FINANCING SMALL SCALE INDUSTRIES IN NIGERIA: A CASE STUDY OF MAKARFI SUGAR INDUSTRIES LTD

BY

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BEING A PROJECT SUBMITTED TO THE DEPARTMENT OF BUSINESS ADMINISTRATION, A.B.U. ZARIA IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF MASTERS DEGREE IN BUSINESS ADMINISTRATION (MBA)

1999

CERTIFICATION

This is to certify that this project, entitled "FINANCING SMALL-SCALE INDUSTRIES IN NIGERIA A CASE STUDY OF MAKARFI SUGAR INDUSTRIES LTD" by SHEHU MUHAMMAD SHITU meets the regulations governing the award of Masters Degree in Business Administration (MBA) of Ahmadu Bello University (ABU), and is approved for its contribution to knowledge and literacy presentation.

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DIGITIZED

DECLARATION

I hereby declare that this project was written by me, and that it is a record of my own research work. All sources of information and where applicable, other writers' view have been duly acknowledged.

SHEHU MUHAMMAD SHITU		31/12/98
STUDENT	SIGNATURE	DATE

DEDICATION

This project is dedicated especially to my daughter Miss Mariyatu Shehu and to the entire members of my family for their endurance, support and understanding.

ACKNOWLEDGEMENT

All thanks go to the Almighty Allah, the beneficient and the merciful for giving me the courage, strength, resources and good health to accomplish this course successfully.

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ABSTRACT

This project seeks to examine the prospects, problems, and scope of Small Scale Industrial Development in Nigeria with special emphasis on our Company's efforts at establishing a Mini-Sugar Refining Plant at Makarfi, one of the Local Government Areas in Kaduna State, where sugarcane grows in abundance. The selection of this topic was informed by the belief that a radical review was required to our quest for industrialisation with new emphasis on the promotion of small scale industries which would be cheaper to establish, easier to manage and simpler to maintain. This was against the previous trend of establishing very large, expensive and complicated as well as capital intensive plants which took very long time to complete. At the end they became white elephants due to their capital intensive nature. The study examines some large scale companies that have not been very successful like Nigerian Sugar Company (NISUCO) Bacita and Savannah Sugar Company Numan as well as those small to medium scale ones such as Santi and Lafiagi Sugar Companies and their degree of success. The Nigeria Industrial Policy 1990 was also examined as well as the role of Structural Adjustment Programme which gave birth to new institutions like Nigerian Economic Reconstruction Fund (NERFUND), Nigerian Export and Import Bank Ltd (NEXIM), Small and Medium Enterprises (SME) and Export Processing Zone Authority and their activities. The role of the newly created Nigeria Sugar Development Council has also been examined. Some of the recommendations made include:-

Restructuring Financial Institutions by the Government to ensure that SMEs benefit from their functions with ease.

Reviewing Industrial Policy periodically to eliminate areas that proved to be out of tune with current realities.

Getting funds SME's should be made more liberal to avoid the mistakes of NERFUND and SME Funds easier created.

Backward and Forward Linkages between Universities, Research Institutes and industries for more effective development in terms of funding research, proto-type machinery production and raw materials development.

Enabling environment creation for large scale agricultural production for both export and local raw materials provision.

Encouraging Private Entrepreneurs to establish small and medium scale industries either singularly or as joint ventures.

Large sugarcane plantations should be established to encourage the establishment of more processing plants.

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CHAPTER ONE

1.0 INTRODUCTION

Finance involved decisions on when, where and how to acquire funds to meet firm's investment needs. The central issue in financing is determining the proportion of equity and debt. The mix of debt and equity is known as firm's capital structure. Finance is acquisition as well as efficient allocation of funds in a firm. The processes of raising funds, investing them in assets and distributing returns to investors are known respectively as financing, investment and dividend decisions.

A firm requires a number of real assets to carry on its business. Real assets can be tangible or intangible. Plant, machinery, offices, factories, furniture and buildings are example of tangible assets while technical know-how, technological collaborations, patents and copy rights are intangible assets. The firm sells financial assets or securities, such as shares and bond/debentures, to investors in the capital markets to raise necessary funds. Financial assets also include lease obligations and borrowing from banks, financial institutions and other sources. There are two types of funds that a firm can raise: equity funds and borrowed funds. A firm has to sell shares to acquire equity funds. Shares represent ownership rights of their holders. Borrowed funds, on the other hand, can be of long term, medium term or short term in nature.

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Another important source of securing capital is creditors or lenders. Lenders are not owners of the company. They make money available to the firm on loan and retain title to the funds lent. The return on loan or borrowed funds is called interest. Loans are furnished for a specified period at a fixed rate of interest. Payment of interest is a legal obligation. A firm may borrow funds from a number of sources such as banks, financial institution, public or by issuing bonds or debentures. Financing function requires skillful planning, control and execution of financial activities. There are four important finance functions:

a) Investment decision

b) Capital-mix decision

c) Dividend decision

d) Liquidity decision

a) **Investment Decision:**

Investment decision or capital budgeting is the "oldest" area of the recent thinking in finance. It relates to the allocation of capital and involves decisions to commit funds to long term assets, which would yield benefits in future. Its one very significant aspect is the task of measuring the prospective profitability of new investment.

b) **Financing Decision:**

This involves obtaining the best financing-mix or optimum capital structure for the firm. The firm's capital structure is optimum where the market value of shares is maximized. The mix of debt and equity is known as the firm's gearing structure. The use of debt affects the return and risk of shareholders, it may increase the return on equity funds but it always increases risk. A proper balance will have to be struck between return and risk i.e.; when shareholders' return is maximised with minimum risk, the market value per share will be maximised.

c) **Dividend Decision:**

Companies should decide whether to distribute all profits, or retain them, or distribute a portion and retain the balance. Like the financing function, the dividend policy should be determined in terms of its impact on the shareholder's value. The optimum dividend policy is one that maximises the market value of shares of the company, the dividend-payout ratio is equal to the percentage of dividends distributed to earnings available to shareholders. Thus, if shareholders are indifferent to the firm's dividend policy then, the company can determine the optimum dividend payout ratio.

d) **Liquidity Decision**:

Current assets (cash, marketable securities, stock of finished goods etc) affects the firm's liquidity and is a very important finance function in addition to the management of long-term assets. Current assets should be managed efficiently for safeguarding the firm against the dangers of inadequate liquidity and insolvency. Investment in current asset affects firm's profitability and risk. A conflict exists between profitability and liquidity while managing the current assets. If the firm does not invest sufficient funds in current assets, it may become illiquid. But it would lose profitability as idle current assets would not earn anything. Thus, a proper balance must be achieved between profitability and liquidity. The firm, therefore, must decide to acquire or dispose of assets and require commitment or recommitment of funds on a continuous basis. This in consequence, will affect the size, growth, profitability and risk of the firm and ultimately the value of the firm. The words of Ezra Solomon (1969) page 3 "the function of financial management is to review and control decisions to commit or recommit funds to new or ongoing uses. Thus, in addition to raising funds, financial management is directly concern with production, marketing and other functions within an enterprise whenever decisions are made about the acquisition or distribution of assets."

1.1 PROBLEM STATEMENT

The operating environment for the manufacturing industries in Nigeria is increasingly getting rough and complex. Through competition, harsh and inconsistent government policies, dwindling economic activities, tight monetary policies, unreliable sources of raw materials/capital and labour unrest etc. Though, of recent, government is showing commitment to arrest the situation with the establishment and introduction of new policies. Government policies of recent times include the establishment of People's bank, Community bank, NDE, NERFUND, FEAP and FSP all with a view to

assisting Small to Medium Scale enterprises to reach funds with ease.

The present economic condition is making the manufacturing industries more responsive and sophisticated since the task of attracting investors is now very tough. The investor has to be assured of the return on his investment with minimum risk. The restive and dwindling exchange rate is one major problem that is affecting the manufacturing sector. It also makes it very difficult for investors in the manufacturing sector to earn desired returns on their investments.

It is in the light of the above factors that a careful study on the financing sources of small-scale industries in Nigeria becomes very important. It is at this crucial time that the manufacturing sector needs reliable sources of capital/raw materials and at the same time conducive environment free of incessant change of government policies and stable consumer demand to guarantee profitable operations.

The one basic aim of this project is to explore means of raising funds for manufacturing industries in Nigeria with particular emphasis on small-scale industries. The small-scale industries are more or less the order of the day in developing Countries and other emerging markets like Nigeria. People now prefer to own and manage their businesses rather than own interest in large organisations where they can only be a party to Annual General Meetings and voting of the Directors. Sources of funds are another very important consideration that makes people now to prefer small-scale holdings. This is because, they are cheaper to establish, easier to manage and simpler to maintain.

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1.2 OBJECTIVES OF THE STUDY

The main objects of this study are:

a) To discuss and highlight the sources of funds available to an investor.

b) To highlight the relevance of Small Scale Industries in Nigeria against large-scale organisation.

c) To highlight the efforts of government in introducing policies that will encourage the establishment of Small Scale Industries.

d) To highlight the significance of manufacturing industries in economic development in Nigeria.

e) To discuss ways of securing external funds; and

f) To discuss implication of debt financing, amongst other objectives.

1.3 SIGNIFICANCE OF THE STUDY

The study is considered very important, vital and relevant because of the problem faced by Small Scale investors in securing financing. It is also important because government today has realised the wisdom in departing from the old thinking and is trying by all means possible to encourage people to establish their own businesses.

The study is equally vital because it seeks to introduce the concept of small-scale manufacturing and highlight its relevance to present day Nigeria.

1.4 SCOPE OF THE STUDY

The boundary of the study is strictly finance with particular reference to the manufacturing sector and the establishment of Makarfi Sugar Industries as a case study. It is for this reason therefore, that the study will cover relevant sources of funds and their implications on the operations of manufacturing industries.

The study will highlight the effort of the Kaduna State Government through KIFC in promoting the establishment of Makarfi Sugar Industries.

It will also try to consider the factors militating against the take-off of the industry several years after conception. The problems and prospects of Makarfi Sugar Industries will also be highlighted.

1.5 LIMITATION OF THE STUDY

Though, the researcher will want to deal with topic most desirably and comprehensively, certain factors will not allow the accomplishment of the desired task. Factors that will hinder the achievement include; time constraint; time is always not enough, for the accomplishment of certain goals; data constraints; some relevant data that will add to the colour of the study are not available at the desired period of time such that only available data is managed and put to efficient use. These and other factors will affect the scope of the study.

1.6 DEFINITION OF TERMS

Finance/Funds - Sum of money saved or made available to support an activity or for a particular project concern.

Financing - The application of funds specifically for a selected enterprise or activity.

