CENTRAL BANK OF NIGERIA

SEMINAR ON

SMALL AND MEDIUM INDUSTRIES EQUITY INVESTMENTS SCHEME (SMIEIS)

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TABLE OF CONTENTS

PREFACE

The production of goods and services in the most efficient manner has continued to be the only viable and reliable option for development, growth and survival of any economy.

The development of Small Scale Enterprises (SMEs) in Nigeria is therefore an essential element in the growth strategy. SMEs not only contribute significantly to improved living standards, they also bring substantial local capital formation and achieve high level of productivity.

It was however, observed that the major gap in Nigeria's industrial development process in the past years was of the dearth of long-term finance for Small Scale Industries (SMI). In other words, the significance of the Small and Medium Industry Equity Investment Scheme (SMIEIS) derives from the critical economic role of the real sector, the sector that engages in actual production (of which SMI sub-sector is a major component) in economic growth.

The concept of SMIEIS in Nigeria was the initiative of the Central Bank of Nigeria with the voluntary support and efforts of the Bankers' Committee. The Scheme requires that all banks in Nigeria should set aside 10 percent of their profit before tax annually for equity investments in small and medium industries. This arrangement will eliminate the burden of interest and other charges associated with normal bank lending. The Scheme is therefore an innovative way of financing the real sector and it has a considerable developmental potential.

Consequently, the approval of the Bankers' Committee on June 19, 2001 and subsequent launching of SMIEIS by the President of the Federal Republic of Nigeria, Chief Olusegun Obasanjo on August 21, 2001 gave impetus to the commencement of the Scheme in Nigeria.

It is against this backdrop that the seminar on SMIEIS was considered timely to enable staff acquire knowledge of the Scheme, articulate its roles in economic development and identify its sources of funding. Also, by describing the concept of SMIEIS from the point of view of the operators in our contemporary environment, we would be able to identify likely problems that may affect the success of the scheme and suggest solutions.

I hope that this publication will create a general awareness and educate participants on the operations of the scheme on which considerable time and resources had been committed.

Deacon Martins Okufolami
Director, Human Resources Department
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ACKNOWLEDGEMENT

This publication came into being as a result of spontaneous interest of some intellectuals in sharing knowledge and experiences with others on Small and Medium Industries Equity Investments Scheme. The belief of the Central Bank of Nigeria (CBN) Training Centre is that a successful implementation of the scheme would engender the much sought industrial breakthrough in the Country. Also, the more the information on the scheme, the better the chance of its wide acceptance among the beneficiaries and the general public.

We appreciate immensely the contributions of the various authors of the papers contained in this Publication. Notably among these are Mr. Fred Udechukwu of AFEX Bank Plc.; Dr. Lawrence Osa-Afiana, MD/CEO, Bank of Industry Limited; Mr. Rotimi Oyekanmi, CEO, SME Manager Limited; Mr. B. O. Adelaja, Assistant General Manager, Union Bank of Nigeria Plc; Chief Abiodun Salami, Development Finance Department, CBN; Mr. C. N. Anyawu Research Department, CBN; and Mr. Job Abiodun Olorunshola of our Faculty.

We do not claim that all information needed to be known on SMIEIS is contained in this publication, however, we hope that it will stimulate readers for further learning and research on Small and Medium Industries and their funding.

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SURVEY OF SMALL AND MEDIUM SCALE INDUSTRIES AND THEIR POTENTIALS IN NIGERIA

By

Fred. N. Udechukwu*

Distinguished Participants, SMEs have been fully recognised by governments and development experts as the main engine of economic growth and a major factor in promoting private sector development and partnership. The development of SME is therefore an essential element in the growth strategy of most economies and holds particular significance for Nigeria. SMEs not only contribute significantly to improved living standards, they also bring about substantial local capital formation and achieve high levels of productivity and capability. From a planning stand point, SMEs are increasingly recognised as the principal means for achieving equitable and sustainable industrial diversification and dispersal; and in most countries SMEs account for well over half of the total share of employment, sales, and value added.

A major gap in Nigeria's industrial development process in the past years has been the absence of a strong and virile small and medium enterprises sub-sector (SMEs). The little progress recorded from the courageous efforts of the first generation of indigenous industrialists were almost completely wiped out by the massive dislocations and traumatic devaluation which took place under the Structural Adjustment Programme (SAP). The policies of SAP are rooted in the neo-classical theory of perfect competitive markets whose assumptions do not adequately reflect constraints on SME in developing countries.

With over 120 million people, productive farmlands, rich variety of minerals deposits, Nigeria should be a haven for Small and Medium Industries. The human and natural resources base is a significant feature that gives the country a special status in Africa. However, like most less developed countries, the country is witnessing a rapid population growth

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and this contrasts with the less than average rate of development in communication, technological and social infrastructure. Instability and high turn over have impacted negatively on the performance of primary institutions responsible for policy monitoring and implementation, resulting in distortions in the macro economic structure, and low productivity. These problems constitute hindrance to the development of Small and Medium Enterprises. As you are aware, this is a very important sector that will enhance the contributions of the private sector and provide the critical building blocks for industrialization and sustainable economic growth.

With the dismantling of trade and other barriers, the world has been transformed into a global village. Consequently, SMEs in developing countries are struggling to survive under intense competitive environments both domestic and international. In developing countries like Nigeria, there is an urgent need to provide the required enabling environment for the development of SMEs, so that they could adequately play the role expected of them in economic transformation. Such role includes mobilization of domestic savings for investment, appreciable contribution to gross domestic product, increased harnessing of local raw materials, employment generation, significant contribution of poverty reduction efforts through sustainable livelihoods and enhancement in personnel income, technological development and export diversification. This will be made possible through a responsive industrial policy and government's overall economic development strategies that will ensure the collaboration of all development partners and the effective coordination and utilization of economic resources.

DEFINITION OF SMEs

Who is an SME?

In a global context, a general definition of SMEs using size and scale of operation is not easy, but within the fixed co-ordinates of national boundaries, it might be relatively easier. At the 13th Council meeting of the National Council on Industry held in July, 2001 Micro, Small and Medium Enterprises (MSMEs) were defined by the Council as follows:

- **Micro/Cottage Industry**
  An industry with a labour size of not more than 10 workers, or total cost of not more than N1.50 million, including working capital but excluding cost of land.

- **Small-Scale Industry**
  An industry with a labour size of 11-100 workers or a total cost of not more thanN50 million, including working capital but excluding cost of land.

- **Medium Scale Industry:**
  An industry with a labour size of between 101-300 workers or a total cost of over N50 million but not more than N200 million, including working capital but excluding cost of land.

- **Large Scale**
  An industry with a labour size of over 300 workers or a total cost of over N200 million, including working capital but excluding cost of land.

FEATURES OF SMEs

One of the commonest features of SMEs is that they are either sole proprietorships or partnerships. Even when they register as Limited Liability Companies, this is merely on paper, as their true ownership structure is one-man or partnership. Secondly, most SMEs have labour-intensive production processes, centralised management and have limited access to long-term capital; even their access to short-term financing is limited and sometime attained at a penal rate of interest and other conditionality.

Since partnership spirit in Nigeria is at its infancy, partners in many SMEs pursue individualistic goals at the expense of the overall interest of the SMEs. Consequently, mortality rate among SMEs is high as a result of mistrust that often develops among the owners. Beside poor partnership spirit, regulatory environment - policy instability and reversals, inadequate infrastructure, etc, - often contribute to their high mortality rate.

Another major feature of many SMEs is their over-dependence on imported raw materials and spare parts. In fact, no industrial sub-unit under SME category is immuned from this structural weakness. Added to this, SMEs in Nigeria suffer from very poor inter and intra-sectoral linkages, and as a result lose benefits synonymous with economies of large-scale production.

Furthermore, many entrepreneurs who found and manage SMEs lack the appropriate management skills and because of lack of adequate capital or sheer ignorance of technological advances, such entrepreneurs purchase obsolete and inefficient equipment thereby setting the stage *ab initio*, for lower level of productivity and poor product quality with serious consequences on product output and market acceptability. As a natural outflow of these deficiencies, it is not a surprise that various attempts by the government to restructure the economy only worsened and wrecked further dislocation and hardship on many industries. The outcome, of course, was closure of some enterprises while many others drastically reduced their scale of operation at the expense of labour. The present unfolding scenario is more frightening in anticipation of the whirlwind that will accompany the implementation of the world trade organization agreements. It is obvious that in the face of uneven competition, many more industries face the grim possibility of closure unless the government applies urgent brake to the present full throttle liberalisation policy.

By their very nature, SMEs constitute the most viable and veritable vehicle for self-sustaining industrial development. From varied experiences especially in developing countries, SMEs indeed possess enormous capability to grow an indigenous enterprise culture more than any other strategy. It is therefore not unusual that SMEs are generally synonymous with indigenous businesses wherever they exist. From all account, SMEs in most developing economies represent the sub-sector of special focus in any meaningful economic restructuring programme that targets employment generation, poverty alleviation, food security, rapid industrialisation and reversing rural-urban migration. In essence, "*SMALL IS PROFITABLE IN AFRICA*", as UNIDO rightly describe the immeasurable contributions of SMEs to the economies of many African countries. In Africa and Asia, most of the jobs, especially those in non-urban areas, are provided by small and medium-scale enterprises. In many cases, SMEs also account for the vast majority of industrial units operating in respective continents.

ROLE OF SMEs IN THE ECONOMY

The historical experience of economic development in the developed countries is replete with success stories of the role of SMEs in industrial development, technological innovation and export promotion. The Industrial Revolution (1760 to 1850) is a testimony of the innovative spirit of SMEs, which is increasingly challenged in the present century particularly after winds of economic change and industrial liberalisation have swept various economies of the world.

Contrary to the general impression, SMEs are as much an important economic catalyst in industrialised countries as they are in the developing world. In many developed countries, more than 98% of all enterprises belong to the SME sector. 80% of the total industrial labour force in Japan, 50% in Germany and 46% in USA are employed in smaller firms. In USA, small business contributes nearly 39% to the national income. Figures in many developed countries are even higher.

Many studies have indicated that the revival of interest in SMEs in the developed economies is due to technological as well as social reasons, namely, the growing importance of knowledge and skill-based industry as against material and energy-intensive industry. This is also due to a paradigm shift to new processes of manufacturing based on flexible systems of production. The social reasons include the need of generation of more employment through self-employment ventures and decentralised work centres.

In the absence of a universal definition of small enterprises, it is difficult to obtain exact and comparable figures on SMEs for developing countries. Nevertheless, it is obvious that the role of small business is equally important in the economies of developing and developed countries. Small domestic markets, inadequate infrastructure, high transport costs, shortage of capital and foreign exchange as well as surplus of low quality labour are the general characteristics of developing countries.

Table 1 gives a broad overview of the contribution of SMEs in some Asian economies.

TABLE 1: CONTRIBUTION OF SMES IN SELECTED ASIAN ECONOMIES (IN PERCENTAGES)

Industrial Characteristics	Malaysia (1985)	Singapore (1990)	Korea Rep (1991)	India (1994)
Contribution to total number of industrial establishment	92.1	88	97	94
Contribution to total industrial employment	49.4	40	63.5	31
Contribution to total industrial production	46.7	26	44.5	40
Contribution to total industrial value addition	30	23	45.8	35

Source: Confederation of Asia Pacific Chamber of Commerce and Industry - Journal of Commerce and Industry, vol. II. 1994: page 6-18

Exports of the SME sector range from 30 to 50 percent in developed and developing countries. In tune with the latest developments in the global economy, their role in future is likely to be even greater and more pervasive with a demonstrable impact on the emerging world trading order.

Almost every country provides some assistance to small-scale enterprises. The emphasis is more on facilities and supportive services than on protection and subsidies. This is generally a hallmark of an effective strategy for promoting the SME sector. Assistance provided by governments is making available commercial finance, venture capital, information, training and retraining, R & D support and infrastructure. The facilities are provided through local authorities and industry associations with increasing involvement of non-governmental organisations (NGOs).

PROBLEMS OF SMEs

The problems of SMEs in Nigeria are enormous and ranges from:

(1) Inadequate and inefficient infrastructural facilities which tend to escalate costs of operation, as SMEs are forced to resort to private provisioning of utilities such as road, water electricity, etc.

