2.4 Sources of Capital for Entrepreneurship

There are two sources of capital for the entrepreneur namely; Internal and external funds. Internally sourced funds include; personal savings, retained profits, sale proceeds of assets, reduction in working capital, credit from suppliers, and accounts receivables. While sources are equity and debt finance external sources. Bhide and Grousbeck (1999) classified alternative sources of financing for entrepreneurship into; (i) Startup financing, (ii) Outside/external equity capital – private investors, venture capital and public equity markets, (iii) Debt capital - cash flow financing and asset-based financing and (iv) internally generated financing – credit from suppliers, accounts receivables, reducing working capital and sale of assets. Generally, entrepreneurs have difficulties in sourcing funds from conventional (formal) financial institutions because of lending conditionality and the unwillingness of commercial banks to advance funds to start-up firms. Alternative financing sources include; self – financing, family and friends, suppliers and trade credits, commercial banks, other commercial lenders, assets-based lenders/lessors, specialized finance companies, Institutions, and Insurance companies, Pension funds, Venture capital, private equity placements, Public equity offerings, Government agencies, and other government programs.

Table 2.5: Proportion of SMEs Financing by Formal and Informal Financial Sectors

Region/Country	**Bank finance (Formal Financial Institutions) %**	**Self-Fund financing (Informal Financial Institutions) %**
Chinese firms	20	80
African firms	19	81
South Asia firms	23	77

Latin America /Caribbean Islands	21	79
East Asia /Pacific	32	68
The Middle East/North Africa	13	87
Brazil	14.30	85.70
Nigeria	29.76	70.24
China	20.37	79.63
India	33.48	66.52
Indonesia	16.34	83.66
Russian Federation	5.93	94.07
Income Groups		
Low Income	17.42	82.58
Middle Income	17.52	82.48
High Income (OECD)	20.78	79.22
Business firms		
Micro	15.06	84.94
Small	14.86	85.14
Medium	22.35	77.65
Large	21.35	78.65
Very Large	30.21	69.79

Source: Policy Research Working Paper Formal and Informal Finance Evidence from China; Meghana Ayyagari, Asli Demirgui – Kunt and Vojislav Maksimovic (2008)

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Table 2.6 SMEDAN REPORT ON SOURCE OF CAPITAL FOR ENTERPRISES

Source	2010 Report %	2013 Report %	2017 Report %
Personal Savings	54.4	65.4	68.3
Loan	22.0	17.9	21.6
Family source	16.7	12.0	14.4
Cooperative /Esusu	5.1	3.8	6.6
Parents	0.9	-	-
Friends	0.9	-	-
Grants	-	1.8	3.3
Others	-	4.3	8.6
TOTAL	**100**	**100**	**100**

Source: SMEDAN(2010, 2013 and 2017 Survey Reports)

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Table 2. 7 OECD (2004) Report on Top Priority Areas

Rank	All Firms		Small firms		Medium firms		Large firms
1	Financing	36.5	Financing	38.9	Financing	38.0	Policy Instability
2	Inflation	34.6	Inflation	36.9	Taxes/Regulation	37.2	Financing

3	Policy instability	34.4	Taxes/Regulation	35.5	Inflation	36.1	Inflation
4	Taxes/Regulation	33.5	Policy instability	35.0	Policy Instability	36.0	Street crime
5	Exchange Rate	28.0	Street Crime	30.6	Exchange Rate	29.7	Corruption
6	Corruption	27.7	Corruption	30.1	Corruption	27.4	Exchange rate
7	Street Crime	27.2	Exchange Rate	28.9	Street crime	25.5	Organized crime
8	Organized Crime	24.5	Organized crime	26.9	Organized crime	23.4	Taxes/Regulation
9	Anti-Competitive practices	21.9	Anti - competitive practices	23.8	Anti - Competitive practices	21.9	Infrastructure
10	Infrastructure	17.0	Infrastructure	16.3	Infrastructure	17.2	Anti-competitive practices
11	Judiciary	13.7	Judiciary	13.8	Judiciary	14.4	Judiciary

Source: OECD (2001) Ranking of firms on Business Obstacles

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2.5 Obstacles to Entrepreneurship

Entrepreneurship growth can be attributed to driving by the small business owner or entrepreneur to take charge or control, make an impact in the world, self – Fulfilment, make and reap profits and eventually contribute to society. The failure rate of small business firms is relatively higher when compared to large scale enterprises. According to Scarborough(2013), small businesses fail because of their limited resources, inexperienced management, and lack of financial stability. Small business firms, unlike the large scale business firms (transnational companies, multinational corporations, public-owned companies or quoted companies) small business enterprises are constrained not only by their nature of the business but by

their legal status. As most of these small and medium enterprises are either as sole proprietorship or partnership business firms that lack access to finance or capacity to approach the capital market to raise funds for their business activities. According to SMEDAN (2010), Survey reports 57.5% of business firms are sole proprietorship type, Partnership business firms account for 8.3%. It further reveals that business firms with total capital less than N10 million accounted for 68.9 per cent and 54.4 per cent of business firms source their capital from personal savings.