Lease - A contract between lessor and lessee for the hire of a specific asset selected from a Manufacturer or Vendor with rental payments covering a specific period.

Small-Scale Enterprises - 1990 Industrial Policy of Nigeria defined Small Scale Industries as those with total investment of between one hundred thousand naira (N100,000.00) and two million naira (N2,000,000.00). It has since changed to conform with current economic realities.

Structural Adjustement Programme (SAP) - This is a set of comprehensive economic reform measures designed to achieve an overhaul of our economic focus with a view to improving productivity and adequate balance of trade/payment.

Capital - The amount of money reserved for investing in a business venture. It can be in form of cash (liquid) property (asset) or loan (debit).

KIFC	-	Kaduna Industrial and Finance Company Ltd
MSI	-	Makarfi Sugar Industries Ltd
NIDB	-	Nigerian Industrial Development Bank Ltd
NERFUND	-	National Economic Reconstruction Fund
NEXIM	-	Nigerian Export and Import Bank
SMEs	-	Small/Medium Scale Enterprises
NDE	-	National Directorate on Employment
FEAP	-	Family Economic Advancement Programme
SMIE'S	-	Small/Medium Industries Equity Investment Scheme
EIB	-	European Investment Bank
Project Cost	-	Total Funds employed in the establishment of a firm which is Equity plus Debit plus Working Capital.
Equity	-	Total contribution of shareholders or promoters to an enterprise divided proportionately through an agreed ratio.
Bonds	-	A bond is a written instrument issued by a firm that promises to pay back the money borrowed after a specific number of years as well as to pay interest to the holder at set intervals over the life of the bond.

CHAPTER TWO

LITERATURE REVIEW

2.0 INTRODUCTION

In any research report an overview of the topic under study is normally undertaken to give the reader an insight into the general literature of the topic. It is for this reason that a chapter is designed to cater for such purposes. In this chapter therefore, all relevant existing literature will be reviewed.

2.1.0 Conceptual framework of financing

Under this heading financing concepts will be reviewed to give the report a better and clear picture.

2.1.1 Finance

Finance has been defined to include the sourcing as well as the efficient allocation of the sourced funds to meet the needs of the firm.

2.1.2 Sources of Finance

Sources of finance means ways through which a firm can secure funds to meet its investment needs. Various ways of funds are available to a business concern but they are broadly classified under two headings: Internal and External sources of finance.

(a) **Internal source**:

This means funds can be generated internally within the business firm. A firm can generate such funds through equity, retained earnings/undistributed profits, depreciation allowances, sales of properties/right (goodwill) etc.

(i) **Equity**:

Though the sales of additional shares, a firm may raise extra funds for its operations. Financing through the sales of shares is known as

equity financing. Accumulated Reserves can also be capitalized to raise additional Equity.

(ii) **Retained earnings**:

This is the portion of profit for a particular trading year which is not distributed to shareholders. Normally, all business firm retained a particular percentage of profit each year. This serves as a very important source of fund for the organisation.

(iii) **Depreciation allowance**:

The amount that is annually set-aside for replacement of assets also serves as a source of funds for the firm. Firms normally charge a percentage in the profit of the operating year before declaring the dividend for the year and post it to the depreciation account. The balance in the depreciation, when accumulated, serves as a good source of finance for the business organisation.

(iv) **Sales of properties/right**:

At certain times a business may decide to sell some of its properties to raise extra funds. It is good to note that most of internal financing is short term in nature.

(b) **External Source**:

Funds that are generated outside the business organisations are normally referred to as external funds. And these could be generated through a number of sources amongst which include; Trade Credit, Bank Credit, Commercial papers, Note and Drafts, Banker's acceptance and Bonds.

External financing may be provided for either short or long term.

Short term financing:

Are funds that are needed for a period not exceeding one year.

Long term financing on the other hand is provided for a period of five years or even longer.

(i) **Trade Credit**:

Most businesses have the option to buy on credit from its suppliers. When such an arrangement come into play the firm is usually allowed to keep the supplies for a period of about 30 days or even 60 days before payment is made from the date of invoice.

(ii) **Bank Overdraft**:

Business organisation may also borrow money from banks. Such loans are granted for up to one year, and the collateral for these loans after consists of the firm's inventory or other specific assets, or it might be the general assets of the firm that are not pledged to other loans.

(iii) **Notes and Drafts**:

A note is a written evidence of debt prepared by the borrower and held by the lender until paid. It is a formal IOU. The person who borrows is the maker of the note and the one who lends is the payee. Usually a bank serves as a safe keeper of the note and handles the collection for the payee.

Drafts are another way to borrow funds outside the business. Drafts normally are prepared by the creditor and presented to the debtor. Drafts are payable on demand or at future date. Drafts do not have an additional charge of interest.

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(vi) **Bankers Acceptance**:

Are time drafts. It comes about when a bank sign a note, which means that if the primary creditor fail to pay on the due date, the bank guarantees that it will pay on the note.

(v) **Commercial papers**:

Only large well known, credit-worthy firms can borrow by issuing commercial paper to the public. Commercial papers are short-term notes carrying high rates of interest and with a life of 90 days to a year. They are issued in large volume to the investing public and are backed by the general assets of the firm not already pledged to other loans.

It is worthy to note that all the above sources are short term.

(c) **Sources of long term funds**:

(i) **Stocks**:

Is a proportionate share of ownership in a corporation. All buyers of stocks become owners of, with the right to vote for directors of the company and certain other issues affecting it. When the Board of Directors declared dividends, stockholders are entitled to receive a proportionate share of them. Stocks are of two types: Common stock and Preferred stocks.

(ii) **Common Stock**:

Common Stock owners are residual owners of the company and are normally called ordinary shareholders. They receive dividend after payment of all outstanding claims; interest on loan due, dividend on preferred share and etc. In the event of liquidation common stockholders receive income after the payment of all creditors and preferred stock and bondholders.

(iii) **Preferred Stock**:

This is a non-voting stock. Holders of such stock receives dividend before the common stockholders. Their stock can be participating or non-participating. It is participating when it is entitled to share in some manner prearranged with the common stockholders in the excess of funds paid on dividend over its contracted rate. Preferred stock can also be cumulative or non-cumulative. Cumulative preferred stock is that which is entitle to any dividend in arrears at specified Naira amounts or percentage rate per share before any current dividends are distributed to any other clan of stockholders. Preferred stock not qualified for this special arrangement is known as non-cumulative.

(iv) **Bonds**:

A bond is a written instrument issued by a firm that promised to pay back the money borrowed after a specific number of years as well as to pay interest to the holder at set intervals over the life of the debt. Such interest due is usually paid to holders semi-annually or as arranged. Bonds issued by a firm normally matured after ten or twenty years, when the principal amount borrowed (face value) is paid back to the holder. Buyers of bonds or bondholders are similar to any outside creditors and they have the same rights with that of a creditor.

Types Of Corporate Bonds

(a) **Debenture bonds**:

The debenture bonds are the type of industrial bonds which are issued without specific collateral. The general credit standing of the firm is the investor's only source of security.

(b) **Convertible bonds**:

These are bonds that can be converted in future into common stock. Convertible bondholders are paid a fixed rate of interest irrespective of the profit of the firm.

(c) **Mortgage bonds**:

These bonds occurred by a mortgage on some specific property of the firm e.g. building or land. In the event of liquidation the mortgage bondholders have first claim to the proceeds from the sale of any asset specified as collateral for the bond issue.

(d) **Collateral Trust bonds**:

These are similar to mortgage bonds, the only difference is that instead of equipment serving as collateral, common or preferred stock or other securities owned by the debtor firm is used.

(e) **Income bonds**:

These are bonds which interest payment is subject to realisation of profit within an operating year. As such if the company declares no profit the interest payment owed to the bondholder is passed and forgotten forever. The bonds attracts higher interest rate.

(v) **The Indenture**:

The indenture is the written contract that backs bond issue. The provisions of the indenture is usually outlined in the prospectus; which is a booklet that contain information (financial) and other information required by law to be given to every potential buyers of

new issues of corporate stock on bonds. Normally, the issuing firm chooses a trustee, the trustee represents the interest of the bondholder.

Cohen and Zinberg – 1973.

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2.1.3 FACTORS AFFECTING FINANCING DECISION

It has been discussed that a firm can make use of different sources of financing but at different costs. These sources may be, for purposes of exposition, classified into those that carry a fixed rate of return and those on which the returns vary. The fixed returns on some sources of finance have implications for those who are entitled to a variable return. Thus, since the debt involves the payment of a stated rate of interest, the return to the ordinary shareholders is affected by the magnitude of debt in the capital structure of a firm. The discussion here will focus attention on the relationship between capital structure and cost of capital and valuation of the firm. The main concern will be the effects of leverage on the aspects of the firm.

The term leverage may be seen as the employment of an asset or source of funds for which the firm has to pay a fixed cost or fixed return. Consequently, the earning available to the shareholders and also the risk are affected. If earnings less the variable costs exceed the fixed cost, or, earnings before interest and taxes exceed the fixed return requirement, the leverage is called favourable. When they do not, the result is unfavourable leverage.

There are two types of leverage: - "Operating" and "Financial".

The leverage associated with investment (asset acquisition) activities is referred to as operating leverage, while leverage associated with financing activities is called financial leverage. Operating leverage is determined by the relationship between the firm's sales revenue and its earnings before interest and taxes (EBIT). The earnings before interest and taxes are also generally called as operating profits. Financial leverage represents the relationship between the firm's earnings before interest and taxes (operating profits) and the earnings available for ordinary shareholders. The

operating profit (EBIT) is, thus, used as the pivotal point in defining operating and financial leverage. In a way, operating and financial leverage represent two stages in the process of determining the earnings available to the equity holders and, hence, their return-risk implication and their combined effect.

(a) **OPERATING LEVERAGE**:

Operating leverage results from the existence of fixed operating expenses in the firm's income stream. The operating costs of a firm fall into three categories:

(i) Fixed costs that may be defined as those which do not vary with sales volume; they are a function of time and are typically contractual; they must be paid regardless of the amount of revenues available.

(ii) Variable costs which vary directly with the sales volume; and

(iii) Semi-variable or semi-fixed costs which are partly fixed and partly variable. They are fixed over a certain range of sales volume and increase to higher levels for higher sales volumes,

Operating leverage therefore is the firm's ability to use fixed operating cost to magnify the effects of changes in sales on its earnings before interest and taxes. Operating leverage occurs any time a firm has fixed costs that must be met regardless of volume. Assets with fixed costs are employed in the hope that volume will produce revenues more than sufficient to cover all fixed and variable costs. Alternatively, with fixed costs, the percentage change in profits accompanying a change in volume is greater than the percentage change in volume. This occurrence is known as operating leverage.