(2) Lack of adequate credit for SMEs, traceable to the reluctance of banks to extend credit to them owing, among others, to poor

documentation at project proposals as well as inadequate collateral by SME operators.

(3) Bureaucratic bottlenecks and inefficiency in the administration of incentives which discourage rather than promote SME growth.

(4) Weak demand for products, arising from low and dwindling consumer purchasing power. Lack of patronage for locally produced goods by those in authority.

(5) Incidence of multiplicity of regulatory agencies and taxes which has always resulted in high cost of doing business and poor management practices and low entrepreneurial skill arising from inadequate educational and technical background or many SME promoters.

CHEAP FUNDING – THE SOLUTION TO FINANCING PROBLEM OF SMEs

While finance is obviously not the only problem militating against the development of the SME sector, it is certainly the most formidable. Like any other investment in the real sector of the economy, investment in SMEs is relatively bulky because of the need for fixed assets such as land, civil works, buildings, machinery and equipment and movable assets. Moreover, empirical studies have shown that the incidence of the extra outlays required to compensate for deficiencies in the supply of the basic utilities is relatively heavier on SMEs than large enterprises. While such extra investments have been shown to account for about 10% of the total cost of machinery and equipment of large enterprises, it represents about 20% of that of SMEs because of the absence of economies of scale. Unlike buying and selling, SMEs have a long gestation period, which may extend into several years.

Invariably, loans to SMEs for capital investment must be long-term in order to avoid a fatal mismatch between project gestation and loan maturity. Consequently, the cost of funds is a critical factor in the sense that it impacts significantly on the competitiveness and survival of SMEs. Long gestation in an unstable environment coupled with unsound financial packaging tends to subject SMEs to a high failure rate, which in turn makes the sector relatively risky and unattractive to the banking system's credit.

The bulk of commercial bank lending to industries is working capital which goes to well-entrenched blue-chip enterprises which have enough bargaining power to negotiate better borrowing terms. The negative bias against SMEs was demonstrated by commercial banks' preference to pay penalty rather than meet the 20% target lending to small-scale enterprises (SSEs) by making risky investments when the Central Bank's credit guidelines were in force. It is therefore not surprising that their lending to SSEs drastically declined after the abolition of the guidelines in 1996 as shown in Table 2 below which contains the share of SSEs in total commercial bank credit to industrial enterprises.

TABLE 2: COMMERCIAL BANK LENDING TO SMALL-SCALE ENTERPRISES (SSES) – 1992-1999

Year	**Commercial Bank Loans to SSEs** % of Total
1992	48.8
1993	32.2
1994	22.2
1995	22.9
1996	25.0
1997	17.0
1998	16.5
1999	11.2

Source: Central Bank of Nigeria (CBN)

It is not in the interest of the competitiveness and survival of SMEs to rely on commercial bank funds because of the high cost even if such funds are available (the drive towards universal banking has blurred the traditional dichotomy between commercial and merchant banks such that the term commercial can now be used for both). As a matter of fact, there are strong indications that commercial banks cannot constitute a major source of finance to SMEs in the foreseeable future.

The core competence of commercial banks is not in long-term lending. This factor together with risk aversion prevented many commercial banks from participating in the defunct SME II and the National Economic

Reconstruction Fund (NERFUND). Being unskilled in project appraisal and monitoring, they were overwhelmed by the prospects of inadequate loan recovery in the face of the automatic debiting of their accounts in the Central bank in respect of their projects. The subsequent distress in the banking system adversely affected the chances of most SMEs financed by the two schemes through participating commercial banks.

The Small and Medium Equity Investment Scheme which I guess we all know about is heading towards failure because just as we speculated earlier Equity investment is new to the commercial banks and it will take some time before they can master and garner enough expertise to executive it.

Small and medium entrepreneurs as observed earlier are mainly family businesses. They are therefore reluctant to open their businesses up, especially to the banks that they regard as intruders.

The small scale and micro-enterprises operate at such a low scale that is unattractive to banks. Many of them are unincorporated and banks are not forthcoming in investing in a multiplicity of small ventures that are scattered all over the country. The concomitant effect is that less than 10% of the funds available for the scheme have been disbursed to date.

OTHER SOURCES OF FINANCE

The stock market is yet to be a factor to reckon with in the financing of SMEs. Few SMEs can as yet be quoted on the stock exchange while the country's bond market is currently too weak to be a major source of finance for the real sector. Even if funding were available in the bond market, the cost would be inconsistent with the competitiveness of SMEs.

The dilemma that a sector with a great economic potential is being starved of funds was what prompted the Federal Government to sponsor the two SME-specific funds earlier mentioned. Unlike funds from commercial sources, the two schemes were primarily developmental. Unfortunately, there has been no successor scheme to the SME II facility while NERFUND is also currently not in position to extend credit. Therefore, there is currently a palpable gap in the funding of SMEs, which Development Finance Institutions (DFIs) have to fill.

DFIs have always been major financiers of SMEs and their funding is the cheapest and mot competitive that is available. It also incorporates substantial advantages such as the tailoring of the repayment period of the gestation of the project, free technical and managerial support. The competitiveness and sustainable growth of SMEs require that Government should channel cheap funds through DFIs to SMEs.

The major untapped sources, which can be mobilized in Nigeria for financing SMEs, include the Nigerian Social Insurance Trust Fund and part of the proceeds of privatisation. Oil is an exhaustible asset and part of the country's oil earnings should be dedicated to a national Development Fund for funding SMEs and other development projects. Yet another possible source is unclaimed dividends, which just lie there idle rather than being made to serve a developmental purpose. In the words of the Securities and Exchange Commission (SEC), 'unclaimed dividends have steadily grown to alarming proportions in recent times'. Available data indicate that unclaimed dividends have grown from N818.80 million in 1996 to over N3.00 billion at present even though usually not all quoted companies report promptly. Channelling unclaimed dividends for investment in SMEs through DFIs means that they would be profitably invested such that the bank would pay the owners of the dividends any time they appear to make a claim. The active operation of the SME Credit Guarantee Scheme SMEs would also be necessary as an added assurance in this regard.

ENABLING ENVIRONMENT FOR SME OPERATIONS – POLICY PROPOSALS

To diversify the economy, there is the need to restructure and strengthen policy in favour of the rapid growth and development of SMEs so that they could serve as the hub for industrial transformation. SMEs are expected to champion local sourcing of raw materials and export drive so that the balance of payments problem faced by developing countries could be eased. With the dismantling of trade barriers as part of globalisation, SMEs in developing countries are facing intense competition from industries of other countries, which have enabling environment for production, distribution and marketing. The environment in which SMEs in Europe, South East Asia and America operate provides stable power and water supply, standard road and rail network, efficient water and air transport system, advanced technology, modern communication facilities, efficient and responsive financial system, and above all good governance. Unless Nigeria puts its policies right, many SMEs may not survive this competitive drive.

In Nigeria, the organized manufacturing sector is made up of over 95% SMEs. Therefore, more than ever before, the country needs to fine tune its industrial policy and align it with other development strategies so that SMEs could compete favourable with the products of emerging economies and that of developed world. It is important to acknowledge the fact that as we speak here, the SMEs Development Bill has received the blessing of the National Assembly. It is our hope that when finalized, the Bill in conjunction with the industrial policy and overall development strategies in the country will facilitate the provision of the following elements that will assist in creating the an enabling environment for competitiveness and growth of SMEs in Nigeria:

i **Research Findings:** making technology available and affordable – the system of making available the results of research institutions in new production techniques to SMEs through extension outreach for popularisation, demonstration and adoption should be further strengthened. This will reduce cost of production, distribution and marketing, which will raise competitiveness, allow expansion and create more jobs. A well-established and operational Business Incubator system should be supported to warehouse critical data and information on these results, as well as locally available raw materials and their uses.

ii **Fiscal Incentives and Support:** tax rebate - for SMEs that put effort on local sourcing of raw materials, serious in adding value to commodities for exports and other business ethics, which government ma wish to foster. Similarly, government could increase funding for the development of the sub-sector through direct budgetary allocations and enhance private sector investment opportunities that will focus on specific areas of capacity enhancement.

iii **Infrastructure Development:** Develop and upgrade rural/urban road and rail network, water and air transport system, and communication infrastructure by Government and the private sector.

iv **Cluster Formation:** encourage networking among SMEs operators and use of shared facilities such as Common Facility Centre (CFC). This also involves development of and access to information and communication technology, and partnership among operators, which, will help reduce cost of production and improve product quality and competitiveness. In this way, the SMEs would be positioning themselves to benefit from the implementation of the proposed programme of NEPAD.

v **Marketing Channels:** provision of effective marketing and distribution channels for SMEs products to penetrate sub-regional and global markets.

vi **Vertical Integration:** encourage linkages between SMEs and large-scale industries to ensure patronage rather than competition among them.

vii **Capacity Building:** a system of technical skills and entrepreneurship training should be developed by Government and the private sector for the operators of SMEs, so that they can improve on product quality, up grade their operations to international standard and attract investment for expansion. With globalisation, it should be noted that the SMEs that cannot meet the acceptable standards would be compelled to close down.

viii **Efficient Financial System:** efficient and responsive financial system that could serve the economy and the introduction of delivery mechanisms of financial support to SMEs in particular.

CONCLUSION

Previous administrations have paid lip service to the development of SMEs in Nigeria. We have a listening administration now but the major problem is lack of the will to implement most of the government's laudable programmes. SMIDA has been unduly delayed, the Bank of Industry (BOI) and Nigerian Agricultural, Cooperative and Rural Development Bank (NACRDB) are yet to be fully mobilised and the much talked about Credit Guarantee Scheme for SMEs is yet to be established. There has been a slight improvement in the area of infrastructural development and communication but a lot is still to be done.

At the international level SMEs in Nigeria have an improved operational environment. The liberalization of trade through WTO Agreements has provided awareness through which SMEs could access international market. Another opportunity is the African Growth and Opportunity Act, which favour imports from African countries to the United States.

There is now a very good opportunity for partnership with big companies from whom SMEs could provide intermediate goods as raw materials. This will leverage their productive capacities and enhance their competitiveness. The international community is gradually regaining confidence in our country Nigeria with the advent of the new democratic political order. The time I belief is ripe for SMEs in Nigeria to play their role as a vital engine of growth and development of the economy.

Distinguished Ladies and Gentlemen, I thank you for your kind attention.

Mr. F. N. UDECHUKWU
AFRICAN EXPRESS BANK PLC
12th August, 2003

THE ROLE OF CENTRAL BANK OF NIGERIA IN ENTERPRISES FINANCING

By

C. M. Anyawu*

INTRODUCTION

The role of capital in enterprise growth and development has been recognized over the years and well documented in literature. Capital is needed for the establishment of new businesses as well as the expansion, modernization and diversification of existing ones. Although, there is evidence that there are many bottlenecks in the growth and development of enterprises in Nigeria such as difficulties in local sourcing of raw materials, capital inadequacy, poor managerial and technical know how, as well as infrastructure deficiencies, the problem of long-term funds and working capital has pre-eminence. In recognition of this and in order to address the problem, various efforts and policies have been put in place.

One of the developmental role of the Central Bank of Nigeria as the apex financial institution in the country is to facilitate the flow of finance to the needy areas of the economy. The objective of this paper, therefore, is to provide an overview of the role of the Central Bank of Nigeria in enterprises financing, in particular, for the Small and Medium Enterprises (SME). For this purpose, the remaining part of this paper is divided into four sections. Section two, following this introduction, discusses the objectives of the Central Bank of Nigeria, highlighting the need for the developmental roles of the Bank. Past institutional arrangements for the financing of SMEs with the support of the CBN is considered in section three, while section four is an overview of the current financing initiatives and proposals on the way forward. Section five summarizes and concludes the paper.

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CBN OBJECTIVES AND THE NEED FOR DEVELOPMENTAL ROLES

The Central Bank of Nigeria (CBN) was established by an Act of Parliament of March 1958, and it became fully operational on 1st July, 1959. The activities of the Bank as contained in the CBN Act, otherwise referred to as its traditional functions, are the issuance of legal tender currency in Nigeria; maintenance of external reserves to safeguard the international value of the currency; promotion of monetary and a sound financial structure in Nigeria and acting as a banker and financial adviser to the government.

