternative method of raising finance for a business, project or idea. It is a way for businesses, organizations and individuals to interact with other individuals, communities and organizations to raise a fixed amount of money as a loan, donation or investment. Unlike angel investment, in which one person typically takes a larger stake in a small business, with crowd funding an entrepreneur can attract a ‘crowd’ of people – each of whom takes a small stake in a business idea, by contributing towards an online funding target. Most often, crowd funding requires that funding be raised during a set timeframe via a digital social network. The United States has a number of crowd funding websites in operation. MicroVentures is one of the crowd funding websites operating the United State. MicroVentures was founded by Bill Clark in 2010 to raise investment for startup companies. Startup companies apply to be listed and undergo due diligence. Accredited investors can then pool resources and invest in the startups for equity. Over $16 million dollars have been raised and invested in startup businesses through the platform.
Reference


National Bureau of Statistics (NBS) and Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) (2010) Survey report on micro, small and medium enterprises, SMEDAN publication