Illustration:

A firm sells its products N100 per unit, has variable operating costs of N50 per unit and fixed operating costs of N50,000 per year. Determine the various levels of EBIT that would result from sale of:

(a) 1,000 units

(b) 2,000 units and

(c) 3,000 units

Assume 2,000 units as the base for comparison.

The EBIT for various sales levels would be as below:

Table 2.1: EBIT for Various sales levels

		(a)	(b)	(c)
1.	Sales in units	1,000	2,000	3,000
2.	Sales revenue (N)	100,000	200,000	300,000
3.	Less variable operating cost	50,000	100,000	150,000
		50,000	100,000	150,000
4.	Less fixed operating cost (N)	50,000	50,000	50,000
	EBIT (N)	0	50,000	100,000

From the result in table 2.1, certain generalisation follows:

(i) A 50% increase in sales (from 2000 to 3000 units) results in a 100% increase in EBIT (from N50,000 to N100,000).

(ii) A 50% decrease in sales (from 2000 to 1000 units) results in a 100% decrease in EBIT (from N50,000 to Zero).

Operating leverage can also be defined in terms of measurement of the degree of operating leverage (DOL). The degree of operating leverage (DOL) measures in quantitative terms the extent or degree of operating leverage. When proportionate change in EBIT as a result of a given change in sales is more than the proportionate change in sales, operating leverage exists. The greater the DOL, the higher the operating leverage.

Symbolically: DOL = $\frac{\text{Percentage change in EBIT}}{\text{Percentage change in sales}} > 1$

Applying the equation to our illustration, we get:

$$DOL = \frac{+\ 100\%}{+\ 50\%} = 2 \text{ (case 1)}$$

$$DOL = \frac{-\ 100\%}{-\ 50\%} = 2 \text{ (case 2)}$$

From the results, since DOL exceeds 1 in both cases, operating leverage exists.

Since operating leverage can be favourable as well as unfavourable, magnifying the effects of a change in sales, higher levels of risk are attached to higher degree of leverage. Since DOL depends on fixed operating costs, it logically follows that the higher the fixed operating costs, the higher the firm's operating leverage and its operating risk. High operating leverage is good when revenues are rising and bad when they are falling. Operating risk is the risk of the firm not being able to cover its fixed operating costs. The larger is their magnitude, the larger is the volume of sales required to cover all fixed costs. Therefore, the financial Manager may be interested in knowing the level of sales that is required to meet such fixed operating costs. Break-even analysis is a measure by which such a level of sales can be determined. It is also known as cost-volume profit analysis. Its usefulness is

that it enables the analysts to determine not only the level of sales which is necessary to cover all fixed costs but also evaluate the profitability or un-profitability at various levels of sales before break-even and after break-even points.

Assume that the Makarfi Sugar Industries had fixed operating costs of N2,000, other factors: price = N10 and variable cost = N6. Determine the Break-even sales in unit and no amount.

(i) Break-even sales in unit = S = F/P-V
S = 2,000/10-4 = 2,000/4=500 units

(ii) Break-even sales as amount = S = F/C and
C = P-V/P
Therefore C = 10-6/10 = 4/10 = 0.4 or 40%

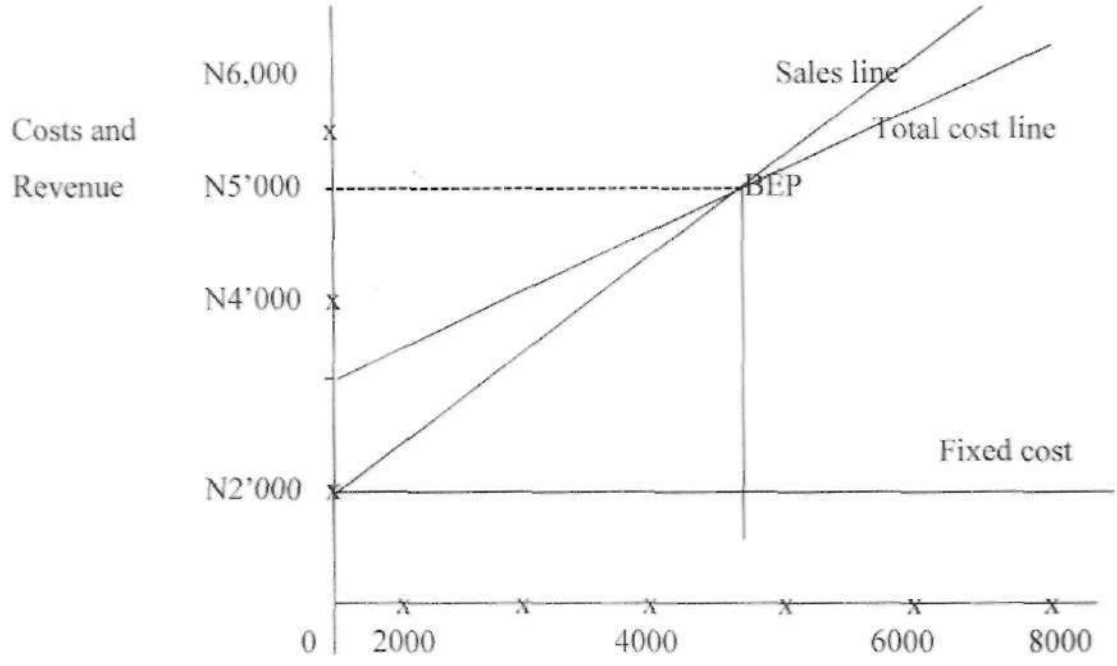
Therefore S = 2000/40% = N4,500

Where:

S	=	Sales
P	=	Price
F	=	Fixed cost
C	=	Contribution
V	=	Variable cost

Above results indicate that at sales level of 500 units or N5, 000, the firm EBIT would be zero. The firm will have positive EBIT for sales greater than 500 units or the leverage will start becoming favourable for sales less than 500 units the leverage will start becoming unfavourable, as the EBIT would be negative.

Graphically, the breakdown analysis could be shown thus:



From the graph it could be noted that the firm's break-even sales level at a point of time is based on the assumption that within the sales range of 0-1000 units, the fixed costs remain constant and there occurs change in per unit variable cost and the sale price of the product of the firm.

(b) **FINANCIAL LEVERAGE**

Financial leverage is related to the financing activities of the firm. The sources from which funds can be raised by a firm can, from the point of view of cost/changes, be classified into:

(i) those which carry a fixed financial change and

(ii) those which do not involve any fixed change.

The sources of funds in the first category consist of various types of long-term debts, including bonds, debentures and preference shares. The long-term debts carry a fixed rate of interest that is a contractual obligation for the firm.

Although, the dividend on preference shares is not a contractual obligation, it is a fixed change and must be paid before anything is paid to the ordinary shareholders. The equity holders are entitled to the remainder of the operating profits of the firm after the prior claims are met.

Financial leverage results from the presence of fixed financial charges in the firm's income stream. These fixed charges do not vary with the earnings before interest and taxes (EBIT) or operating profits. They have to be paid regardless of the amount of EBIT available to pay them. After paying them, the EBIT belongs to ordinary shareholders. Financial leverage is concerned with the effects of changes in EBIT on the earnings available to common shareholders. It is seen as "the ability to a firm to use fixed financial charges to magnify the effects of changes in EBIT on the firm's earning per share (EPS)". In other words, financial leverage involves the use of funds obtained at a fixed cost in the hope of increasing the return to the shareholders.

For this therefore, financial leverage is seen as "trading on equity". Furthermore, financial leverage is based on the assumption that the firm is to earn more on the assets that are acquired by the use of funds on which a fixed rate of interest/dividend is to be paid. The difference between the earnings from the assets and the fixed cost on the use of the funds goes to the equity holders. In a way, therefore, use of fixed-interest sources of funds provides increased return on equity investment without additional requirement of funds from the shareholders. However, in periods of persisting adversity when earnings are not adequate, the presence of fixed charges will imply that the shareholders will have to bear the burden. Thus, the leverage or trading on equity will operate in the opposite direction such that the earnings per share (EPS), instead of increasing, will actually fall as a result of the use of funds carrying fixed cost.

Favourable or positive leverage occurs when the firm earns more of the assets purchased with the funds, than the fixed cost of their use. Unfavourable or negative leverage occurs when the firm does not earn as much as the funds cost.

For example the Makarfi Sugar Industries Ltd expects that its earnings before interest and taxes (EBIT) in the current year would amount to N10,000. The firm has 5% bonds aggravating N40,000, while the 10% preference shares amount to N20,000. What would be the earning per share (EPS)? When EBIT is N6,000 (ii) N14,000, and how would the EPS be affected? Assume tax bracket of 50% and outstanding ordinary shares of 1,000.

The EPS for various EBIT levels would appear thus:

Table 2.2 EPS for various EBIT levels

	Case 2	Base	Case 1
EBIT	6,000	10,000	14,000
Less interest on bonds	2,000	2,000	2,000
Earning before tax (EBT)	4,000	8,000	12,000
Less taxes (50%)	2,000	4,000	6,000
Earnings after tax (EAT)	2,000	2,000	6,000
Less preference dividend	2,000	2,000	2,000
Earnings available for Ordinary shareholders	0	2,000	4,000
Earning per share (EPS)	0	2	4

From the result in table 2.2 certain conclusions follows:

Case 1: A 40% increase in EBIT (from N10, 000 to N14, 000) results in 100% increase in EPS (from N2 to N4).

Case 2: A 40% decrease in EBIT (from N10, 000 to N6,000) leads to a 100% decrease in EPS (from N2 to Zero).

In another way the Makarfi Sugar Industries Ltd may decides to 100,000, 10% debentures with 5,000 equity shares outstanding. Its tax bracket remain 50% but EBIT levels change to

(i) N50,000

(ii) N30,000 and

(iii) N70,000

What would be the effect on EPS?

The EPS for the various EBIT levels would appear thus:

Table 2.3 EPS for various EBIT levels

	Case II	Base	Case 1
EBIT	30,000	50,000	70,000
Less interest	10,000	10,000	10,000
Earnings before taxes (EBT)	20,000	40,000	60,000
Less taxes	10,000	20,000	30,000
Earnings after tax	10,000	20,000	30,000
Earnings per share (EPS)	2	4	6

From the result in table 2.3 it could be seen that a 40% increase in EBIT in case II from the base level of EBIT has led to 50% increase in EPS. But a decrease of 40% in EBIT has decreased the EPS by 50%.

It should be clearly noted that the presence of fixed-interest source of funds had led to a more than proportionate change in EPS as a result of change in EBIT level. It can also be deduced that whenever a firm has fixed cost in its capital structure, financial leverage is present. The greater is the amount of fixed-interest sources of funds and, therefore, larger fixed financial cost, the higher is the financial leverage. For instance, from the results obtained in the

two examples it could be seen that the amount of fixed cost in the first instance is higher than in the second instance owing to the preference dividend. As a result of this difference the proportionate change in EPS was much higher (+100%) for the first instance as compared to (+50%), though, the change in EBIT in both case is the same (+40%).