In addition to the above, the CBN also performs with some developmental functions. These include the promotion of money and capital markets development and the establishment of development finance institutions. Consequently, the CBN has been very active in the establishment and development of the Nigerian capital market. The Nigerian capital market is a source for raising long-term finance for project development in both public and private sectors. The capital market deals in both government securities (which are issued and managed by CBN) and private ones. The volume of private securities was boosted in 1978, following the implementation of the Nigerian Enterprises Promotion scheme, which the CBN through its monetary and credit policy effectively facilitated.

Also, in order to ensure steady availability of long-term finance to enterprises, the CBN contributed to the establishment of development finance institutions (DFIs) in which the CBN holds substantial equities shares. The CBN also facilitated the setting up of the =N= 100 million Agricultural Credit Guarantee Scheme Fund (ACGSF) in 1977 to guarantee up to a maximum of 75 percent of commercial and merchant banks' agricultural credit. The fund was aimed at increasing the flow of credit to the agricultural sector. The fund is currently managed by the CBN. Other institutions, which the CBN facilitated their establishment, include the Nigeria Export-Import Bank (NEXIM), which was established in 1991. NEXIM provides export financing and export related services such as rediscounting and refinancing facilities and stocking facility to export firms.

These developmental roles of the Bank have been justified on the following grounds:

- **Acute shortage of capital and low rate of domestic savings at independence:**
  The Nigerian economy as at 1960, was characterized by acute shortage of capital and low rate of savings. There was therefore the need to generate savings within a short time to enhance economic development.

- **Need for requisite institutional framework:**
  The traditional functions of the central bank would be hampered if the bank did not undertake some developmental functions. For instance, issuance of legal tender currency as well as the execution of monetary policies would fail in the absence of concomitant development of money and capital markets. Even now, the lingering problems in these markets still constrain the smooth transmission of monetary policies.

- **Need for a sustainable rate of economic growth:**
  There is need to have a government agency capable of carving out a growth path for the economy. This is common to emerging economies and constitutes the divergence in the roles assigned to the central banks of the developed and those of the developing economies. The CBN therefore, is to ensure the development of the economy through the establishment and nurturing of requisite institutions that would facilitate the allocation of resources. For instance, both the agricultural and industrial sectors of the economy need supportive policies and measures to grow on a sustainable basis so as to provide the much needed employment and transformation of the economy. This is in appreciation that the achievement of macro economic stability, which the bank pursues, would be better facilitated if the performance in the real sector is enhanced and focused, such that demand-pull inflation can be controlled through improved productivity.

  In a nutshell, an appreciation that the success of the traditional functions of the CBN requires an enabling and conducive productive environment, which is a prerequisite for the growth and development of the economy, provides a strong basis for the developmental roles of the CBN.

CENTRAL BANK OF NIGERIA'S SUPPORT AND SCHEMES FOR SME FINANCING

The SME have been generally acknowledged as the bedrock of the industrial development of any country. Apart from the numerous goods produced by SMEs, they provide veritable means of large-scale employment, as they are usually labour intensive. They also provide training grounds, for entrepreneurs even as they generally rely more on the use of local materials. Moreover, if well managed, the SMEs can gradually transform into the giant corporations of tomorrow. These contributions thus explain why Governments and International Agencies mobilize efforts towards the realization of sustainable industrial growth and the creation of mass employment through the rapid growth and development of the small-scale enterprises.

However, the SME have had limited access to institutionalized credit facilities, owing to various factors. Some of the major factors include:

- Consideration that the SME are very risky in view of their vulnerability in the market as well as their high mortality rate.

- Banks and other financial institutions are operationally biased in favour of lending to large corporate borrowers, where there is assurance of security, high profitability and faster rates of returns.

- Owing to their nature, SME seeking loans are usually unable or unwilling to provide accounting records and other documentation required by banks, while most are unable to provide acceptable collateral for their loans.

In recognition of these constraints and in order to ensure the realization of the potential benefits of virile SME in the economy, the Central Bank of Nigeria has remained committed to the growth and development of the small and medium scale enterprises in Nigeria. This stance has been successively reflected in the Bank's policies over the years. In particular, the CBN has through its credit guidelines over the years, and until very recently, required the erstwhile commercial and merchant banks to allocate stipulated minimum of credit to the preferred sectors including the SME. In 1979/1980 fiscal year for instance, the minimum stipulated percentage was 10 of total credit to indigenous borrowers, which constituted the SME. It was raised to 16 and 20 of total loans and advances in 1980 and 1989, respectively. In cases of default by banks, such shortfalls were deducted at source from 1987, from the defaulting banks' deposits with the CBN and passed on to the appropriate sector through the relevant development banks, such as the NBCI, NACB, etc. This led to greater compliance by the banks, thus credit to the SME sector expanded. For instance, aggregate credit to SME rose from ₦ 23.9 billion in 1992 to ₦41.5 and ₦177.1 billion in 1995 and 1997, respectively. This represented 45.1, 24.2 and 16.0 percent of total loans and advances for 1992,1995 and 1997, respectively (See table). The financial sector was, however finally liberalized in1993 when the open market operations became the major policy instrument. In spite of this, credit allocation to the SME remained in force until 1996.

Other financial support initiatives and schemes pioneered by the Central Bank of Nigeria include the following:

- **Rural Banking Scheme**
  The rural banking scheme started in Nigeria in 1977 and was basically designed to solve the problems of rural underdevelopment and inadequacy of credit to the agricultural sector and the rural based small-scale industries. The scheme mandated commercial banks in Nigeria to establish branches in the rural areas. By 1989, about 12 years of the life of the scheme, a total of 756 new rural bank branches had been opened with total deposits in all the rural branches amounting to about ₦5.7 billion. This averaged about ₦ 7.5 million per branch.

- **The National Economic Reconstruction Fund (NERFUND)**
  With the introduction of the Structural Adjustment Programme (SAP) in 1986 and the resultant devaluation of the Naira, many small and medium scale enterprises found it difficult to secure finance for their working capital and investment purposes. In order to bridge the observed widening resource gap among this class of enterprises, the Federal Government set up the National Economic Reconstruction Fund (NERFUND), effective 9th January, 1990 with the CBN as one of the facilitating institutions.

It was aimed at providing relatively long term loans (5-10 years), to small and medium scale enterprises at concessionary rates of interest, thereby removing the most formidable handicap to SME development. Between 1990 and 1998, NERFUND disbursed US$144.9 million (Foreign Exchange Component) and ₦681.5 million (Naira Component) to support 218 projects. NERFUND credit extension activities have been seriously constrained mainly by the significant impact of devaluation of the Naira and its effects on loan servicing by beneficiaries. NERFUND was merged with two other DFIs to form the Bank of Industry in 2001.

- **World Bank –Assisted SME II Loan Project**
  In order to further expand credit delivery to SMEs, the Federal Government negotiated some financial assistance in 1989 with the World Bank to complement other sources of funding the SMEs. Altogether, this facility involved a loan of US$ 270 million, which was to be made available for on lending to SMEs through eligible participating banks. The credit components and other related activities of the World Bank loan were administered by the CBN, which in 1990 established an SME Apex unit in order to facilitate its proper implementation. The SME apex office approved a total of 211 projects valued at US$132.8 million between 1990 and 1994 when project approval stopped. Total disbursement of US$ 107.1 million as at June 1996 resulted in the establishment and modernization of 102 projects.

- **People's Bank of Nigeria**
  The People's Bank of Nigeria (PBN) was formally commissioned in October 1989 with the objective of meeting the credit needs of the very small (micro) enterprises. By 1993, the activities of the bank had extended to all the states of the federation in the bid to achieve a target of 170 branches. The bank's loans were administered to groups of entrepreneurs rather than individuals on a deliberate policy based on the "peer pressure" concept.

- **Community Banks**
  The CBN facilitated the establishment and the development of the community banks scheme, which took off in 1991. The objectives of the community banks include: the promotion of rural development by providing financial and banking services to

communities inadequately supplied with such services. Although the National Board for Community Banks was inaugurated in 1991 with the responsibility of setting up community banks in the country, the Community Banks have since come under the surveillance activity of the Central Bank of Nigeria and their activities are therefore receiving adequate guidance from the Apex Bank.

- **The Nigerian Industrial Developmental Bank Ltd (NIDB)**
  The Nigerian Industrial Developmental Bank was established in 1962 with the primary mandate of providing medium to long-term loans for investments in industrial activities. Although its loan portfolio covers mainly large-scale industries, the bank had special units focusing on SMEs financial requirements. An attractive feature of NIDBs financing is its policy of equity participation in the paid up share capital of some of the projects it financed. It disbursed a total of ₦174.6 million to the SME between 1980 and 1988 and was also responsible for the bulk of credit delivery to the SME under SME II loans scheme, accounting for more than 80 percent of the total number of disbursements under the scheme. Arising from financial and other constraints, NIDB has been merged with similar institutions under the newly established Bank of Industry.

- **The Nigerian Bank for Commerce and Industry (NBCI)**
  The Nigerian Bank for Commerce and Industry (NBCI) was set up in 1973 to provide among other things, financial services to the indigenous business community, particularly SME. The NBCI operated as an apex financial body for the SME and also administered the SME I World Bank loan scheme. It approved a total of 797 projects with a credit value amounting to ₦965.5 million between 1973 and 1989 and disbursed ₦141.82 million between 1987 and 1988. The bank also financed a total of 126 projects under the World Bank loan scheme, some of which were however cancelled due to the failure of project sponsors to contribute their counterpart funding. The NBCI suffered from operational problems, culminating in a state of insolvency from 1989. It is now part of the newly established Bank of Industry.

- **Agricultural Credit Guarantee Scheme Fund**

  The Agricultural credit guarantee scheme was introduced in 1978 to facilitate the accessibility of credit to the agricultural sector. The decree that established the scheme provided for a fund of ₦100 million subscribed to by the Federal Government (60 percent) and the Central Bank of Nigeria (40 percent). In 2001, the capital base of the fund was increased to ₦3.0 billion in order to enhance its coverage and performance.

  The purpose of the fund was to provide guarantee in respect of loans granted by the commercial and merchant banks for agricultural purposes with the aim of increasing the level of the bank credit to the agricultural sector. In order to guard against the misuse of the funds, the decree provided that in the event that such loans are used to purchase livestock, machinery or farming equipment, the loan should not be paid to the borrower but to the supplier who should furnish the Bank with the document in evidence of the delivery of the items.

  The Agricultural Credit Guarantee Fund has made some impact on the extension of credit to the agricultural sector as the introduction of the scheme in 1978 increased the percentage of commercial banks' loans to the agricultural sector. The scheme has granted over N3.3 billion to beneficiaries since inception.

- **Nigeria Export Import Bank**

  The Nigeria Export-Import Bank (NEXIM) was established in 1991 to provide finance, risk mitigating facilities and trade information as well as advisory services to Nigerian exporters. NEXIM's Rediscounting and Refinancing Facility was introduced to assist banks to provide pre and post shipment finance in support of non-oil exporters.

  In summary, though the schemes and programmes which were put in place to find solutions to the problems of credit delivery to the SME have achieved considerable successes, there still exists a huge gap which should be filled. The need to reduce the credit risks on loans to SMEs by the financial institutions has become more pronounced given the extremely slow rate of draw down on facilities like the World Bank- assisted SME 11 loan and

NERFUND. In its analysis, the technical committee for the establishment of a National Credit Guarantee Scheme for Small and Medium Enterprises (SMEs) in Nigeria, established that not more than 50 percent of aggregate effective demand for investment loans in the manufacturing sector are currently being met. This therefore, necessitates further action aimed at enhancing the flow of financial resources to the SME sub - sector.

CURRENT FINANCING INITIATIVES AND THE WAY FORWARD

In order to make the SME sector more vibrant, the Central Bank of Nigeria has evolved new initiatives, which are geared towards improving accessibility and availability of credit to the SME through the following:

- **The Small and Medium Industries Equity Investment Scheme (SMIEIS)**

  Bothered by the persistent decline in the performance of the industrial sector and with the realization of the fact that the small and medium scale industries hold the key to the revival of the manufacturing sector and the economy, the Central Bank of Nigeria successfully persuaded the Bankers' Committee in 2000 to agree that each bank should set aside 10 percent of its annual pre tax profit for equity investment in small and medium scale enterprises. To ensure the effectiveness of the programme, banks are expected to identify, guide and nurture enterprises to be financed under the scheme. The activities targeted under the scheme include agro-allied, information technology, telecommunications, manufacturing, educational establishments, services, tourism and leisure, solid minerals and construction. The scheme was formally launched in August 2001. With the introduction of the scheme, it is expected that improved funding of the SMEs will facilitate the achievement of higher economic growth. As at August 2002, the sum of ₦11.572 billion had been set aside by 77 banks. Out of this amount, ₦1.692 billion had been invested in the small and medium scale enterprises.