The key problems of the SMEs globally are financing, unstable policies of the government, inflation, taxation, regulation, corrupt practices, crimes, insecurity, the legal system, poor infrastructure and social amenities, and regulatory issues.

2.6 Financial System

The role of a financial system in economic growth cannot be overemphasized, its importance as a catalyst of economic development has long been recognized in finance and development literature. It provides the catalyst for productive activities to ensure economic growth and development through financial intermediaries (Onasanya B, { ed}, 2014). Ojo (2012) argues that an economy can be broadly grouped into two systems of financial and economic, the financial sector facilitates borrowing by the deficit economic units and saving by the surplus economic units through the intermediation of financial intermediaries. "These various types of financial transactions engaged in have major implications for consumption, investments, production, macroeconomic stability and achievement of other economic objectives. The financial systems in no doubt shapes own domestic economy and in turn, economies shape financial systems, since economic growth usually leads to further developments of a financial system" The financial system of any country provides the catalyst for Economic growth and development. The state of any economy is a reflection of the state of the financial system. Ezike (2003) defines the financial system as a network of financial Institutions,

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Instruments, and financial markets that facilitate the transfer of financial resources from the surplus sector to the deficit of the Economy. The most basic function of any financial system is to facilitate the flow of payments in an economy and the quality of these services affects the performance of the economy as a whole. According to Olowe (2011), the financial system of any country provides the catalyst through financial intermediaries for productive activities to ensure economic growth and development, that is the state of any economy is a true reflection of the state of its financial system. Therefore economic development of a country is a function of the development of its financial system. This correlation seems to be true of both developed and developing countries globally. The financial system consists of financial institutions, Financial Instruments, financial markets, and financial regulatory bodies. Generally, the financial system promotes financial intermediation of moving financial resources from the surplus segment to the deficit sector of any economy.

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List of Lending Institutions in Nigeria as at December 2019

SN	Type of Regulated Formal financial Institution	Number of licensed Institution
1	Commercial Banks	24
2	Development Finance Institution	6
3	Merchant Banks	5
4	Microfinance Banks	911
5	Non-Interest Banks	2
6	Finance Houses/Companies	79
7	Primary Mortgage Institutions	34
8	Bureaux de Change	5,156

Source: Central Bank of Nigeria Data (2019)

2.7 Informal Financial Institutions

It is instructive to note that the formal financial institutions have not been able to cater needs of the informal economic sector as these operators are usually financially excluded due to the lending terms and conditions. The parallel existence of both formal and informal financial institutions is known as financial dualism. According to Philip Consulting 2014 Report," the informal sector is a vital part of any country's economy and contributes to overall economic growth by creating employment opportunities and contributions to GDP however it is unregulated and workers are often subjected to the whims of their employers". Globally the contributions of the informal sector have been acknowledged in terms of income generation, raw materials supplies, production of goods and services, wealth creation, employment creation among the low-income groups. This informal sector consists of Agriculture (small scale farmers), Financial services (Thrift cooperatives societies, Esusu, Ajo), Moneylenders,), Service Providers (make- up artists, Photographers, fashion designers, Event planners, Artisans, Technicians), Retail businesses (Street vendors, roadside sellers, hawkers, caterers), Education providers (private schools and tutors) and transport (private hire taxi drivers, tricycle operators, motorcycle operators).

It is estimated that the informal economy is worth $10 Billion and accounts for about 80% of the global workforce. According to the 2010 Report of Shadow Economies All over the World, the informal economies in 162 countries between 1999 and 2007 it was estimated that the informal economy represents at least 30% of Gross National Product (GNP) in 107 countries, the figure for Nigeria was 57%. The contributions of the informal economy in Nigeria show it accounts for 57.9 % of rebased GDP according to the United Nations Development Programme (UNDP). The National Bureau of Statistics states that the informal sector consists of over 17 million micro and small business firms. Between July 2012 and June

2014, over 2.48 million jobs were created and the informal sector contributing 1.48million employments. Oloyede (2008) states that the informal sector in Nigeria comprises all economic activities existing in all sectors of the economy that are functioning outside the framework of governments' regulatory and supervisory activities. The informal sectors involve all economic and productive activities of goods and provision of services.

2.8 Description of Informal Financial Institutions

The informal financial system has been variously defined in the literature. The Central Bank of Nigeria 2014 Report defines the informal financial systems as the whole arrangement of non-market financial institutions such as money lenders, cooperatives societies among others that are not governed by formal contractual requirements. The reports further say the informal financial sub-sector plays a complementary function to its formal counterpart by servicing the lower end of the market including community-based organizations such as cooperatives, microfinance institutions, rotating savings and credit associations (ROSCAs), self-help groups and other similar institutions. Ojo (2010), the informal financial sector consists of individuals, groups, and associations that mobilize local savings and grant credit. A common feature of informal financial sector operators is the self-regulation and discipline. These informal financial intermediaries include friends, relatives, traditional mutual aid groups like esusu, daily funds, collectors, middlemen, landlords, and professional moneylenders. Sambe, N. and Abanyan, N.L. (2013) describe the IFIs as institutions that are not controlled directly through major monetary and financial sector policy instruments but are created by individuals and groups with no legal status. According to Aryeetey (1995), informal financial institutions could be conceptualized as those institutions that embrace all financial transactions that take place beyond the functional scope of various countries and other financial sector regulations. The World Bank report of