Financial leverage could also be defined in terms of the degree of financial leverage (DFL). The DFL can be calculated using the formula thus:

$$\text{DFL} = \frac{\text{Percentage change in EPS}}{\text{Percentage change in EBIT}} > 1$$

Applying the formula to case 1 and 2 in illustration one regarding Makarfi Sugar Industries, the following result would be obtained:

$$\frac{+100\%}{+40\%} = 2.5 \text{ (case 1)}$$

$$\frac{-100\%}{-40\%} = 2.5 \text{ (case 2)}$$

From the results it can safely be said that financial leverage exists because in both cases the quotient is more than one. It is good to note that the higher the quotients of percentage change in EPS and percentage in EBIT, the greater the degree of financial leverage. It is also important to note that there is no financial leverage if there is no fixed-charged financing.

A firm has the choice to raise funds for financing its investment proposals from different sources in different proportion. For instance, it can

(i) exclusively use equity capital;

(ii) exclusively use debt;

(iii) exclusively use preference capital;

(iv) use a combination of equity and debt in different proportions;

(v) use a combination of equity and preference capital in different proportions, and etc. The choice of the combination of the various

sources (financial plan or capital structure) would be one which, given the level of earning before interest and taxes, would ensure the largest EPS.

2.2.0 CONCEPTUAL FRAMEWORK OF SMALL SCALE INDUSTRIES

Present day Nigeria is constantly changing as the environment for operating business is increasingly becoming complex and challenging. For this reason, therefore, it becomes pertinent to make a review of the Small Scale Industries in Nigeria with particular reference to the efforts of the Federal Government of Nigeria in encouraging and enhancing small Scale Industries establishment in the Country. The study is designed in such a way that a critical review of recent economic policies that affect the establishment of Small Scale Industries as well as the problems and prospects of the Small Scale Industries can be analysed and feasible solutions proffered.

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2.2.1 SMALL BUSINESS DEFINED

Business concerns may be differentiated as either being small, medium or large. What is seen as large-scale business may turn out to be small or medium scale business over time, this is as a result of the factors that affect the growth and development of business. Such factors are: level of economic development of a Country, yardstick for measuring business performance (asset value, turnover rate, number of employees, and size within the industry) etc.

The World Bank define Small and Medium Scale enterprises as those with assets plus cost of investment (excluding land) not exceeding N10 million in constant 1988 prices. The Centre for Economic Development (C.E.D.) in the United States of America sees Small/Medium scale enterprises as the one which satisfies at least two of the following characteristics:

i - Managers are usually the owners

ii - Capital is provided by an individual/owners or a small group.

iii - The area of operation is local.

iv - Size within the industry is relatively small

In the Nigerian context, Small Scale Industry is the one which has a total investment (excluding cost of capital but including working capital) of between N100,000 to N2,000,000.

2.2.2 SOURCES OF FINANCE FOR SMALL/MEDIUM SCALE ENTERPRISES

The various sources of funds discussed in this chapter under 2.1.2 are applicable to Small/Medium Scale Enterprises so also the various programmes and policies of government discussed in 2.2.3. It should be noted that most of these policies are initiated with the sole aim/purpose of providing funds for Small/Medium Scale Enterprises.

2.2.3 ROLE OF GOVERNMENT IN REGULATING SME

A small business is the one that is self-initiated, largely self-reliant, closely self-managed and is of relatively small-size when considered as part of the whole industry. Small businesses are of paramount importance to the economic development of a Country. In Nigeria for instance small businesses provides job opportunities to millions of Nigerians and also encourage local indigenous technology.

It is in recognition of the importance of Small/Medium Scale Enterprises (SME) that the Federal Government of Nigeria initiated policies and programmes, and play active role in stimulating SME's growth and development in the Country. The objectives that the government intends to achieve by implementing its policies regarding SME include amongst others the followings:

(i) Industrial development and national integration through industrial dispersal;

(ii) Provision of greater employment opportunities;

(iii) Increased production of manufactured goods;

(iv) Development of indigenous technology;

(v) Increasing local content of industrial output;

(vi) Increase utilization of local raw materials; and

(vii) Encouraging the manufacturing sector to produce for export and improve Forex earnings.

The government's policies towards SME's growth and development include amongst others;

(i) Providing infrastructural facilities by setting up of industrial estates and areas (to reduce overhead costs)

(ii) Provide local finance through its agencies particularly the Nigeria Industrial Development Bank (NIDB), the Nigerian Bank for Commerce and Industries (NBCI), National Economic Reconstruction Fund (NERFUND) etc.

(iii) Establishment of Industrial Research and Development Centres.

(iv) Establishment of Raw Materials Research and Development Council (RMRDC).

(v) Facilitating and guaranteeing external finances through International Financial Institutions such as the World Bank, IFC and the African Development Bank (ADB).

In 1971, the Federal Military Government started to provide a more direct form of financial assistance to Small and Medium Scale Enterprises (SME). It set up a small-scale Industries Development Programme to provide technical and financial support for SME's. Thereafter, it established Small Industrial Credit Committee (SICC) to administer Small Scale Industries Credit Fund (SICF) throughout the Country. In the third national development plan (1975 - 1980) the SICF was formally launched as the Small Scale Industries Credit Scheme (SSICS). The scheme was operated as a matching grant between the Federal Government and the State Government and it was designed to make credit available on liberal terms to enterprises with capital

investment outlay not exceeding N150,000.00.

The Industrial Development Centre was first set-up in 1962 in Owerri by the then Eastern Nigerian Ministry of Trade and Industry, and in 1970 the Federal Government took over the Owerri IDC. In the second National Development Plan (1970 - 1975) N800, 000 was allocated for setting up IDCs throughout the Federation. Essentially, Industrial Development Centres were aimed at providing extension services to SMEs in terms of technical appraisal of loan application, training of entrepreneurs, Management assistance, product development, production planning and control, and other extension services.

State governments throughout Nigeria via their IDCs and Ministries of Commerce and Industries also promoted the development of SME's. The Oyo State government for instance allocated N10, 000,000 in 1987 for industrial fund aimed at assisting Small and Medium Scale Industrialist.

Recent government efforts aimed at promoting SME's include National Economic Reconstruction Fund (NERFUND), Peoples Bank, National Directorate Employment (NDE), Community Banks, Family Economic Advancement Programme (FEAP), World Bank assisted loan schemes etc. Most of these Institutions were established to provide funds to the SME's as catalysts to the much needed industrial growth of the Country. The benefit is that SME's are likely to project the Country's industrial development faster than the large scale industrial set ups that have been difficult to complete all over the Country.

(a) **National Economic Reconstruction Fund (NERFUND)**

The NERFUND was established by the promulgation of Decree No 2 of 1989 with the primary aim of mobilising long term financial resources for the development of indigenous Small and Medium Scale enterprises which were hitherto faced with the problem of inadequacies of funds in both Naira and

foreign currencies. The funds are to be disbursed to eligible project through participating banks for the importation of their machinery and equipment. Only a maximum of N10,000,000.00 can be granted to any particular project or enterprise. The amount made available at the inception of the programme comprises:

(i) N300 million in local currency

(ii) US$550 million out of which US $50 million can be utilised only in purchasing machinery and equipment form Czechoslovakia.

For an enterprise to be eligible to apply for the funds it must be 100% owned by Nigerians. The project must have a total fixed assets cost (excluding land) of not more than N10,000,000.00 in 1988 constant prices. And that manufacturing concern must be able to source locally at least 40% of their raw materials at the beginning and thereafter increase to 60% in the future.

(b) **Peoples Bank of Nigeria (PBN)**

The Peoples Bank scheme is meant for the less privileged/poor people who due to non-availability of collaterals can not have access to the facilities obtainable in Commercial/Merchant banks. The maximum amount obtainable was N2,000.00 at inception while the minimum was N50.00. The maximum amount has however been increased to N5,000.00 in 1991. The loan is interest-free, but an administrative fee of 5% is chargeable for any amount secured. The tenor is one year (52 weeks) and a grace period of 2 weeks (moratorium) for trade loans, variable for agricultural and industrial credits.

The facilities provided by PBN include: granting of credit (loans) provision of savings account/current account to customers. Beneficiaries include Small Scale farmers and petty traders.

(c) **National Directorate for Employment (NDE)**

The broad objective of the Directorate is to promptly and effectively combat unemployment through the design and implementation of radical strategies to prepare the beneficiaries for gainful employment.

- The provision of training opportunities for participants
- Guidance and finance to the unemployed citizens for the creation of jobs for themselves and others.

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The programmes of the NDE include:

(i) Youth Employment and Vocational Skill Development

(ii) Small Scale Industries and Graduate Employment

(iii) Special Public Works

(iv) Agricultural Programmes

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Small Scale Industries Loans (SSI loans) are provided the following categories after the required training:

(i) Graduate job creation loan scheme - N25, 000 - N35, 000

(ii) Mature peoples scheme - N150, 000

(iii) School leavers loan scheme - N2, 000 to N10, 000

(iv) Graduate Agricultural loan scheme - N11, 500 to 13,500

Beneficiaries of any of the above facilities must undergo the Entrepreneurship Development Programme (EDP) which trains participants in project identification, feasibility studies, resource mobilisation and marketing.

(d) **Community Banks**

The Community Bank is a self-sustaining financial institution, owned and managed by a Community or a group of Communities for the purpose of providing credit, deposit, banking and other financial services to its members,

largely on the basis of their self recognition and credit worthiness. This is a radical departure from the rear total reliance by the orthodox banks on viable and negotiable collaterals as the basis for granting credit.

The bank is aimed at promoting rural development by providing financial and banking services (credit and deposit services) to communities inadequately supplied with such services. enhancement of the development of productive activities in the rural areas and hence the improvement of the economic status of both the rural people and the rural areas, and the promotion of the emergence of an effective and integrated national financial system that responds to the needs of the whole economy, from the individuals and ground roots community levels, through the level of Local Government Areas and States to the National level.

(e) **<u>African Development Bank (ADB)/Export Stimulation Loan (ESL)</u>**

The objectives of the ADB is to stimulate Nigeria's non-oil exports by providing foreign loans to support:

(i) Small/Medium Scale Enterprises engaged in production, processing or manufacturing for export or exportable goods;

(ii) Small/Medium Scale Enterprises through commercial/merchant banks, by providing short and medium term export loans;

(iii) Nigeria's non-oil export sector and

(iv) Utilisation of local raw materials/intermediate goods by industrial enterprises so as to save foreign exchange and provide a solid base for competitive export, among others.