- **Nigerian Agricultural, Cooperative and Rural Development Bank (NACRDB)**
  The Nigerian Agricultural Cooperative and Rural Development Bank Limited is an amalgam of the former Peoples Bank of Nigeria, Nigerian Agricultural and Cooperative Bank and the Family Economic Advancement Programme (FEAP). It was set up in October 2000, primarily to finance agriculture as well as small and medium enterprises. The NACRDB is structured to accept deposits and offer loans /advances in which the interest rates are graduated according to the purpose for the loan to Nigerians and their business. The bank also offers a number of financial products including target savings; start – up as well as smallholder loan schemes.

- **The Bank of Industry**
  This is an amalgam of the former Nigerian Industrial Development Bank, the Nigerian Bank for Commerce and Industry and the National Economic Reconstruction Fund (NERFUND). It was set up in 2000 with the principal objective of providing credit to the industrial sector, including the small and medium scale enterprises.

- **Refinancing and Rediscounting Facility**
  With effect from January 2002, the CBN introduced the Refinancing Facility at concessionary interest rate to support medium to long term bank lending to the productive sectors of the economy. This facility was instituted to provide liquidity to banks in support of their financing of real sector activities. This was in recognition of the fact that aggregate credit by deposit money banks was mainly short term, and as such loans were channeled mainly to general commerce and trade. Furthermore, there is need to encourage medium to long term lending to the productive sectors of the economy, if the production base of the economy is to be expanded and diversified. The RRF is designed to provide temporary relief to banks, which face liquidity problems as a result of having committed their resources to long term financing to the specified productive sectors. The sectors include agricultural production, semi manufacturing and manufacturing, solid minerals and information technology. Under the facility,

banks shall have access up to 60 percent of qualifying loans. Qualifying loans must have been held for not less than one year.

The Way Forward

The various measures taken to ensure the growth and development of the small and medium scale enterprises have witnessed limited success as a result of myriad of reasons. These include inadequate infrastructural facilities, continued restricted access to credit as well as abuse of the various programmes by both the beneficiaries and the operators arising from insincerity of purpose, among others.
The small and medium scale industries however remain very prominent in the industrial growth path of any economy. Consequently, efforts towards a sustainable growth of the sub sector should be intensified. In this regard, the various current initiatives (SMIEIS, BOI, NACRDB, ACGS etc) should be strengthened and refocused in order to obviate the problems associated with past initiatives.

Towards this, the following should be seriously considered:

- Efforts should be intensified towards the adequate provision of infrastructures.

  This would not only reduce the cost of production and enhance competitiveness, but would also encourage further investment and growth of the sector.

- Observed constraints such as demand for cumbersome collateral security in accessing available credits should be removed.

  Operators of the different initiatives should therefore endeavour to ensure that funds get to the targeted group of investors. This may require a review of the existing framework to ensure greater flexibility without sacrificing the principle of sound financial practice.

- Government should on its part endeavour to fund the Banks of Industry and the Nigerian Agricultural Cooperative and Rural Development adequately.

- The apparent lull in the activities of the Small and Medium Industries Equity Investment Scheme (SMIEIS) shows that the problem with the growth of the SMEs is not just capital. There is the problem of inertia, unwillingness to dilute ownership and control, fear of the unknown, etc. These can be solved through enlightenment. Therefore, the active involvement of the Nigerian Association of Small Scale Industrialists (NASSI) and all other groups of the organized private sector should be encouraged in order to have wider coverage and patronage. Experience has also shown that information on SMIEIS is yet to be adequately disseminated.

- Effort should be made by the Government to attract international financial institutions towards the growth and development of SMEs in Nigeria. Such organizations as the World Bank, the International Finance Corporation, among others have made laudable contributions towards this in the past.

SUMMARY AND CONCLUSION

The Central Bank of Nigeria in pursuance of its traditional role has also been involved in development issues. These developmental roles of the Bank become necessary in order for the economy to grow in a sustainable way. The CBN has aided the financing of enterprises through several approaches including the establishment of developmental finance institutions, use of monetary and policy guidelines to channel credit as well as operation of loan guarantee scheme among others. These efforts have attained varying levels of success and have actually moved the SME sub sector forward. However, much still needs to be done by all the stakeholders in the sub sector. This has necessitated the new initiatives which hopefully would minimize the constraints to accessing institutional credit by the SMEs, while ensuring that identified bottlenecks to the efforts are corrected.

TABLE
COMMERCIAL AND MERCHANT BANKS' LOAN AND ADVANCES TO SMALL AND MEDIUM ENTERPRISES 1993 - 2000

	Total Credit (1) ₦'m	SME Credit (2) ₦'m	(2) Percentage of (1) %
1992	529998.8	23893.9	45.08
1993	73245.8	20363.9	27.80
1994	126809.1	26041.8	20.54
1995	171768.2	41534.1	24.18
1996	210381.2	47897.9	22.77
1997	1,100,883.1	176126.8	16.00
1998	1264251.8	201160.6	15.91
1999	402,338.1	53213.1	13.23
2000	565871.3	51001.1	9.01

Source: 1. CBN Statistical Bulletin, December 1998
2. Commercial and Merchant Banks' Returns

PROBLEMS AND PROSPECTS OF SMALL AND MEDIUM-SCALE INDUSTRIES IN NIGERIA

By

Job Abiodun Olorunshola*

INTRODUCTION

Small and Medium Industries (SMIs) have been widely acknowledged as the springboard for sustainable economic development. In particular, developing countries including Nigeria, have since the 1970s shown increased interest in the promotion of small and medium scale enterprises for three main reasons: the failure of past industrial policies to generate efficient self-sustaining growth; increased emphasis on self-reliant approach to development and the recognition that dynamic and growing SMIs can contribute substantially to a wide range of developmental objectives.

These objectives include efficient use of resources, employment creation, mobilization of domestic savings for investments, encouragement, expansion and development of indigenous entrepreneurship and technology as well as income distribution, among others. Consequently, programmes of assistance in the areas of finance, extension and advisory services, training and provision of infrastructure were designed by the government for the development of SMEs to enhance the attainment of these objectives. However, the full potential of the SMIs in the developmental process have not been realized, owing to various constraints.

The thrust of this paper is, therefore, to articulate the challenges posed to the development of a dynamic SME sub-sector arising from some lingering constraints despite previous and current government measures, which were aimed at facilitating the sub-sector's development.

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The paper is divided into five sections. The first section reviews the concept and definition of SMIs, their characteristics and potential benefits. Section two is an overview of policies and incentives that have been used in promoting SMIs in Nigeria, including a brief appraisal of some of these measures.

The lingering problems of the sub-sector are discussed in Section three while prospects and suggested future policy focus for the sub-sector are outlined in Section four. Section five summarizes and concludes the paper.

SECTION I

DEFINITION, CHARACTERISTICS AND BENEFITS OF SMEs

Definition:

The concept of SMEs is relative and dynamic. The definitions change over a period of time and depend, to a large extent, on a country's level of development. Prior to 1992, different government agencies in Nigeria such as the Central Bank of Nigeria tended to adopt various definitions to reflect differences in policy focus. However, in 1992, the National Council on Industry streamlined the various definitions in order to remove ambiguities and agreed to revise them every four years. Small Scale Enterprises were defined as those with fixed assets above ₦1 million but not exceeding ₦10 million, excluding land but including working capital, while Medium Scale Enterprises are those with fixed assets, excluding land but including working capital, of over ₦10 million but not exceeding ₦40 million. The definitions were revised in 1996 with Small Scale Industry defined as those with total cost, including working capital but excluding cost of land above ₦1 million but not exceeding ₦40 million with a labour size of between 11 and 35 workers; while Medium Scale Industry was defined as those with total cost, including working capital but excluding cost of land, above ₦40 million, but not exceeding ₦150 million with a labour size of between 36 and 100 workers.

Characteristics:

The SMEs are characterized by limited access to financial capital, simple management structure resulting from the fusion of ownership and management by one person or very few individuals. SMEs tend to strongly revolve around the owner-managers, rather than as a separate corporate entity. There is often greater subjectivity in decision taking, and prevalence of largely informal employer - employee relationships. As a result of their greater use of local resources, they are widely dispersed throughout the country. They are also closely attached to the products that launched them; many are labour-intensive although modern SMEs are increasingly employing reasonably high technology.

The Benefits of SMEs:

The benefits of SMEs are well documented in the literature and would only be summarized here to put into proper perspective the issues involved. They provide an effective means of stimulating indigenous entrepreneurship, create greater employment opportunities per unit of capital invested and aid the development of local technology. Through their wide dispersal, they provide an effective means of mitigating rural-urban migration and resource utilization. By producing intermediate products for use in large-scale enterprises, they contribute to the strengthening of industrial inter-linkages. Small enterprises are known to adapt with greater ease under difficult and changing circumstances because their typically low capital intensity allow products lines and inputs to be changed at relatively low cost. They also retain a competitive advantage over large enterprises by serving dispersed local markets and produce various goods with low scale economies for niche markets.

SMEs also serve as veritable means of mobilisation and utilization of domestic savings as well as increased efficiency through cost reduction and greater flexibility. They have been very prominent in the manufacture of bakery products, leather manufactures, furniture, textiles and products required for the construction industry. The SMEs in Nigeria have expanded following the adoption of the Structural Adjustment Programme (SAP) to fill the supply gap in industrial consumer goods created by the difficulties faced by large scale firms which have not easily adapted to the policy changes of SAP.

SECTION II

AN OVERVIEW OF POLICIES AND INCENTIVES FOR PROMOTING SMALL AND MEDIUM SCALE ENTERPRISES IN NIGERIA

In order to realise the benefits of promoting small and medium scale enterprises, the Federal Government has employed monetary, fiscal and industrial policy measures to achieve its desired goals, which included:

(i) Employment generation,

(ii) Industrialization particularly of rural areas and even development through industrial dispersal. Accordingly, it has enunciated policies through national development plans, annual budgets and its agencies to provide financial assistance, training and some infrastructural support to SMEs.

Specifically, the government has been active in the following areas:

(i) Funding and setting up industrial areas and estates (to reduce overhead costs);

(ii) Providing local finance through its agencies - the Central Bank of Nigeria Federal Ministry of Industries (Small-Scale Industry Credit Scheme - SSICS), Nigerian Industrial Development Bank (NIDB), Nigerian Bank for Commerce and Industry (NBCI);

(iii) facilitating and guaranteeing external finance through the World Bank, African Development Bank and other international institutions willing to, and capable of assisting SMEs;

(iv) Facilitating the establishment of the National Directorate of Employment (NDE) which also initiates the setting up of new SMEs;

(v) Setting up of the erstwhile National Economic Reconstruction Fund (NERFUND) which is a source of medium to long-term local and foreign loans for small and medium scale businesses, particularly those located in the rural areas;

(vi) initiating the them Family Economic Advancement Programme (FEAP); and

(vii) provision of technical, training and advisory assistance programmes through establishment of Industrial Development Centres, etc.

1. Industrial Development Centres (IDCs)

Essentially, IDCs are established to provide extension services to SMEs in areas such as technical appraisal of loan application, training of entrepreneurs, managerial assistance, product development, production planning and control as well as other extension services. The first IDC was established in Owerri in 1962 by the then Eastern Nigeria Government and taken over in 1970 by the Federal Government. Subsequently, in the Second National Development Plan (1970 - 1975), the Federal Government initiated the setting up of more IDCs at Zaria, Oshogbo, Maiduguri, Abeokuta, Sokoto, Benin City, Uyo, Bauchi, Akure, Ilorin, Port Harcourt, Kano and Ikorodu.