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1997 defines informal financial transactions as financial activities that are not regulated by the Central Bank supervisory authorities, unlike the formal institution's such transactions rarely use legal documentation or the legal system to enforce contracts. Atieno (2001) defines informal finance as all transactions, loans, and deposits occurring outside the regulation of a Central Monetary authority while the semi-formal sector has the characteristics of both formal and informal sectors. Informal financial institutions involve the operations of savings and credits associations, rotating savings and credit associations (ROSCAs), professional money lenders, part-time money lenders. The Overseas Development Institute (1992) makes a difference between the formal financial institutions and informal financial institutions that "theoretically the formal financial sector would refer to an organized urban-oriented institutional system catering to the financial needs of the modernized modern sector, while the informal financial sector itself unorganized and non -institutional would deal with the traditional, rural subsistence (non-monetized) spheres of the Economy" The financial exclusion of the informal market or lack of access to credit through the conventional banking institutions are responsible for the patronage and growth of the IFLs in the country, especially with the rising unemployment.

Types of Informal Financial Institutions

The informal financial sector refers to the unorganized and non-money institutional financial services providers that deals with the informal, traditional and rural sector of the economy. Therefore the informal financial institutions (IFLs) include; Rotating Savings and Credit Associations (ROSCA), Professional money lenders, Savings collectors, Daily contributions scheme or Daily collections, Credit unions, Professional Trader Association, Cooperative Thrift and Credit societies.

Rotating Savings and Credit Associations – ROSCA (ESUSU)

Rotating Savings and Credit Associations are usually small groups of individuals that agree to contribute a fixed amount of money for a specific duration and the contributed sum is then given to members in rotation. This contributory scheme brings together a group of people for savings through the contribution of a fixed amount of money on fixed days of the week, month, or year. There variants of ROSCA such as Esusu, Susu, Dashi, Isusu, etc. Esusu arrangement is advantageous in business finance as it provides members with a lump to support business activities.

Money Lending

Money lending has been a traditional source of credit in rural areas of the country. Moneylenders are mostly individuals who specialize in money lending and eventually form money lending credit unions. This can be through socio- non-commercial lenders or professional money lenders, a close family, a cooperative fund to help members of the needy family. Money lending offer opportunities for borrowers or loan seekers who ordinary has no access to credit from the formal banking institutions

Daily contribution scheme

The daily contribution is a scheme where people unknown to themselves contribute unequal amounts to the collector or coordinator daily for a month. This contributory scheme is usually referred to as " Ajo ojumo" meaning daily contribution. A day's contribution is the commission that the collector deducts from the total contribution for the month. The money contributed is kept with the collector and which can advance as a loan to any contributing member as a short term loan.

Professional traders association

Members of the same trade group or association often engage in compulsory savings contributions to form a pool of funds to support the businesses of their members. Members normally contribute money weekly or monthly and fundraised is disbursed to members in the form of loans at a concessionary interest rate

Cooperative thrift and credit societies

Cooperative thrift and credit societies are institutions that mobilize savings from their members and extend loans to members at the lower interest rates. Cooperative thrift and credit societies have proven a good medium for grassroots savings mobilization for the productive sector. Sources of funding for the Cooperative thrift and credit societies include share subscription, special savings, membership fees, and dues and which are given to members as loans

Attributes of Informal finance institutions

Meyer, R L and Nagaarajour G (1991) in their contributions of the activities of Informal finance institutions identified the major characteristics as; heterogeneity /widespread, services (loans and savings), specialization, accessibility, collateral substitution, interest rates and transactions costs, and contributions to development. The growth of informal financial institutions is their accessibility and the services tailored to the specific needs of the small business owners.

2.9 Lending Terms and Conditions of Informal Financial Institutions

According to Schmidt and Kropp (1987), the access problem, especially among formal financial institutions, is one created by the Institutions mainly through their lending policies – this is in the form of the prescribed minimum loan amount, complicated application procedures, and restrictions on credit for specific purposes. Provision of credits by formal financial institutions are regulated by the licensing and supervising Authorities, unlike the informal financial institutions that

are unregulated. Lending terms and conditions of formal financial institutions such as loan amount, loan tenor, repayments, collateral security, credit history, financial statements and analysis, credit analysis are anti-small business borrowers.

Policy formulation

The informal financial system thrives among small business owners or entrepreneurs they provide services that access to their clients because of personal relationships on extending credits rather than on formal guarantors or collateralization of loans. Similarly, informal financial institutions are socio-culturally compatible with the operating environment.

The demand for credits in the informal financial sector has continued to increase due to several factors such as flexibility and creativity of the loan process, simple credit application, sound loan screening procedure rather on loan monitoring, less emphasis on collateralization of the loan, tailoring of financial services on the specific needs of the borrowers, application of group joint liability, failure of Government intervention funds and lower transactions cost especially under group lending

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