The facilities available under this programme include term loan for the acquisition of fixed assets and working capital finance for the purchase of raw materials and spare parts. The goods that can qualify for importation from member countries of the ADB include: Industrial raw materials, spare

parts, agricultural inputs, packaging materials and capital equipment. Small and Medium Scale enterprises with investment excluding cost of land not exceeding US $350,000 are eligible to apply for loan provided they are registered as a limited liability company, they produce, process or manufacture for direct export or exportable goods and they have local material content of their products in excess of 40% or local value added in excess of 35%.

Interest charges ranges between 9.5% to 10.5% on working capital and capital equipments respectively. The participating banks charge administrative charges. The tenor for non-capital investment shall be 18 months while a maximum of 5 years goes for capital investment.

(f) **European Investment Bank (EIB)**

The EIB facility is available to finance Small and Medium sized projects in the industrial, agro-industrial, mining and tourism sectors of the economy. Both working capital and term loan ca be obtained under the facility. And the facility is obtainable through primary borrowers such as NIDB, NNDC, NBCI etc, who normally determine the allocation of the facility to the eligible enterprises. Maximum lending per project is US $3.5 million or 50% of total project cost whichever is lower, and minimum lending is US $38,000. The maximum tenor for this facility is 13 years, with ranges from 3-10 years. The interest rate is fixed at 16% per annum on term loan and 20% per annum for working capital. The interest rate may however vary due to risk assessment variation from organisation to organisation. The EIB facility is normally provided in foreign currency and the payment of interest and the principal sum would be in equivalent foreign currency, at exchange rate ruling at the date the Central Bank of Nigeria effects remittances. Collaterals may however be tangible assets.

(g) **World Bank Loan for Small and Medium Scale Enterprises Scheme**

A World Bank Loan of US $270 million has been made available through Central Bank of Nigeria for development of existing and new small and medium scale enterprises in the private sector with fixed assets (excluding land) plus cost of investment project not exceeding N15.184 million in June 1988 and N607,000 in June,1989 prices in case of Micro-Enterprises. The projects that can be financed under this scheme include; manufacturing and Agro-Allied, Mining, Quarrying, Equipment Leasing and Industrial Support Services and etc. Eligible Small/Medium Scale Enterprises who can apply for this facility must be 100% owned by Nigerians and at least 40% of their raw materials must be locally sourced.

The available facilities include: Line of credit to finance fixed assets and working capital, the total amount available was US $200 million. Pilot finance Restructuring; to finance the restructuring of existing projects that are in financial difficulties but are viable, equipment leasing, pilot studies facility; to provide finance on long terms for pre-feasibility implementation studies, management and technological know-how and solve operational problems, etc.

The loan is denominated in Naira and repayment shall be in Naira. Federal Government indemnifies borrowers under this scheme. The tenor vary between 2 and 12 years depending on the type and purpose of facility taken, within moratorium period varying between 6 months and 3 years, again depending on the type of facility. Interest rate shall be variable, determined and adjusted by the Banks in accordance with changes in the CBN Minimum Re-discount Rate (MRR) from time to time. The maximum loan that can be granted to a beneficiary or a group of related beneficiaries is N10 million or 70% of the total project cost whichever is higher. Project promoters would be expected to contribute a minimum of 30% of the cost of

project. Security may be on fixed or floating assets of the enterprise. Additional security may be required where necessary.

(h) **Family Economic Advancement Programme (FEAP)**

The Family Economic Advancement Programme (FEAP) was announced in the 1997 budget speech by the then Head of State, General Sani Abacha. The goal of the programme is to promote investments and encourage the establishment of cottage industries in all the wards of each local government to stimulate appropriate economic activities across the country. It is also aimed at alleviating poverty through the utilization of local raw materials and indigenous technology to raise the economic power of the family and further improve the economic development of the country.

Specifically, FEAP was established by Decree 11 of August 12, 1997 to function as a Parastatal under the Presidency. The main functions of FEAP, therefore, are:

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(i) Provision of capital needed by way of loans directly to people at Ward level to enable the them set up and run their own cottage enterprises;

(ii) Provision of opportunities for the training of ward based business operators;

(iii) Reducing rural-urban migration;

(iv) Encouraging the design and manufacture of appropriate plants, machinery and equipment locally;

(v) Encouraging producers at ward level to form cooperative societies;

(vi) Creation of employment opportunities at ward level, and

(vii) Improving the living standard of the people, among other functions.

The first task in obtaining the FEAP loan is registration with FEAP as a cooperative society or a family group, then an account is open with any

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designated FEAP banks and deposit 10% of the amount to be requested as loan. The initial 10% deposit of loan required by the cooperative society is mandatory for any group wishing to benefit from the loans. And such deposits are not to be withdrawn until after repayment. All projects to be executed by FEAP loans are insured by NICON and NAIC at cost of 2% insurance premium. Such payments are to be made by participating banks from beneficiaries' savings account (1%) and FEAP call interest account (1%). Beneficiaries of the loans are expected to select equipment fabricators among those accredited by FEAP.

The first batch of loan disbursement by FEAP was released on the 3rd of September, 1998 totaling N426,882,500 for about 2,855 cooperative societies. And for the second batch disbursement, a total of N1.3 billion for about 10,000 cooperative societies have been processed and approved. It is worthy to note that the sum of N5.18 billion was budgeted by FEAP in 1998 for disbursement as loans for micro and small-scale enterprises. The table below shows the summary of second disbursement:

S/NO	STATE	APPLICATION	REJECTED	ACTUAL REQUEST	RECOMMENDED
1	Abia	62	2	20,360,000	12,500,000
2	Adamawa	67	0	23,519,470	10,840,000
3	Akwa Ibom	116	2	28,259,000	17,730,000
4	Bauchi	396	0	117,654,645	59,250,700
5	Bayelsa	148	5	41,691,000	18,395,000
6	Anambra	35	0	13,650,000	8,450,000
7	Benue	312	1	93,835,000	51,651,000
8	Borno	273	10	72,251,000	31,030,000
9	Cross River	102	0	36,220,000	18,330,000
10	Delta	90	0	36,800,000	19,990,000

11	Ebonyi	241	0	65,050,000	39,950,000
12	Edo	113	0	25,841,000	13,300,000
13	Ekiti	51	0	14,252,000	9,050,000
14	Enugu	167	2	46,450,000	30,600,000
15	FCT (Abuja)	233	6	87,746,000	41,315,000
16	Gombe	418	1	92,312,650	48,985,500
17	Imo	147	0	40,170,000	28,275,000
18	Jigawa	167	4	56,682,860	26,210,000
19	Kaduna	174	0	62,275,000	26,078,000
20	Kano	735	45	280,332,750	114,335,000
21	Katsina	419	7	135,454,360	62,585,000
22	Kebbi	354	13	57,174,300	30,165,000
23	Kogi	419	11	116,657,000	58,715,000
24	Kwara	82	0	23,060,000	13,905,000
25	Lagos	148	0	68,370,000	33,170,000
26	Nasarawa	392	15	68,810,000	46,636,000
27	Niger	390	3	118,967,500	52,670,000
28	Ogun	74	0	29,804,200	14,780,000
29	Ondo	224	0	80,638,000	45,100,000
30	Osun	56	1	16,609,840	9,360,000
31	Oyo	93	0	20,307,400	13,280,000
32	Plateau	602	4	156,224,400	85,400,700
33	Rivers	279	0	135,207,800	45,190,000
34	Sokoto	566	11	157,491,452	7,679,600
35	Taraba	144	1	53,600,000	21,177,000

36	Yobe	222	8	59,647,000	25,764,000
37	Zamfara	407	2	129,225,000	48,770,000
	Total	8,918	154	2,687,603,027	1,309,818,400

Source: ASOCORPS VOL 4 No 4, DECEMBER 1988

The total funds allocated to Kaduna State amounts to N160,000,000 out of which 83,168,000 have been disbursed in the first and second batch disbursement through the participating banks.

2.2.4 PROBLEMS OF SME

All business enterprises whether large or small face problems which sometimes caused the business to fail. The followings are some of causes of business failure.

(a) **Lack of Management Ability**:

Poor Management in one of the serious operating problem of small business. For most of these businesses, the owners are often the managers and they lack the necessary skill and experience needed for effective management.

(b) **Lack of Proper Credit/Debt Control**:

Most small businesses are in the habit of extending unwarranted credit, this caused a very serious problem in the liquidity position and therefore a great cause of business failure.

(c) **Excessive Overhead and Operating Costs**:

Some small businesses tie up too much money in fixed assets (land, equipment) others lack adequate expenses controls as they carry habits of personal extravagance into the business. Such could lead to heavy operational expenses and consequently business failure.

(d) **Competitive Weakness:**

Some small business operators lack the managerial foresight of predictive the environment, as a result they fall victims of competitive advantage. Some small businesses lack product planning and this is a serious problem for the small business owner.

(e) **Financing:**

Despite the fact that there are several sources of raising capital for small business, the issue of raising capital is a problem of major importance to many small businesses. For instance financing small business through equity capital has a great disadvantage; investors insist on a greater degree of control of the enterprise. Also when compared to large business concerns, small businesses are at disadvantage when it comes borrowing money because interest rates of secured funds is the same with that of large firms. The effects of inflation and unfavourable tax policies may be so heavy that the typical small business may find it difficult to retain sufficient profit to set up reserves against bad years let alone to provide for growth and expansion.

2.2.5 **SUGGESTED SOLUTIONS TO PROBLEMS OF SMB:**

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1. Careful study of the market to ensure that business opportunity exists.
2. Strategic location with particular reference to the market but also bearing in mind resources and transportation of goods.
3. A well-planned sales promotion programme.
4. Application of modern method, research and scientific approach to solution of the problem of the business.
5. Management ability and background that possess the following:
   a) Sound policies that are flexible to meet changing business conditions.
   b) Vigilant control of investment, credit, etc.
   c) The ability to win and maintain confidence.
   d) The ability to direct, lead and inspire others.

e) Ability to apply strict cost control and minimize excessive running cost

2.3.0 SUGAR MANUFACTURING IN NIGERIA

The product "Sugar" is a world wide sweetening agent manufactured from **sugar cane** in the tropical climate and **sugar beet** in the temperate and monsoon climates. Sugar is primarily used by most homes in Nigeria as sweetener in breakfast beverages (cocoa, coffee, tea, etc) pap, oat, custard, gari and also to flavour some food items such as yams and beans. Industries such as breweries, bottling companies and confectionaries are a good example of industrial users of sugar.