2. Small Scale Industries Credit Scheme (SSICS)

A basic thrust of government's financial policy with respect to SMEs is the provision of credit facilities to ensure their development and sustenance. Accordingly, the Federal Government set up in 1971, a Small Industries Development Programme to provide technical and financial support for SMEs. This led to the setting up of the Small Industries Credit Committee (SICC) to administer the Small Industries Credit Fund (SICF) throughout the country. The SICF was formally launched as the Small Scale Industries Credit Scheme (SSICS) in the Third National Development Plan, 1975-1980. The scheme, which operated as a matching grant between the Federal and State Governments, was designed to make credit available in liberal terms to SMEs and was managed by the states' Ministries of

Industry, Trade and Co-operatives through the Loan Management Committees (LMCs).

However, the SSICS which was meant to be a revolving loan scheme became increasingly starved of funds arising from massive loan repayment defaults, such that the Federal Government, by 1979 extricated itself from the scheme and introduced a new policy of using the Nigerian Bank for Commerce and Industry (NBCI) as an apex financial body for funding SMEs. The rationale was that banking discipline and prudence would not only ensure the flow of financial assistance to 'bankable' projects, it would also facilitate loan recovery.

3. The Nigerian Bank for Commerce and Industry (NBCI)

The NBCI was set up by the Federal Government through Decree 22 of 1973 to provide, among other things, financial services to indigenous business community, particularly SMEs. The NBCI operated as the apex financial institutional body for SMEs. It also administered the SME I World Bank Loan Scheme of US$41 million secured in 1984. The scheme had maturities period ranging from 4 to 10 years, including a moratorium of 2 to 4 years, and the foreign exchange risk was borne by the Federal Government. NBCI has been merged with NIDB and NERFUND to form the new Bank of Industry.

4. The Nigerian Industrial Development Bank (NIDB)

The NIDB, which was set up in 1964, provided credit and other facilities to industrial enterprises especially medium and large scale ones. Some small-scale enterprises also come under its scope of financing whose terms are relatively soft. An attractive feature of NIDB's financing is its policy of equity participation in the paid up share capital of some of the projects financed.

5. Central Bank of Nigeria (CBN)

The Central Bank of Nigeria has since 1970 been instrumental to the promotion and development of enterprises particularly in the small and medium scale sub-sector. The CBN credit guidelines required that the commercial and merchant banks allocate a minimum stipulated credit to sectors classified as preferred, including the SMEs. The CBN also stipulated differential interest rates for sectoral credit allocations with varying moratorium on the repayment of loans and advances. For instance, the CBN in 1979/80 directed that at least 10 per cent of the loans advanced to indigenous borrowers should be allocated to SMEs. This was subsequently raised to 16 and minimum of 20 per cent of total loans and advances from April 1980 and 1990, respectively. However, given the uneconomic nature and cumbersome administration of such loans, banks preferred to pay prescribed penalties rather than channel credit to the SMEs. The failure of the banks to meet the prescribed credit allocation led the CBN to mandate such defaulting banks as from 1987, to make such lending shortfalls available to it for onward transfer to the relevant sector or sub-sector. This brought about a remarkable improvement in credit to the SMEs as banks continued to meet this minimum sectoral credit requirement while it lasted.

6. World Bank SME II Loan Scheme

In order to promote the establishment of a new generation of viable investments and services as well as improve the quality and range of financial and extension services available to SMEs, the Federal Government negotiated for a financial assistance package from the World Bank from 1987. The loan package was approved in 1989 and the SME Apex Unit located in the CBN executed it. The total project cost was estimated at $418 million, including $264.4 million (63%) in foreign exchange. The World Bank provided a loan of $270.0 million or 65% of the total project cost (100% of the foreign exchange requirements and 4% of local costs). The balance of $148 million was to be financed by the beneficiary enterprises and the participating banks (Pbs) from their own resources. The Pbs are to bear the credit risk while the foreign exchange risk is to be borne by the Federal Government. The loan was sub-divided into five components, namely, line of credit ($200 million), pilot financial restructuring ($20 million), pilot mutualist credit guarantee scheme ($45 million), equipment leasing ($25 million) and others ($20 million). Pilot financial restructuring and pilot mutualist credit guarantee scheme were cancelled and replaced with the urban mass transit scheme. Term loans provided under the programme have a maturity period of 15 years, including a grace period of 3 years. The scheme also provided working capital to the beneficiaries with maturity period of 3 years and 1-year grace period. When the programme began, approval of projects and disbursement of funds were very slow because of inadequate publicity, lengthy and cumbersome approval processes, assumption of all credit risks by the Pbs and the floating of the naira, which affected the viability of many projects.

7. National Economic Reconstruction Fund (NERFUND)

The Federal Government, through Decree No. 2 of 26th January 1989 established the National Economic Reconstruction Fund (NERFUND). The main focus of NERFUND is the provision of soft, medium to long term funds for wholly Nigerian owned SMEs in manufacturing and agro-allied enterprises, mining, quarrying, industrial support services, equipment leasing and other ancillary projects. The NERFUND decree provides for eligible enterprises under the scheme, as SMEs, with fixed assets plus cost of new investment (land excluded), not exceeding ₦36 million and sourcing not less than 60 per cent of their raw materials locally in the case of manufacturing projects. The interest rates payable on funds obtained from NERFUND are expected to be slightly lower than the market rates and shall be fixed during the duration of the loan. Furthermore, the rates payable by the participating banks (Pbs) are limited to 1.0 per cent above NERFUND's cost of borrowing the particular fund. Pbs are allowed a spread of not more than 4.0 per cent over their cost of funds. For all types of facilities, and irrespective of the ability of the beneficiary to pay maturing obligations, it is required that a Pb repays NERFUND, failing which the CBN will automatically debit the bank's accounts with it. Thus, Pbs are expected to bear the full credit risk involved in financing SMEs under the scheme. The fund has granted loan approvals to a number of projects spread across the country. The number rose significantly from 5 in 1989 to 75 in 1990 after which it maintained a downward trend. NERFUND's investments in the projects have been substantial, the total naira component was ₦774.2 million, while the counterpart approval in foreign exchange was $97.5 million.

8. State Governments

State Governments, through their Ministries of Commerce and Industries also promote the development of SMEs. In this connection, some State Governments promote the SMEs through state-owned Finance and Investment companies which provide technical and financial assistance to SMEs. However, owing to numerous constraints, some were less active than others.

9. **The National Directorate of Employment (NDE)**

Established in 1986, the NDE is another channel through which government has promoted the development of SMEs. In January 1987, NDE launched a number of programmes to generate self-employment. These were (i) Small Scale Industries (SSI), (ii) Agriculture, (iii) Youth Employment and Vocational Skills Development and (iv) Special Public Works. The programme operates two credit guarantee schemes complemented by an entrepreneur development programme to assist the SMEs. The two credit schemes are the Graduate Job Creation Loan Scheme (GJLS) and the Matured People's Scheme (MPS). Facilities under the two schemes are repaid over a five-year period at a concessionary interest rate with varying periods of moratorium. SME projects covered included soap making, food processing, flour milling.

10. **International Financial Assistance**

Government have continued to approach international financial agencies to source needed foreign capital for the SMEs. Such international agencies include the World Bank and its affiliates and the African Development Bank (ADB). The Federal Government often guarantees and agrees to monitor or co-finance the SMEs receiving such external financial support. For example, in 1988, the African Development Bank granted an export stimulation loan of US$252 million for SMEs in Nigeria. The loan is repayable in 20 years with a concessionary interest rate of 7.3 per cent.

11. **Bank's Equity Holding in Companies**

In its 1988 Budget, the Government amended the Banking Act Section 73(f) of 1969, which restricted banks from holding equity shares in non-banking related enterprises. The Government thus provided opportunities for Banks to participate in the ownership of business. The policy objectives are to stimulate increased availability of equity capital to SMEs and help in restructuring their capital bases for survival and growth.

12. **The Second Tier Securities Market (SSM)**

In order to deal with the bias of the capital market in favour of large enterprises, the Second Tier Securities Market (SSM) was established in 1985 to assist small and medium sized indigenous enterprises in accessing funds from the capital market for expansion and modernisation.

13. **Other Technical Training and Extension Services Programme**

This includes activities of Industrial Training Fund (ITF), Raw Materials Research and Development Council (RMRDC), Federal Institute of Industrial Research, Oshodi (FIIRO), Project Development Agency (PRODA), and Centre for Management Development (CMD).

An Appraisal of Policy Measures and Incentives

An appraisal of the various policies and incentives aimed at promoting the development of the SMEs showed various degree of success. The implementation of the IDCs was poor and their performance devoid of luster. This is because many of them were inadequately equipped and funded. The SSICs was largely unsuccessful because of the dearth of executive capacity to appraise, supervise and monitor projects. As a result many unviable projects were funded which led to massive loan repayment default. Consequently, the scheme, which was expected to be revolving, had to be stopped.

As the main Federal Government instrument for SME credit provision, the NBCI approved a total of 797 projects, amounting to ₦965.5 million between 1973 and 1989 and disbursed ₦141.82 million between 1981 and 1988. These covered various sub-groups such as textiles, paper products etc. The Bank financed a total of 126 projects under the World Bank Loan Scheme 1 and many others were cancelled for failure of project sponsors to contribute their counterpart funding. The NBCI has however, suffered major problems culminating in a state of insolvency in 1989. The NIDB has played a major role in SMEs financing, its assistance covers 17 sub-sectors of industry. The NIDB disbursed a total of ₦ 174.6 million to the SMEs between 1980 and 1988. The level of NIDB's direct project sanctions and disbursement to the SMEs since 1989, however, has tended to fluctuate downwards due to the establishment of NERFUND, the SME II Loan Scheme, amongst other reasons. The CBN has continued to play a leading and catalytic role in channeling credit to the SMEs through its guidelines to the banks. This has resulted in expanded credit to the SME sub-sector. For example, hanks' loans and advances to the SMEs rose from ₦113.4 million in 1980 to ₦1,454.3 million, ₦5,900 million, ₦20.400 million and ₦42,302.1 million in 1986, 1990, 1992, and 1996, respectively. Loans and advances to the SMEs as a percentage of total loans rose from 1.8 per cent to 9.3, 22.9, 40.0 and 26.8 per cent in 1980, 1986, 1990, 1992 and 1996, respectively. NERFUND since its inception, and up to 1994, approved 373 projects with disbursements initiated on 200 and commitment of US$80.9 million and N333 million. About 70 of the sub-projects have been fully disbursed while 21 of them have fully amortized the total loan value. Despite these successes, NERFUND was confronted by a number of problems. Evidence in this regards suggest poor and untimely loan recovery rate, while demand for loans have plummeted after 1990 because of concern for foreign exchange risk which was borne by the borrower.

Furthermore, the SME Apex Office approved a total of 211 projects for US$132.8 million between 1990 and end March 1994 when projects approval closed. Total disbursements of $107.1 million as at June 1996 resulted in the establishment of 85 new SMEs and the expansion, diversification and modernization of 102 existing ones.

Also, the number of SMEs listed on the Second Tier Market (SSM) has risen to 16, 19 and stood at 20 in 1990, 1991 and 1995, respectively. While at least 4 SMEs have moved to the Main List of the market. This shows increasing use of the capital market by the SMEs to raise funds for expansion and modernisation.

SECTION III

LINGERING PROBLEMS OF THE SME SUB-SECTOR

In spite of this array of measures put in place to facilitate its growth, numerous problems have continued to hinder the optimal performance of the SMEs. Such problems include:

1. **Constrained Access to Money and Capital Markets**:
   The banking sector tends to be lukewarm in meeting the credit requirements of the SMEs. This is because of inadequately prepared project proposals, incomplete financial documentation, and inadequate collateral, including the inability to raise the required equity contribution by the SMEs. The banks also regard many SMEs as high risk ventures because of absence of succession plan in the event of the death of the proprietor. As a result, working capital is still a major constraint on production, as most SMEs are restricted to funds from family members and friends and are therefore unable to respond timely to unanticipated challenges. More worrisome is SMEs inability to adequately tap available finance from the capital market. This has been attributed to their aversion to disclosure and ownership dilution, although many SMEs blamed this phenomenon on the cumbersome requirements and procedure for listing on the Stock Exchange.

2. **Shortage of Skill**:
   Inadequate financial resources, as well as desire to operate with limited openness on the part of proprietors lead many SMEs to employ semi-skilled or unskilled labour. This, of course, affects productivity, restrains expansion and hinders competitiveness.