However, sugar manufacturing is within the food-processing sub-sector in the manufacturing sector of the Nigerian economy. Before the advent of western technology in sugar manufacturing, Nigerians produced sugar locally from sugar cane. Sugar cane is a giant grass belonging to the genius saccharin. All sugar canes are nearly of the same specie. However, difference in climate condition (climate) affect the features of its juice. If well grown the stem contains over 85% juice. The composition of sugar cane is as stated below:

Water	75%
Soluble solids	10 - 15%
Fibre	11 - 15%

It should, however, be noted that sugar cane juice contains impurities like Acid, Wax, Gum and Phosphate Areas in Nigeria that are suitable for commercial sugar cane production include: Adamawa, Taraba, Kwara, Kogi, Kaduna, Niger, Kano, Bauchi, Oyo and all riverine areas of Nigeria. (NSDC, sugar production in Nigeria, (1999).

The plant matures for harvest after 10 - 12th months of planting. A good crop of sugar cane could be obtained consecutively for up to four years from a plantation replanting simply by good maintenance of the rooting crops after each harvest.

Currently, three sugar producing companies have sugar cane plantations in Nigeria as follows:

Company	Area cultivated	Production capacity
Savannah	250,000 hectares	500,000 tons
Nig. Sugar Co Ltd	5,000 hectares	60,000 tons
Tate and Lyle	2,300 hectares	44,000 tons

Furthermore, sugarcane and its by-products, molasses and bagasses, have industrial applications. The following industries utilize sugar as an important raw materials:

INDUSTRY	USAGE
Confectioneries	(Sweet, candies, fondants, chocolate toffees, and acts as preservative)
Bottling plant	(Carbonated soft drinks manufacturing and preservative)
Food and Beverages	(Jams, marmalades, jellies, drinks, biscuits, bakeries and cereals)
Pharmaceuticals	(Sweetener for bitter drugs)

National Sugar Production Importation and Consumption 1990 to 1999

(Importation Tonnes)

Year	Consumption (Tonnes)	Production (Tonnes)	Quantity	Cost $360/ton
1990	645,248	41,478	603,770	217,357,200
1991	773,463	44,893	728,570	262,285,200
1992	598,986	32,420	566,566	203,963,760
1993	405,590	28,576	377,014	135,725,040
1994	360,060	22,814	337,038	121,408,560
1995	358,038	20,000	338,038	121,693,680
1996	525,986	12,104	513,882	184,997,520
1997	552,573	15,805	535,768	192,876,480
1998	773,264	9,850	763,414	274,829,040
1999	781,782	10,000	771,782	277,841,520

NB: Consumption is taken a simple addition of yearly production and importation.

Source: National Sugar Development Council Data.

Before 1964 Nigeria imported over 95% of its sugar requirements, but with the establishment of sugar manufacturing plants in the country the situation has changed, although the change is not very significant. The country even at today imports more than 90% of its requirements. There is currently no restriction on importation of sugar into the country but a reasonable import tariff has been maintained to encourage the local plants.

2.3.1 DEMAND AND SUPPLY

Sugar usage in Nigeria has no reliable statistics or records, but Alhaji Abubakar of Savannah Sugar Council put the local demand for sugar in 1990 at one million metric tonnes per annum. The Nigerian plants all put together produce less than 100,000 metric tons per annum. The remaining balance is by way of importation. It shows that there is a wide gap between the demand for sugar and its supply in the country production wise. This also has the potential of serious disadvantage for the country.

What is more baffling is the fact that the country has the capacity and the capacity to improve the local manufacturing level but not much effort was put towards increasing the manufacturing capacity over the years. This was partly due to the fact that past efforts have all been promoted and financed by the Federal Government. As we all know government's are never in a hurry to do their assignments. No industrial establishment of Government was completed within the time and cost originally envisaged. As a result the only two companies established by Government i.e. Nigeria Sugar Company Ltd Bacita and Savannah sugar Company Numan were not fully functional and their running cost were at variance with their results.

It is therefore, imperative that if we, in Nigeria are desirous of increasing our manufactured sugar quantity we need to establish more factories. Since the established of large scale factories is very expensive and time consuming, our solution lies in the establishment small scale ones which could be scattered in the sugar cane producing areas and managed by small holders mostly owners or with State Government complementary participation.

This was what informed us in Kaduna Industrial and Finance Company Ltd, an investment arm of Kaduna State Government, to pursue the setting up and implementation of Makarfi Sugar Industries Ltd at Makarfi, one of the largest sugar cane producing areas in the country.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 INTRODUCTION

The chapter will deal with the overviewed of the various methods of collecting data and will also highlight the methods that will be adopted for this study.

3.1 RESEARCH METHODOLOGY

Research is a process of arriving at a dependable solution to problems through planned and systematic collection, analysis and interpretation of data. It is devoted to finding the conditions under which a certain phenomenon occur and the conditions under which they do not occur. Research is an important tool for advancing knowledge for promoting progress and for enabling man to relate more effectively with his environment to accomplish his purpose and resolve his conflicts.

The validity or otherwise of a research work is to a large extent dependent on the research approach being employed. It could be seen that there are various ways of carrying out a research project, but the adoption of a particular method of a research is usually influenced by the nature of the problem being studied.

3.2 DATA COLLECTION

The various ways through which data can be gathered include amongst others the followings study of existing literature, interview, questionnaire and observation. It is important however, to note that the purpose of any research work is to explore, describe and explain a topic under study. And for any research work to be valid, the research work should embrace accuracy and precision in analysing and explaining data. It is equally important to note that method is merely an operational framework within which facts are placed so that a clear meaning could be given to them. The most important methods of data collection are:

(a) **Questionnaire**

A questionnaire is an instrument for collecting the data beyond physical reach of the observer. It attempts to secure answers to question by using a means that the respondent fills in himself. Questionnaire may be sent to respondents who will take away and whom the researcher may or may not see. Questionnaires need to be written in simple and clear language, they should be designed to fulfil a specific research objective and at the same time very brief and concise. One important feature of a questionnaire is that it should be limited in its length and scope, and it can be used to obtain facts about past, present and anticipated events, about prevailing conditions and practices and to obtain information on people's attitude and opinions.

Questionnaires may be of two categories:

(i) Closed or structured questionnaires and

(ii) Open or un-constructed questionnaires

(b) **Interview**

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The interview involves face-to-face contact with members of the public concerned. The face-to-face interaction situation in which one person (the interviewer) asks another person (the interviewee) questions which are responded to orally. Interviews permit the researcher to obtain direct first hand information. An interview could be structured in such a way that the interviewer has a planned series of questions or it could be instructed with very important topics.

Advantages of Questionnaire

1. **Less expensive**
2. Can be used to cover large population
3. Can be used in a wider area
4. Create greater confidence

Disadvantages of Questionnaire

1. People may not be willing to give information to an unknown person
2. It is not suitable in an illiterate community
3. It can be a waste of time on the part of the researcher when the information is urgently needed.

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Advantages of Interview

(i) It is easy to use even in illiterate environment

(ii) It offers better opportunity in appraising validity of a response

(iii) Helps to approximate various social parameters in a given society.

Disadvantages

(i) It may create bias in the selection of people to be interviewed

(ii) Interpretation of the result depends to a large extent on the researchers ability

(c) **Study of existing literature**

This method involves reading around the subject i.e. a study of existing records and documents that relate to the subject under study. This method often proves to a useful starting point for a researcher's fact-finding work. It enables the researcher to connect the past with the present. It attempts to update knowledge for the present state.

Sources of data could be gathered through documentary records, official records, minute of meeting, committee reports, legal documents, bulletins, biographies, diaries and etc.

Observation

Observation is an instrument used to obtain direct information about a phenomenon. By this method, the researcher is able to see at first hand, the characteristics behaviours of the phenomenon under study. One important requirement for using observation is that the researcher should develop check lists and schedules for recording data, thus to ensure accuracy of information. This method is more useful in a scientifically related research that requires a lot of laboratory experiments.

3.3 RESEARCH METHODS USED

The validity or otherwise of any research work is to a large extent dependent on the methods of collecting data employed and also the method of analysing the collected data. The adoption of a particular method of collecting and analysing data is usually influenced by the nature of the problem being researched. For the purpose of this particular project study of existing literature and interview was used to help gather relevant data.

3.3.1 JUSTIFICATION OF THE METHODS USED

The employment of interview and the study of existing literature was justified considering the nature of the research work. Interview created face-to-face contact with professionals and practitioners and other intellectuals in the field of finance. Interview provided first hand information regarding the phenomenon under study.

The use of the study of existing records is justified by considering the fact that it is when the past and the present situations are studied that a clear, sound and solid foundation for the future could be built. Both methods are used because of there

efficiencies in providing information and the time taken to supply the required information. It is also relevant in the sense that the subject of our study is an on-going project which is still in the implementation stage, such that new data is continuously being built while new hypothesis are also coming up as we go along.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.0 INTRODUCTION

In the previous chapters of this project an overview of the literature of the topic was deeply dearth and in chapter three a thorough analysis of methods of collecting data was carried out. In this chapter, therefore, an attempt would be made to present and analyse the gathered data of this research work.

As mentioned in chapter two the existing wide gap between supply and demand of refined sugar in Nigeria provided Kaduna Industrial and Finance Company Limited (KIFC) the incentive and encouragement to promote a mini-sugar refining plant at Makarfi town.

4.1 KADUNA INDUSTRIAL & FINANCE COMPANY LTD (KIFC)

Kaduna Industrial and Finance Company Limited (KIFC) was incorporated on 13th February, 1989 as a Development Finance Institution wholly owned by Kaduna State Government with an initial share capital of N10 million divided into 10 million ordinary shares of N1.00 each. It commenced operation on 1st April 1989 having inherited the Kaduna State interest in the defunct Kaduna Investment Company Limited (KICL) which was liquidated as a result of the creation of Katsina State out of the former Kaduna State. The authorized share capital of KIFC had since been increase to N30 million to cope with the present day financial requirements of the industry.

As a Development Finance Institution, KIFC is charged with the primary objective of assisting to accelerate the pace of industrial development of the State in particular and the country in general, other organisational goals includes:

(a) Supervising State Government investments in major sectors of the economy.

(b) Investing in economically viable and socially desirable projects.

(c) Promoting and developing commercially viable industrial projects in the State in collaboration with other interested local and foreign investors both individual and institutional.

(d) Providing free advice to indigenous entrepreneurs with a view to modern business approach particularly in the establishment of industries.

(e) Researching into matters of industrial development, monetary and economic policies.

(f) Engage in capital market operations and provide consultancy services; etc.

The challenge of KIFC has been to answer the call of its objectives by way of setting viable industrial projects around the States. to fulfil that in 1990 a study was conducted, in the State, of the availability of raw materials and what industries could be promoted to utilize these raw materials. The result of the study gave the company four immediate companies that could be promoted in line with the availability of raw materials, availability of market and supply of cheap labour. The four industries slated for promotion were:

(1) Mini-sugar refining at Makarfi

(2) Gemstone cutting and Polishing at Kafanchan

(3) Fruit juice concentrate production at Zagon Kataf; and

(4) Printing Ink Manufacturing at Kaduna.

Pre-feasibility studies were conducted for each project and were all found to be viable with varying degrees of implementation processes. Finally, Makarfi Sugar Industry was chosen as the 1st to be implemented. A full feasibility study was conducted with the assistance of Raw Materials Research and Development Council who were to be shareholders.

4.2.0 MAKARFI SUGAR INDUSTRIES LIMITED (MSI)

Makarfi Sugar Industries Limited was incorporated on the 20th day of August, 1991 as private liability company with an authorized share capital of N3,000,000.00 divided into 3,000,000 ordinary shares of N1.00 each. The initial subscribes as well as their percentage holdings were as follows:

	SUBSCRIBER	% OFFER
1.	KIFC	20
2.	Alhaji Z. Abdullahi	10
3.	Alhaji A.M. Makarfi	10
4.	Shika Ranch	10
5.	Uban Investment Limited	10
6.	10 others (with less than 10%)	30
7.	Special Allocation to Farmers & Staff	10
		100

The initial Board of Directors was comprised of renowned and experienced industrialist and administrators. Kaduna Industrial and Finance Company Limited has two representatives on the Board. this was to ensure a balance in the Board's composition and to give it a good sense of business direction. The Board of Directors was made up of eight (8) persons as follows:

1.	Alhaji T.A. Yakubu (KIFC)	Chairman
2.	Alhaji Dahiru Mohammed (KIFC)	Director
3.	Alhaji Zubairu Abdullahi	Director
4	Alhaji Salman Abdullahi (Uban Invest)	Director
5.	Alhaji Ahmed M. Makarfi (Canes)	Director
6.	Alhaji Yusuf Ahmed (Shika Ranch)	Director
7.	Makarfi Local Government Council	Director

The proposed management of the company was to comprise of the General Manager, who would be the Chief Executive in charge of the general administration, planning and control of the company; the Production Manager, who would be in charge of the production section. Others were the Commercial Manager and the Chief Accountant.

4.2.1 FACTORS THAT AFFECT THE ESTABLISHMENT OF MSI

(a) **Market**

For any industry to be viable it must have a market for its product. A market in economic sense must not necessarily be a physical location but what appears more important is the ability to make an exchange either through telephone, letters or face-to-face contact between the buyer and the seller.

For the MSI, its product i.e. sugar is both domestic and industrial product, its impacts on the economy as industrial goods is, however, stronger than as domestic goods. Over 30% of Nigeria's industries are food based.

It is heart warming to note that the food and beverage industry serves a s one of the major marketing outlets for sugar even in times of economics crisis as people have to eat. In 1984 sugar was christened essential commodity.

(b) **Government Regulations**

As part of government contributions towards encouraging the development of industries that would utilize available local raw material, government has been funding research on sugar manufacturing plant through National Cereal Research Institute since 1987. Other contribution include the establishment of National Sugar Development Council (NSDC) in 1992, the introduction of FEAP loans to encourage the establishment of cottage industries in the country as well as the establishment of Raw Materials Research and Development Council among others.

(c) **Raw Materials**

The major raw material of the company is expected to be sugar cane. In Makarfi, sugar cane was grown by individuals whose farm holdings averaged 3 acres and the reddish-brown species was the common type grown. The plant capacity for MSI is 100 tone per day and based on estimate about 70% of total raw materials production is sourced in Makarfi zone alone. The remaining 30% comes from Ikara, Kadawa, Anchau and Zaria. The promotion of the company is being done in conjunction with the development of improved variety of sugar cane for better yield.

Other raw materials apart from water are industrial chemicals which can be obtained both locally from other M & B or ICI and internationally, through import. On the other hand, machinery, equipment and facilities required by the plant are obtainable here in Nigeria, Europe and the Far Eastern countries.

(d) **Labour**

The availability of labour both skilled and unskilled in the area makes the location of MSI in the area viable. The total of 18 skilled workers ranging from the GM to vehicle drivers are easily obtainable within Kaduna State, so also the 24 unskilled labourers that would be working in the factory.

(e) ***Competition***

As mentioned earlier, the total local production of sugar in Nigeria is not up to 10% of the country's requirement. As such the competitive impact is not very significant in the sense that the market will consume all the company's output and still leave room for import. In fact the most pronounced competition is from the large-scale importers such as Dangote and Ibru. MSI's production of about 8 tons per day could easily be consumed within Kaduna and Kano markets without much problems.

4.2.2 FINANCING MSI

The initial estimated project cost for the MSI in 1991 was valued at N6,705,773 comprising of equity fund of N1,676,000, term loan amounting to N4,694,000 (specifically committed to machinery and equipment purchases) and Bank Overdraft amounting to N33,773 expected to be provided by commercial banks to finance working capital.

Right from inception, MSI was intended to be a small-scale project which should be easier to finance and simpler to implement. The company was expected to be promoted in conjunction with private investors as against the previous practice of the Government promoting the project on its own before inviting other shareholders, without success due to high cost and other governmental bottlenecks. KIFC, the only Government arm in the project was restricted to a maximum participation of 20% of the equity. The plant and machinery, as mentioned earlier, were to be imported from borrowed funds (Term Loan).

Three proposals were received from machinery suppliers viz.:

(1)	KHANDSARI Sugar Mills (India) 100 tons per day at	N2,452,773
(2)	BOJE AMBROSE (Nig) 140 tons per day at	N2,754,250
(3)	ISGEC (India) 600 tons per day at	N48,786,000

The promoters settled for KHANDSARI Sugar Mills which was in line with the capacity envisaged and the cost could be afforded. The choice was also supported by the Raw materials Research Development Council then and had indicated its desire to participate in the equity. The project was expected to be a pilot project for the Council's effort at assisting in promoting small-medium scale industries in the country.

The foreign loan application was written to many Development Banks as well as SME, NERFUND and New Nigeria Development Company (NNDC). Finally it was NNDC that approved the proposal to finance the project under its On-Lending facility, sourced from European Investment Bank (EIB) line of credit. When the full proposal was taken to EIB for final approval, they turned it down for two reasons;

(1) That the sugar industry was over protected in Nigeria, and

(2) That the capacity was too small to ensure viability. They would have preferred a 500-1000 tons of sugar cane crushing per day.

None of these reasons were actually tenable, because Nigerian economic liberalisation was already in full swing under SAP. The promoters concluded that the loan was turned down because they were to purchase the machines from INDIA with a European loan. They (EIB) would not allow it. This situation started the woes of the implementation of MSI.

The promoters had to go back to the drawing Board and approached other financiers. Meanwhile the cost structure of the project was changing rapidly due to the progressive depreciation of the local currency, the naira.

By the time Leasing Company of Nigeria (LECON) approved the application to purchase the required machinery and lease same to MSI, the project cost had gone up to N23,442,000 made up of;

Equity	-	7,282,000
Leasing (Term Loan)	-	12,370,000
Overdraft (W/Capital)	-	3,790,000
TOTAL		N23,442,000

This compounded the implementation problems of the project because share capital had to be increased and paid for, exchange rate had gone up from N8.9 to a $1 in 1991 to N22.00 to $1 in 1994. The whole feasibility projections had to be updated to conform to the then economic realities.

By that time also the machinery suppliers had been reviewed and Wellon International Industries of China as well as Nigeria Sugar Company at Bacita were introduced. Quotation form the three companies were all presented to LECON who preferred dealing with Wellon International of Hong-Kong.

Somewhere along the line, before a Letter of Credit (L/C) could be established it was December 1994. The bank waited for the New Year's (1995) budget. That spelt another serious set back for the project. This was because the 1995 Federal Budget further deregulated foreign exchange rate, which instantly rose from N22 to a $1 to N82.00 to a $1.

Thereafter, LECON reviewed the application and informed the promoters that they would not be able to finance the project. This devastated out hope drastically as the implementation of a simple project was taking 5 years to source for the required financing. The promoters were, however, not completely deterred by the set back. So they went to Nigeria Industrial Development Bank (NIDB) with a new projection which had then increased the project cost to N69 million thus:

Equity	-	N35.00 million
Term Loan	-	N32.00 million
Overdraft	-	N 4.00 million
	Total	N72.00 million

NIDB appraised our application and, after 2 years of struggle approved to finance the project through its ADB credit line, but with very stringent terms. The approval came in September 1996. Even after this approval, the eventual administrative bottlenecks that ensued before the Letter of Credit could be established was another piece of cake. Finally, it was in July 1998 before a Letter of Credit was established.

4.2.3 SOURCES OF FUNDS FOR MSI

All the various sources of raising funds discussed in chapter two are applicable to MSI, but of major importance is the actual source through which the funds finally materialised. From the foregoing it could be seen that the following sources were all pursued in various combinations in order to achieve success in the implementation of MSI:

These include:

(i) Equity;
(ii) Term loan;
(iii) Lease financing; and
(iv) Bank overdraft

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i) **Equity**:

This is the shares or owners contribution to the firm, in other words it is the total authorized share capital of the firm divided into ordinary shares for subscription. The Makarfi Sugar Industries has an authorized share capital of N35,000,000, which were divided into 35,000,000 ordinary shares of N1 each. The shares are offered at a percentage to various subscribers, seven of whom formed the BOD of the firm. KIFC has the largest percentage holding (30%) amounting to N10.5 million of the total share capital. Of the total share capital, N25.425 million has been subscribed and fully paid, while the balance of shares were unpaid for yet.

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ii) **Term Loan**

A loan or credit facility for a stated period of time, usually 3-5 years; with fixed interest charges. Repayments may be instalmental consisting of principal and interest. The total amount of term loan, available to Makarfi Sugar Industries was N32.044m. The interest rate chargeable per annum is 14.5% and tenor is ten years with repayment being made every quarter after a moratorium two of years.

iii) **Lease**

This is a contract between the lessor (financer) and the lessee (hirer) for hire of specific asset selected for a manufacture or vendor of such asset by the lessee. The lessor retains ownership of the asset while the lessee has possession and use of the asset on payment of specific rental charges over a period. Makarfi Sugar Industries did not utilize the lease option in this financing as such it is nil.

iv) **Bank Overdraft**

Where a long-term relationship exists between a bank and its clients, overdrafts facilities could be granted and can be continuously renewed. The facility allows a customer to overdraw his account. The total overdraft facilities required by Makafi Sugar Industries in 1996 amounted to N5.00 million.