3. **Financial Indiscipline:**
   Some SME proprietors deliberately divert loans obtained for project support to ostentatious expenditure. Some do not divert, but refuse to pay back as and when due, the interest and the principal, because of the misconceived notion of sharing the so-

called national cake. The Failed Banks Decree has gone a long way in sanitising this incidence. It must be admitted, however, that there are genuine cases of loan defaults arising from operational difficulties.

4. **Inadequate Infrastructural Base**:
   Inadequate provision of essential services, such as telecommunications, access roads, electricity and water supply, constitutes one of the greatest constraints to SME development. Most SMEs resort to the private provisioning of these at huge costs. A World Bank Study (1989), estimated that such cost accounted for 15 - 20 per cent of the cost of establishing a manufacturing enterprise in Nigeria. Contemporary evidence has shown that the relative burden of the compensatory provision of infrastructural facilities is much heavier on SMEs than on large enterprises.

5. **Poor Implementation of Policies**
   The poor implementation of policies, including administration of incentives and measures aimed at facilitating SMEs growth and development have had unintended effects on the sub-sector. This had resulted, for instance, into confusion and uncertainty in business decisions and planning as well as weakened the confidence by the SMEs on government's capacity to execute faithfully its programmes.

6. **Poor Management Practices and Low Entrepreneurial Skill**:
   Many SMEs do not keep proper accounts of transactions. This hinders effective control and planning. Moreover, lack of relevant educational background and thorough business exposure constrains their ability to seize business opportunities that may lead to growth and expansion.

7. **Restricted Market Access**:
   Insufficient demand for the products of the SMEs also imposes constraint on their growth. Although many SMEs produce some inputs for the large enterprises, the non-standardization of their products, the problem of quality assurance as well as generally low purchasing power, arising from consumers' dwindling real incomes, effectively restrict their markets. This is further

compounded by the absence of knowledge about the existence of fringe markets by the SMEs.

8. **Overbearing Regulatory and Operational Environment**
   The plethora of regulatory agencies, multiple taxes, cumbersome importation procedure and high port charges has continued to exert serious burden on the operations of the SMEs. Many SMEs have to deal with myriad of agencies at great cost.

SECTION IV

PROSPECTS AND FUTURE POLICY FOCUS FOR SMI DEVELOPMENT

The SMIs provide great prospect for sustainable economic development. They can be valuable agents to initiate growth in employment through the development of modern efficient enterprises. They can also serve as instruments for achieving poverty alleviation because they are largely labour intensive. They similarly have tremendous potential in the expansion of non-oil exports. Moreover, the SMIs would remain very virile in the area of sub-contracting for large companies especially in fields like electronic components and spare parts. However, these can only be achieved if future policy focus seeks to address:

(i) inadequate and deteriorated state of infrastructures such as roads, telecommunications, electricity and security. This would include upgrading and expanding them. Moreover, necessary steps to privatise these services should be stepped up to ensure greater efficiency;

(ii) restricted access of SMIs to the Money Market. This would involve the resolution of the collateral issue. Moreover, listing procedure on the Second Tier Securities Market on the Stock Exchange should be re-fashioned in order for more SMIs to access the capital market for needed funds.

(iii) cumbersome regulatory environment, through further streamlining and simplification of regulatory procedures. This should also involve strengthening the capacity of relevant institutions in order to effectively implement and administer programmes and incentives for the SMIs;

(iv) penetrating the export market through the strategy of promoting specific export oriented SMEs. This would include the promotion of extractive and agro-processing, textiles and garments, leather, oil products as well as computer components and other light industries;

(iv) entrepreneurial development through intensive, non-formal training of existing and prospective SME promoters' programmes;

(v) improved production processes and quality control to meet exports standard. Others would include provision of assistance to improve marketing skills, information about markets as well as trade support services, including export infrastructures;

(vii) the problem of reducing the commercial risks associated with lending to SMIs. There is need for risks sharing arrangement between the banks and the Government as a means of encouraging the banks to channel funds to the sub-sector;

(viii) the need to sustain, multiply and strengthen the linkages between small and large scale industries, particularly through sub-contracting. This would involve the creation of information exchange system on supply and demand, as well as technology matters among the relevant private sectors;

(ix) the need for Government to consolidate its efforts in IDC development.

This focus should be to strengthen and provide them with relevant operational budget to get them functioning efficiently. On the other hand, the IDCs could be turned to the private industrial associations for their management and for the IDCs to charge a fee.

CONCLUSION

Undoubtedly, a dynamic SME sub-sector is vital and imperative for the overall economic development of the country. The observed weak performance, occasioned by lingering constraints should, however, serve as a lesson for policy makers to fashion out an enduring strategy that would be sufficiently dynamic and responsive to the needs of indigenous SMEs. Future policy thrust would, therefore, have to focus on addressing those endemic problems that have militated against the optimal development of the sub-sector.

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GUIDELINES AND STAKEHOLDERS RESPONSIBILITIES IN SMIEIS

By

Chief A.T. Salami*

INTRODUCTION

It is a great pleasure, honour and privilege for me to address participants at this seminar on the subject of Small and Medium Industries Equity Investment Scheme (SMIEIS), a theme of undoubted relevance to growing of the Nigerian economy.

Permit me to note that the scheme is an ingenious initiative of the Bankers' Committee as the banks' contribution to kick-start the economy. It is therefore inspiring to review the concepts, stakes and operational guidelines with fellow colleagues. In my view, a continuous review and exchange of ideas of this nature is the minimum conditions for keeping the vision and operations of SMIEIS on track and spreading gospel.

Prior to the 1970s or thereabout, the view that large firms were cornerstone of modern economy dominated economic literature. He theory of economy of scale, which is predicated, on the advantages of large scale operations was almost a decline. In this context, Small-Scale Industries (SSIs) were seen as belonging to the past, out-model and a sign of technological backwardness. Indeed, their rapid decline became an index of industrial progress (Owualah, 2001) lately, however, this view has changed, as the importance of small-scale industries in promoting industrialization and economic growth has been recognized globally.

The experience of many countries indicates that small and medium scale industries (SMIs) can meaningfully contribute to the attainment of many economic development objectives. These include output expansion, employment generation, even location of industries among regions in a country, income redistribution, promotion of indigenous entrepreneurship and technology, as well as production of intermediate goods to strengthen

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inter and intra-industrial linkages. These among others, explains the increased interest, which many countries have shown, in the promotion of small and medium scale enterprises (SMEs) since the 1970. Governments have, therefore, designed programmes of assistance to enhance the achievement of this objective. These are usually in the areas of finance, extension and advisory services, training and provision of infrastructural facilities. Financing programmes have attracted more attention than others because every enterprise will require funds for its capitalization, working capital and rehabilitation needs, as well as for the creation of new investment.

This Paper is an attempt to review the guidelines of the Scheme and exposit on the roles of all stakeholders in its implementation. Following this introduction, section II discusses the definition of small and medium scale industries. The importance of SMI in economic development is the subject matter of Section III, while an overview of past government support for SMI is in Section IV.

Section V discusses the guidelines and the roles of stakeholders in SMIEIS. The paper ends with challenges and way forward in Section VI.

DEFINITION OF SMALL AND MEDIUM SCALE INDUSTRY

There is no universal definition of small-scale industry. Each country tends to derive its own definition based on the role SMIs are expected to play in that economy and the programmes of assistance designed to achieve that goal. Varying definitions among countries may arise from differences in industrial organization at different levels of economic development and differences in economic development in parts of the same country (Sule, 1986). For example, a firm that can be regarded as micro of small in an economically advanced county like the United States of America or Japan, given their level capital intensity and advanced technology, may be classified as medium or even large in developing countries like Nigeria and Ghana. Definitions also change over time, owing to changes in price levels, advances in technology or other considerations. Even in the same country different institutions may adopt difference definitions, depending on their policy focus. The criteria that have been used in the definitions include capital investment (fixed assets), annual turnover, gross output and employment.

Prior to 1992, different institutions in Nigeria adopted varying definitions of small enterprises. The institutions included the Central Bank of Nigeria, Nigerian Bank of Commerce and Industry, Centre for Industrial Research and development and the national economic Reconstruction Fund. In 1992, the National Council on Industry (NCI) streamlined the definition of industrial enterprises to bring in uniformity and provided for its review every four years. The definitions were revised in 1996as follows (NCI, 1996):

(i) Cottage industry – enterprise with total cost (including working capital but excluding cost of land) not more than 1 million, with a labour size of not more than 10 workers;

(ii) Small-scale industry – enterprise with total cost (inclusive working but excluding cost of land) above 1 million but not exceeding 40 million, with a labour size of between 11 and 35 workers; and

(iii) Medium-scale industry – enterprise with total cost (inclusive working capital but excludi9ng cost of land) above 40 million but not exceeding 150 million, with a labour size of between 36 and 40 workers; and

(iv) Large-scale industry – enterprise with total cost (inclusive working capital but excluding cost of land) above 150 million and a labour size of over 100 workers.

THE IMPORTANCE OF SMIs IN ECONOMIC DEVELOPMENT

The contribution of the small and medium scale industries (SMIs) in promoting industrial and economic development are well documented in the literature. Specifically, the SMIs can help in the achievement of the following economic development objectives:

i. Employment Generation

Globally, employment generation is one of the most important reasons for promoting the development of SMIs. This more so in the developing countries in which a large proportion of the labour force is unemployment size in many countries to small and medium enterprises, ranging from 45 per cent (manufacturing sector only in

Australia to 79.3 per cent in Switzerland (see Table). In addition, the study showed that recent gains in employment in the US, U.K., Germany and Spain were almost confined to small firms, employing fewer than 20 workers. In Nigeria, the small and medium enterprises sub-sector has been expanding, especially since the mid-1980s, following the prolonged recession in the economy which forced many large enterprises to lay off large proportions of their workforce. The sector accounts for about 70 per cent of industrial employment (World Bank, 1995). Also, the agricultural sector, which largely consists of SMEs, employs over 60 per cent of the nations work force.

ii. Utilization of Local Resources

Small and medium scale industries are known for their creativity in the utilization of local raw materials, that do not require high level technology to process. In Nigeria for instance, SMIs are concentrated in such enterprises as food processing, textiles, wood works, leather products, soap and detergent sub-sector that require simple technology and the raw material are in abundance. Small enterprises also recycle discarded by-products of large firms as primary inputs in their own production processes.

iii. Output Expansion

In many middle-income economies small and medium industries contribute substantially to the national output. In India for example, the small scale industry sub-sector alone, excluding medium enterprise, accounted for 40 per cent of total industrial output and 35 per cent of total exports in 1998.

The sub-sector produces over 75,000 products (India, 2000). In Nigeria, however, the output of the sector is low. Although the SME sector as a whole account for about 70 per cent of total industrial employment, its contribution to manufacturing output is estimated at only 10-15 per cent, indicating very low large ones in meeting new consumer requirements that utilise local resources.

iv. Transformation of Indigenous Technology

All economies have transited from household artisan industries over time to the modern industrial set-up which has witnessed phenomenal upgrading in skills, machinery and equipment, and management practices. Historical evidence indicate that most of today's giant corporations began as very small firms. These include Guinness of Dublin and Philips international of the Netherlands; as well as Sonny and Honda of Japan. Developing countries can learn from the experience of these giants and create a conducive environment that will enable small and medium enterprises to adapt imported technologies, modernize their process and grow to become large corporation.

v. Production of intermediate Goods

SMIs product intermediate and final consumption goods needed by larger enterprises and the economy as a whole. These include raw materials, machinery and equipment, spare parts and household goods. The deliveries to the large corporations is done through sub-contracting, which enables smaller enterprise to supply their needs, instead of competing with them in the production of final consumer goods in which small enterprises are relatively disadvantaged. The inter-dependence of the sector provides the backward and forward linkages which an economy needs for self dependence and sustenance. In the advanced economies, this symbiotic relationship is so developed that the sectors extensively depend on each other for survival. In Japan for instance, about 70 per cent of the value of exports of large firms is the products of SMEs (ADCG, 2000).

vi. Promotion of Even Development and Reduction of Income Disparities

The promotion of SMIs development aids the dispersal and diversification of economic activities, and induces even development in a country or region. This is because SMIs need relative small seed capital to start operations and their raw materials are widely dispersed in most countries. In addition, their processing technologies and management styles are simple, making investment in the sector affordable to the ordinary people in the society.

vii. Increase in Revenue Base of Government

Through various forms of taxes, including personal and company income taxes, SMIs contribute to increasing government revenues.

AN OVERVIEW OF FINANCIAL SUPPORT PROGRAMMES TO SMALL AND MEDIUM SCALE INDUSTRIES IN NIGERIA

Financial support programmes for promoting SMIs in Nigeria have been many and included:

(i) Small Scale Industries Credit Guarantee Scheme which was established in 1971 as a matching grant arrangement between the Federal and State Governments;

(ii) Establishment of the Nigerian Bank for Commerce and industry (1973);

(iii) Central Bank of Nigeria credit guidelines which required banks to allocate varying amounts of stipulated minimum credit to the preferred sectors of the economy, including small scale enterprises (1970);

(iv) Establishment of the National economic Reconstruction Fund (1989)

(v) The World Bank SME II Loan Scheme (1990);

(vi) Fiscal incentives in the form of tax relief to all small and medium enterprises during the first six years of operation, pioneer status involving non-renewable tax relief for five years, and periodic downward adjustment of tariffs to reduce production cost; and

(vii) Second-Tier window on the Capital Market, designed to accommodate small enterprises that cannot satisfy the listing requirements of the main window.

In spite of these support programmes, the potentials of the small and medium enterprises sector have not been fully exploited as the SMEs, contribute about 70 per cent of total industrial employment account for only 10-15 per cent of total manufacturing output as noted above. Also, the agricultural sector, which engages over 60 per cent of the nation's labour force produces only about 40 per cent of the gross domestic produce.

As of now, there appears to be no viable means of funding SMIs, as the development finance institutions have not functioned for years, while externally sources funds have been exhausted. The only formal sources of funding available to the sector are the conventional banks and the capital market which have not reason that the Small and Medium industries Equity Investment Scheme (SMIEIS) was initiated by the Bankers' Committee. The scheme requires all banks in Nigeria to set aside 10 per cent of their profit before tax annually for equity investments in SMIs. The education of all Nigerians on the modus operandi of this scheme is a major objective of this workshop.

GUIDELINES

Establishment of the Programme

The SMIEIS programme which requires all licensed banks in the country to set aside 10% of their Profit Before Tax (PBT) for equity investment in the small and medium industries was approved by the Bankers' committee at its 246th meeting held on 21st December, 1999.

(a) Objectives of the Scheme

The objectives of the Scheme, among others include:

- facilitating the flow of funds for the establishment of new small and medium industries and reactivation, expansion or restructuring of on-going projects in this sub-sector
- stimulating economic growth, development local technology and generating employment.
- Management and stimulation of corporate governance in the SMIs.

(b) Management of SMIEIS Funds

The bank's financial statement shall clearly highlight reserve maintained for investment in SMI. Specifically, 10% of PBT shall be classified as reserve.

Participating banks may operate the scheme directly or through their wholly owned subsidiary companies or through venture cap city companies floated by a consortium of banks. Banks could also operate the scheme directly through desk officers assigned to SMIEIS funds investment. However, because some banks may not have requisite manpower and skills mix to handle the task, they are allowed to form venture capital companies for the purpose.

(c) Modalities of the Scheme

- Under the Scheme, funds invested by participating banks shall be in form equity investment in eligible industries.
- Equity investments under the scheme may be in the form of fresh injection and/or conversion of existing debts owed to participating banks into equities.
- A participating industry may obtain more funds by way addition to those they presently have relationship with, for funds under the scheme.

HOW TO ACCESS SMIEIS FUNDS

i. Conditionality

To access SMIEIS fund, the following conditions have to be met:

- Commercially viable business;
- A good business plan;
- Acceptance of the business plan by the equity-financing banks;
- Acceptance/meeting the requirements of the equity investor;
- Acceptance to maintain competent management in the business;
- Access to support services;
- A clear exit strategy

ii. Eligibility for Funding

To be eligible for equity funding under the Scheme, a prospective beneficiary shall:

- Register as a limited liability company with Corporate Affairs Commission and comply with all relevant regulations of the Companies and Allied Matter Act (1990) such as filing of annual returns, including audited financial statement;

- Comply with all applicable tax laws and regulations and render regular returns to the appropriate authorities.

iii. Activities Covered By the Scheme

The ranges of activities in respect of which the funds shall be applied are those in the real sector of the economy as listed below:
Agro-allied;

- Information technology and telecommunication;
- Manufacturing;
- Educational establishments;
- Services;
- Tourism and leisure;
- Solid minerals;
- Construction;
- Construction;
- Any other as may be determined from time to tine by the Bankers' Committee. Commerce is not included.

iv. Definition of a Small and Medium Industry

For the purpose of this Scheme, a small and medium industry is defined as any enterprise with a maximum asset base of 200 million, excluding land and working capital; and the number of staff employed by the enterprise not less than 10 and not more than 300.
This is subject to review by the Banker's Committee from time to time.

v. Period of Scheme

The Scheme shall be subject to annual progress report and comprehensive review after 5 years from commencement date, by the Bankers' Committee.

vi. Date of Commencement of the Scheme

The scheme commenced on June 19, 2001 with deductions from the banks' profit before tax for the accounting period year 2000.

vii. Investment Exit

The exiting of investment under the scheme shall be after a minimum of years. Divested funds shall be ploughed back to shareholders' funds and shall not be subject to tax.

viii. Utilization of the Scheme's Funds

The following restrictions shall apply to funds reserved for the Scheme:

- The funds committed to the Scheme (i.e. 10% of PBT) shall be appropriated from the previous year's profit and loss account as at the end of the bank's accounting year and maintained in a non-distributable reserve (Reserve for SMI Investment):
- The Reserve for SMI Investment can only be distributed on liquidation of investment;
- Banks must utilize all reserved funds within the specified period failing which the Central Bank of Nigeria will apply the appropriate sanction as approved by the bankers' Committee;
- These assets shall be segregated from other assets in the balance sheet.

ix. Registration with Securities and Exchange Commission as Venture capital Operators

Fund managers shall register with the Securities and Exchange commission (SEC) as venture capital operators.

x. Performance of the Scheme

As at July 31 2003 about N18.6 billion has been set aside by banks. However, only N4.6 billion has been actually invested in eligible companies.

About 97 investments are covered by 37 banks, predominantly in the Lagos/Ibadan area (see Table).

STAKEHOLDERS AND THEIR RESPONSIBILITIES IN THE SMALL AND MEDIUM INDSTRIES EQUITY INVESTMENT SCHEME

(i) Identified key Stakeholders:

The identified key Stakeholders include:

- Government;
- Central Bank of Nigeria (CBN);

- Bankers' Committee;
- Individual Banks;
- Independent Fund Managers;
- Securities and Exchange Commission (SEC);
- Promoters of Small and Medium Industries (SMIs).

(ii) Responsibilities of the Stakeholders

(a) Government:

- Stable macro-economic environment.
- Regulatory and legal framework.
- Provision of Infrastructure.
- Prudent fiscal regime.
- Capacity building.
- Make the banks' contribution to the Scheme enjoy 100 percent
- Investment allowance;

(b) Central Bank of Nigeria:

- Ensure a sound financial system;
- Liaise with the Federal Ministry of Finance to ensure that the required tax incentives are granted;
- Monitor the implementation and gather statistics to quantify the impact of the scheme;
- Articulate clear guidelines for the implementation of the scheme;
- Liaise with SEC to facilitate and simplify the registration of venture capital operations;
- Ensure each Bank's compliance with the guidelines of the scheme and penalize banks in accordance with the penalty stipulated for non compliance;
- Capacity building;
- Disseminate information on the scheme to SMIs and the larger public;
- Prepare annual progress report;
- Provide data for the review of the scheme after 5 years, for the Banker's committee.

(c) Banker's Committee:

- Obtain the cooperation of the major stakeholders;
- Disseminate information on the scheme to SMI promoters and the larger public;
- Oversee joint collaborative efforts under the scheme;
- Monitor the implementation of the scheme;
- Promote SMIEIS related capacity building among banks;
- Review the scheme after 5 years.

(d) Individual Banks

- Provide funding for equity investment in SMIs;
- Comply with the guidelines of the scheme;
- Report on the activities of the scheme on monthly basis;
- Capacity building.

(e) Independent Fund Managers:

- Manage equity investment in SMI on behalf of Banks;
- Report on the activities of the investment to the banks on a monthly basis;
- Provide strategic support to small and medium scale industries in order to minimize the risk of the investment;
- Exit the investment at the instance of the bank;
- Comply with the guidelines of the scheme;
- Register with Securities and Exchange Commission (SEC).

(f) Promoters of Small and Medium Scale Industries:

- Ensure prudent utilization of funds;
- Keep up-to-date records on project activities for inspection by appropriate authorities when required;
- Comply with the guidelines of the scheme.

(g) Securities and Exchange Commission

- Facilitate and simplify registration of venture capital operators;

- Provide enabling environment, specifically, the development of the capital market;
- Liaise with other arms of government to reform the capital market to ensure that SMIs have access to the market.

CHALLENGES FACING SMIEIS

The various challenges facing the Scheme can be summarized as follows:

(i) **Ignorance:**
Many of the promoters of SMEs demonstrate outright ignorance on the difference between loans and equity.

(ii) **Wrong perception about the Scheme**
Some potential SMI entrepreneurs see the Scheme as yet another loan scheme and a "National Cake" to be shared and this was reflected in the initial proposals prepared by the entrepreneurs.

(iii) **Lack of Requisite Knowledge**
Many entrepreneurs lack requisite knowledge of their chosen field of endeavour and are most unwilling to expand shareholding for reasons of dilution of ownership and control.

(iv) **Fear of Loss of Control**
Some of the small and medium enterprises shy away from equity participation by banks in their businesses. This accounted for their observed tardy adoption of the entire Scheme.

(v) **Inability to Package Bankable Proposal**
Most ideas presented for financing by promoters are not bankable.

(vi) **Poor Accounting/Record Keeping:**
The mixing of the owners' personal funds with business funds is common among the SMEs.

(vii) **Over Bloated Business Proposals:**
Business proposals are usually over-bloated to attract the investing public. SME promoters believe the higher the size of the business plans, the higher the chances of interested investors.

(viii) **Exaggerated/Defective Asset Revaluation:**
This is done to create false impression of higher equity of the promoters.

(viii) **Poor Management Structure:**
In most instances, formal management structures are usually not in place. The owner usually undertakes different functions in the enterprise with little or no support.

THE WAY FORWARD

Considering the slow-paced and lopsided investment pattern, including the likelihood of further accumulation of un-invested funds, operators must take steps to give the Scheme a fresh impetus so that the present low SMIEIS investment can be overcome, thereby accelerating the implementation of the scheme. The following points are the considered imperatives:

(i) **Business Environment**:
The business environment should be made more investment friendly. Basic infrastructures should be provided or upgraded by government. The process of incorporation of businesses should be easy and straightforward. Trade barriers, multiple and high tax regimes should be significantly be reviewed.

(ii) **Regulation:**
CBN should slow down on penalizing banks for non-compliance, as more time is needed to install investment structures, personnel, skills and competencies. Banks are expected to be shrewd investors, taking only calculated risks.

(iii) **Need For Incentives:**
There is need to provide necessary guidance, incentives and support for the participating banks to ensure that investible funds already set aside by banks do not remain in their vaults, but are productively

channelled into the viable projects identifiable by thorough search and better information flow.

(iv) **Adequate Publicity:**
The Banks need to embark on public enlightenment campaigns in order to become more visible. The banks also need to carry out in-house enlightenment to pass down all necessary information on the Scheme to their staff in the operations units and branches.

(v) **Needs to Improve on the Public Perception of the Scheme:**
Comprehensive enlightenment should be made to reverse the public perception of the Scheme as a loan scheme, and duly canvass the merits of equity investment as a complement to existing loan facilities.

(vii) **Access to Information Technology**
Government should promote the spread of Internet facilities to the sub urban and rural communities so that local entrepreneurs can access information and opportunities available in the global economy and possibly establish strategic business partnerships.

(viii) **Capacity Building**:
If small businesses are to become a success, current efforts to organize workshops and training programmes for entrepreneurs to improve their skills and capabilities must be sustained.