Equity was constant as long as the promoters have to contribute a certain percentage of funds required. Term loan on the other hand is needed for the purchase of plant and machinery. In the case of MSI, the machinery have to be imported as such the loan has to be in foreign currency for better effectiveness. Lease on the other hand, could be for plant and machinery as well as other equipment. In the case of MSI we initially sought for Lease financing of plant and machinery. When Leasing could not materialise we went back to long term loan again which later materialized through NIDB. In the case of Bank overdraft it is used to finance working capital, so it is short term in nature. The total project cost which was finally approved included all these except for Lease financing. This is summarized below:

Equity	-	N42.778.000
Term Loan	-	N42.906,000
Overdraft (Working Capital)	-	N10.608,000
Total Project Cost		N96,292,000

This was the final project cost upon which a Letter of Credit was established for the purpose of finalizing the project.

4.2.4 MAJOR FINANCIAL STATEMENTS OF MSI

(a) **Cashflow statement Table 4.1 Cashflow for four years (N'000)**

Year of operation	**1995**	**1996**	**1997**	**1998**	**1999**
TOTAL REVENUE	-	223,429	248,254	273,079	297,905
Costs					
Total capital costs	56,634	12,197	1,247	1,284	2,785
Working capital charge	0	10,608	11,337	12,249	13,167
Operating cost	0	97,444	106,429	117,169	128,213
Cash before financing	(56,634)	103,180	129,241	142,377	153,740
Sources of external funds:					
Term Loan	33,044	0	0	0	0
Lease	0	0	0	0	0
Overdraft	-	10,608	0	0	0
External fund repayments:					
Term loan	0	0	4,621	4,721	4,721
Overdraft	0	3,535	3,535	3,535	-
Interest & exp.	3,752	7,019	5,848	4,421	2,995
Lease rentals	0	0	0	0	0
Cashflow after financing	(27,343)	103,234	115,137	129,700	146,024
Tax VAT		11,171	12,413	13,654	14,895
Dividend (25%)	0		18,282	20,563	22,833
Net cashflow	(27,343)	92,063	84,442	95,483	108,296

(b) **BALANCE SHEET STATEMENT**

Year of operation	**1996**	**1997**	**1998**	**1999**
ASSETS				
Current:				
Receivables	(2,764)	(3,060)	(3,366)	(3,672)
Stocks	12,197	13,444	14,727	16,013
Cash/Bank balance	105,985	183,042	235,613	297,147
Total current assets	115,427	193,425	246,974	309,488
Fixed Assets:	58,910	52,962	42,013	41,064
Depreciation	5,949	5,949	5,949	5,949
Net fixed assets	52,969	47,013	41,064	35,115
Total assets	168,396	240,438	288,038	344,603
Total current liabilities	45,457	47,946	49,767	55,101
Term Loan Balances	33,044	28,323	23,603	18,882
Share Capital	31,619	31,619	31,619	31,619
Reserves (retained earning)	62,873	73,130	82,251	91,333
Total shareholders fund	94,492	104,749	93,870	122,952

(c) **PROFIT AND LOSS ACCOUNT (N'000)**

Year of operation	**1996**	**1997**	**1998**	**1999**
Sales Revenue:	223,429	248,254	273,079	297,905
Variable costs				
Raw materials & packaging	100,527	111,697	122,865	134,035
Factory supply cost	1,050	1,155	1,271	1,398
Utilities	1,200	1,320	1,452	1,597
Maintenance	1,556	1,714	1,885	2,074
Deprecation (machinery)	5,209	5,209	5,209	5,209
Sub total	109,544	121,095	132,682	144,313
Fixed cost:				
Labour	644	731	804	884
Admin & general expenses	819	901	991	1,091
Sales & advertisement	2,234	248	273	298
Amortisation	1,150	1,150	1,150	1,150
Depreciation	740	740	740	740
Sub total	5,607	3,770	3,958	4,163
Total cost	115,151	124,865	136,640	148,476
Profit before tax/financial charges	108,278	123,389	136,439	149,429
Interest charges	7,019	5,848	4,421	2,995
Profit (loss) before tax	101,259	117,541	132,018	146,434
Company tax	38,386	44,411	49,767	55,101
Profit after tax	62,873	73,130	82,251	91,333

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SOURCE – Feasibility Report prepared by Klutt Company Ltd. 1996.

4.2.5 PROBLEM AND PROSPECTS OF MSI

Generally, all things remaining the same, an establishment must have its merits and demerits. For this reason, therefore, MSI must not be an exception, a manufacturing firm such as MSI must have its own peculiar prospects as well as inherent problems. Below are some of the prospects and problems of the firm:

(a) **Prospects**

(i) It creates job opportunities to the economy

(ii) It enhances the living standard of the immediate environment through employment farming

(iii) It enhances revenue generation of the local communities around of.

(iv) It minimizes shortage of raw materials of the food and beverages companies which use sugar as one of their raw materials

(v) It reduces rural – urban migration within the locality

(vi) It provides revenue/income to the owners

(b) **Problems**

(i) Limited source of financing with high interest charges

(ii) Strong (stiff) competition within and outside Nigeria

(iii) High costs of maintenance/replacement of obsolete equipments

(iv) If promotion takes long it may not be made

(v) Lack of awareness of the local businessmen in supporting the set up

(vi) Reduces the amount of chewing sugarcane cultivation

(vii) Cost effectiveness could be a problem

CHAPTER FIVE

SUMMARY, RECOMMENDATION AND CONCLUSION

5.1 SUMMARY

From the foregoing, it is apparent that finance is the sourcing as well as efficient allocation of funds (money, machineries etc), and that fund could be sourced from a variety of sources; internal and external sources. The internal sources of funds are those which can be generated within the firm e.g. issues of shares, depreciation allowance, selling of assets, goodwill etc, and retained profits. Externally funds are raised through Banks, finance houses, trade associates, government agencies.

Small/Medium Enterprises are also seen by CBN as enterprises with annual turnover not exceeding N500,000. Government of the Federation of Nigeria ha s been doing a lot to encourage the establishment as well as developing the SMEs operating in Nigeria.

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To this end, various policies and programmes have been put in place to ensure the realization of this goal. Recent attempts by government include the establishment of Peoples Bank to provide small scale loans and encourage the habit of savings among rural dwellers; Community Banking to promote joint venture establishment among community of investors; Family Economic Advancement Programme to provide capital needed by way of loan to people at ward level to set up and run their own cottage enterprises and reduce rural-urban drifts.

In the early 1970s the industrialization efforts of the governments (Federal and States) concentrated in establishing giant industries to conform with the then perceived notion of Nigeria being the Giant of Africa. By the early to mid eighties it became apparent that those giant industries were becoming while elephants. The finished ones were becoming difficult and expensive to maintain while the uncompleted ones were being abandoned without the prospect of completion.

This position gave birth to Structural Adjustment Programme (SAP) to re-appraise our policy direction. On the industrial sector, the need to de-emphasise the setting of large-scale industries in favour of smaller ones was created. In addition, the funding system also was overhauled whereby SMEs promotion was encouraged. Funding strategies also followed the pattern. This gave birth to institutions to assist in sourcing funds for the establishment of SMEs. These include. NERFUND, Peoples Bank. SME departments in most Banks NBCI and NIDB. All these institutions were directed by the CBN to assist with moderate to low priced funding for the establishment of SMEs. ADB. EIB and a host of other international financial institutions came in with various funding arrangements.

This scenario encouraged KIFC to embark on the promotion of Makarfi Sugar Industries Ltd. The company was promoted in conjunction with Private Investors as well as the company (KIFC). The initial idea was to utilize a loan facility from European Investment Bank (EIB) to promote the company with a capacity of crushing 100 tons of sugarcane per day to produce about 10 tons of sugar per day.

However, the intrigues of European financing and Asian technology stalled the success of the promotion for much longer period than was envisaged.

MSI is a privately owned limited liability company with an initial authorized share capital of N6,000,000. KIFC is the initial lead promoter of the company with fourteen other eminent persons/industrialists amongst whom include; Mallam Zubairu Abdullahi, Alhaji Ahmed Mohammed Makarfi. Alhaji Yayaha Hamza, mni, Ikara Local Government. Makarfi Local Government, Alhaji Aliyu M. Shika, Alhaji Danjuma Adamu, Alhaji Mohammed Sani Aminu. Alhaji Abubakar Zailani and Alhaji Sarki Mohammed Mai Lemu. The company has the potential of creating job opportunities to the economy, enhancing the living standard of the people of the local community and reducing rural-urban drifts. The major problem of the company include: limited sources of funds, high costs of maintenance and poor

source of utilities such as power supply, water and technical expertise as well as long gestation period.

5.2 RECOMMENDATION

The project (MSI), though a very good one which seeks to provide solution to the industrial development of the country could not be realized within the envisaged period due to certain constraints. Providing solutions to some of these constraints could pave way for more successful project implementations. Below are some of the recommendations that could assist:

(i) Government should restructure the financing institutions in the country to enable them perform their functions for the benefit of SMEs by making it easier to access the funds by industrial promoters.

(ii) The industrial policy of the country should be reviewed periodically to address areas that are not in the interest of the country's industrial development.

(iii) The recently established SMEs should be managed by an agency different from contributing banks in order to make access to the funds less cumbersome and frustrating.

(iv) Government should in conjunction with NIPC and IDC promote industrial machinery production outfit for the development of small-scale proto-type machinery in identified locations to reduce dependence on importation.

(v) Government should also harmonise taxation policies to reduce instances of multiple taxation that discourages investors from setting up industries.

(vi) Raw Materials Research and Development Council should be encouraged to develop cooperative arrangements with our various research institutes to develop the required weal raw materials for our local industries.

(vii) Our Universities should be encouraged to work with big industries for the purpose of funding research projects attached with various incentives to ensure our research findings are utilized for the advancement of industrial development.

(viii) This country is well endowed with agricultural potential. Private sector should be encouraged to go into large scale farming of both food and cash crops for both local utilization and export.

(ix) MSI should also set up its own sugarcane plantation to augment the outgrower farmers in order to ensure adequate supply of raw materials for the company.

5.3 CONCLUSION

From the foregoing, it is beyond doubt that financing has a very strong link to the growth and development of any firm. The availability and efficiency with which funds can be obtained will go in no small way in upgrading the status of the firm and vice versa. The large scale firms which were thought to be the solutions to our industrial growth proved otherwise due largely to over-dependant on Government financing which proved difficult to come by. Also this largely was responsible for the large-scale corruption and inefficiency which characterize the organizations culminating in their collapse.

With all the recent policy redirection efforts by the government and emphasis on private sector-driven economy, there is ray of hope that the industrial development of this country with change direction. All the institutions put in place to assist SME source micro credit for establishing small scale and cottage industries we are surely heading in the right direction. When some time thing is done in the delivery system coupled with some degree of dedication and honestly in the part of the people, we shall all laugh at last.

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