CONCLUSION

Nigeria is blessed with vast resources, including oil, gas and solid minerals, already confirmed to exist in commercial quantities. She also has enormous electric power resources; a large human population, forming a very big market and substantial idle capacity in all industrial sectors (CBN, 2000). In addition, small and medium scale industries are known to exist all over the country and most of them where established from the mid-1980s, with the inception of the structural adjustment programme (SAP). All these indicate great potentials for the emergence of a vibrant industrial sector, particularly the small-scale segment. In this context, a well-focused SMI development programme in an investment friendly environment can achieve the long-sought industrial transformation, which the programme of large-scale capital-intensive industrialization failed to deliver. Greater caution, enlightenment and discernment were recommended for the nascent stages of the scheme to enable banks identify, nuture, negotiate with proprietors and participate in establishing feasibility/viability of envisaged investments. This would ultimately reduce the huge gap between funds set-aside and actual investment.

Thank you for your attention.

CONCEPTS OF EQUITY FINANCING AND ITS IMPLICATION FOR SMIEIS

By

Rotimi Oyekanmi*

INTRODUCTION

It is generally accepted that small and medium enterprises (SMEs) play a key role in economic growth and industrialization in both developed and developing countries. Furthermore, experts often draw symbiotic and important relationships between large, medium and small firms in promoting and sustaining economic growth. That is why most countries attempt to promote all the three sectors for rapid economic development.

The Role of government has shifted from being a key player to facilitator and creating enabling environment for fostering enterprises. Also, as globalization has resulted in increased competition, countries have now tended to focus on competitive advantages rather than use of tariffs to protect local industries (not banning of imports)

This paper discusses concept of equity financing and its implication for the newly introduced small and medium industries equity investment scheme (SMIEIS).

OVERALL PERSPECTIVE

Constraints and Strategies

World over, the development of SMEs have been characterized by certain constraints. To mitigate these bottlenecks, many strategies have been adopted. Some of these constraints and accompanying strategies include the following:

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S/N	CONSTRAINTS	STRATEGIES
i.	Macro-economic Instability	•Financial discipline, prudent fiscal management, commitment to low inflation and free markets
ii.	Capital Inadequacy	• SME targeted loans (direct/guaranteed) • Development of financial institutions • Provision of tax incentives to encourage investments.
iii.	Inadequate Infrastructure	•Private and Public provision of infrastructure • Shift of govt. spending to infrastructure provision; • Encouragement of business clusters/incubators etc.
iv.	Limited Human Capital	•Give education high priority in govt. spending (macro) • Private technical training programs (micro) • Joint Ventures/Arrangements with Foreign firms
v.	Lack of Access to Foreign Markets	• Membership of trading associations (e.g. WTO) • Provision of information on foreign markets • Organization of trade fairs and missions for export promotion
vi.	Low Technological Capabilities	• Access to Govt. funded research • Promotion of tie-ins, technical service agreements, joint ventures and franchising with larger and/or foreign firms
vii.	Lack of Long-Term Finance	• Development of comprehensive financial infrastructure • Development of viable capital markets

Nigerian Experience

Nigerian economy is dominated by the public sector with the private sector largely playing residual roles especially in output terms. For instance, while SMEs employ a lot of labour (60% of non-farm labour) the sector only contributes very little to overall GDP (35% of industrial output and account for 10% of industrial exports).

Nigerian SMEs have not helped economic development of Nigeria, due to

- Unstable macro economic environment
- Poor implementation of government policies
- Inadequate access to capital
- Inadequate infrastructure - high cost of doing business.

- Weak management capability
- Lack of institutionalization and succession planning
- Inadequate information base
- High import dependence

Past Programs to Facilitate SMEs Development**:**

The dismal performance of SMEs in the economy had not resulted from lack of policy initiatives as many programmes have been evolved in the past to promote activities in the sector. These include the following schemes established and directed at SMEs promotion:

- Small-scale Industries Scheme (1971);
- Agricultural Credit Guarantee Scheme(1973);
- Nigeria Agricultural and Co-operative Bank(1973);
- Nigerian Bank for Commerce and Industry(1973);
- Small and Medium Scale Enterprises Loan Scheme(1992);
- National Economic Reconstruction Fund(1994);
- Family Economic Advancement Program(1997);

In addition, a number of specialized banks that could aid SMEs development were introduced, including the Peoples' Bank in 1989 and Community Banks 1992.

Brief Assessment of Past Programs:

On the, most of the past efforts have not yielded the expected results while many of the banks have been associated with high rates of default due inter alia to:

- Dominance of public-sector ownership, corruption, etc;
- Poor loan processing and credit administration procedures;
- Lack of adequate project monitoring techniques;
- Use of public rather than private resources – "High agency costs;"

Reasons why SME schemes have worked in other countries:

Evidence of thriving SMEs abounds in other economies and the reasons for such successes are not far-fetched, chief among them are:

- Well-defined and Complementary roles of the private and public sectors in SME promotion;
- Structure of credit/capital provided to the SMEs;
- Nature of the incentives directed at SMEs; and
- Identification and implementation of factors driving such programs.

Economy	% SMEs	Year	%EmployedBySMEs	Year
Australia	95%	1991/92	50.6%	**1991/92**
Philippines	98.7%	1988	50.77	1993
Canada	99.8%	1992	59.24%	1991
Hong Kong	97.95%	1993	63%	1993
Japan	99.1%	1991	79.2%	1991
Mexico	98.17%	1993	50.77%	1993
USA	99.72%	1990	53.67%	1990
South Korea	99.8%	1992	78.5%	1991

TYPES OF FINANCING

Basic Characteristics:
Various sources of SME financing have distinguishable features. This is illustrated below:

TYPE:	**FEATURES:**
OWNER'S EQUITY	• Commitment to the business
DEBT	• Lower cost of capital • Leverage the equity return • Enforce fiscal discipline • Preoccupation with collateral
EQUITY	• Patient capital promoting growth • Committed to the business • Funds expansion

Debt vs. Equity Comparison:

Debt:	**Equity:**
• Fixed repayment (strain on cash flow) • Collateral/Security • Interest is an expense • Limited downside and upside • Takes finance risk Investments easier to analyze and monitor	• No fixed repayment (less strain on cash flow) • No collateral/security • Dividend is an appropriation • Unlimited upside and downside (limited to zero) • Takes business risk Investments more difficult to analyze and monitor

It is noteworthy that analysis and monitoring of both equity and debt financing require different mindset, skills, techniques, processes/ procedures and returns.

THE NEW SCHEME

SMIEIS – Justification:

Globally, SMEs have played an important role in economic growth and development. However, as noted earlier, this is yet manifest in of Nigeria, due to lack of:

- An enabling environment;
- Skilled management/entrepreneurship; and
- Access to long-term finance.

All these point to the fact that an all-embracing scheme like SMIEIS is therefore required to boost activities in the sector for the overall economic development.

SMIEIS Objectives:

The SMIEIS was designed initially to achieve certain broad objectives, including the following:

- Sustained economic development;
- Employment generation;

- Value added production; and
- Develop equity investment culture

SMIEIS Guidelines:

Highlights of the scheme are:

- SMIEIS requires all banks in Nigeria to set aside 10 per cent of their profit before tax (PBT) for equity investment in small and medium industries (SMIs)
- SMI is defined as an industry with:
    - Total assets excluding land and working capital of not more than N200 million; and
    - 10 to 300 employees

Qualifying Enterprises:

- For an enterprise to qualify, it must be
- Limited liability company;
- Comply with CAMA (1990);
- Comply with all applicable laws and regulations; and
- Render regular returns.

Initial SMIEIS Guidelines:

Initially, SMIEIS was to cover only the understated activities:

- The range of activities in respect of which funds shall be applied were those of the real sector as listed below, with the exclusion of trading;
- Agro allied;
- Information technology and telecommunications;
- Manufacturing;
- Education establishments;
- Services;
- Tourism and leisure;
- Solid minerals; and
- Any other activities as may be determined from time to time by the Bankers Committee.

Other Features:

- Equity investment may be by:
  - cash injection and/or
  - conversion of existing debts
- Additional funds could be provided by banks by way of loans.
- The following tax reforms and incentives have been proposed:
  - Tax rate of SMIs reduced to 10%;
  - Bank's contribution to enjoy 100% investment allowance;
  - 5-year tax holiday to SMIs under SMIEIS;
  - Exempt divested funds under SMIEIS from CGT;
- Investment exit shall be after 3 years.

Benefits of SMIEIS- Macro economy

SMIEIS is expected to generate some benefits both at macro and at firm levels. Among the anticipated benefits to the macro-economy are:

- Employment creation;
- Precursor to genuine industrialization and modern economy;
- Improved entrepreneurship and motivation;
- Encourage social and political stability; and
- Wealth creation.

At the firm level, the scheme will afford the SMEs, among others, gain:

- Access to long-term funding;
- Access to other critical resources that follow "the money";
- Disciplined approach to business and management;
- Wealth creation;
- Improved relationship and access to banks;
- Added incentives to sector; and
- Opportunity to become part of the formal sector.

Brief Appraisal of SMIEIS Performance:

As at May 2003, SMIEIS has recorded the following achievement:

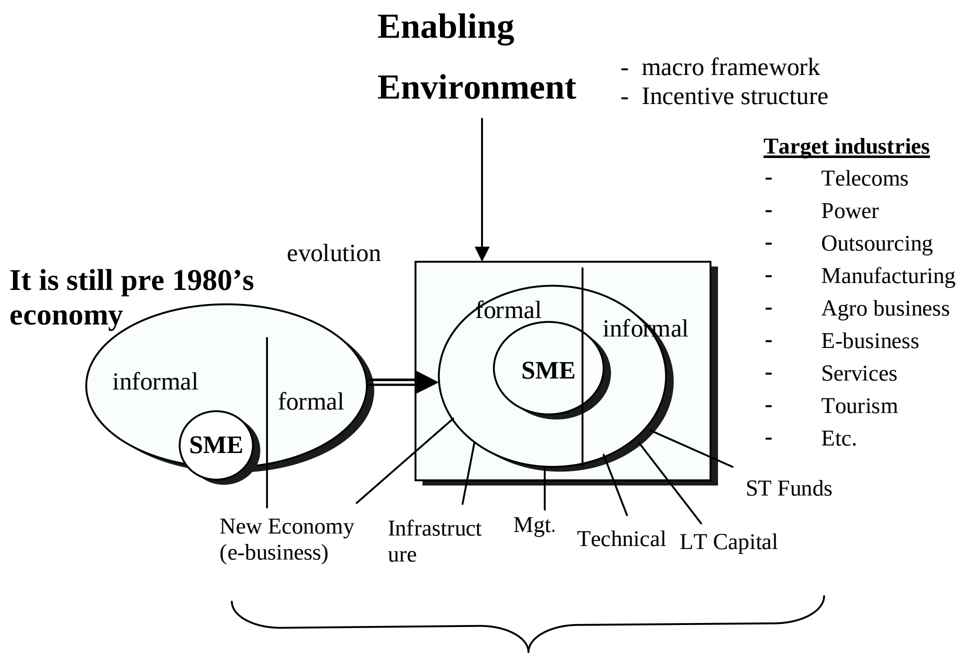
- A total of N14.6 billion had been set aside by banks for equity investment under the scheme;

- However, despite the rapid accumulation of resources, only N4.3 billion or 29.9 percent of the fund has been invested by 41 banks in 113 projects;
- The number of participating banks under the scheme increased from 79 to 81.

Amendments to Guidelines:

- **Sectoral targets**
  - Real sector – at least 60%
  - Services sector – not more than 30%
  - Micro enterprise – up to 10%

Hypothesis



Stakeholders to provide Requirements

A Govt.
B Banks
C SME
D Universities
E Local investors
F Local entrepreneurs
G Foreign investors/technical partners

CRITICAL SUCCESS FACTORS

For SMIEIS to succeed, it must be supported by fundamental and complementary remedial measures. These critical factors can be broadly classified into:

- Enabling environment;
- Macro issues;
- Micro issues;
- Professional management of the funds; and
- Support services.

Components of the Factors:

Elements of these success factors have been highlighted in the following policy matrix:

- **Enabling Environment**
  (a) Macro-economic Stability:

S/N	Findings	Recommendations
i.	• Public sector dominance; leads to dysfunctional decision making in very key areas of the economy	• Privatize public corporations and encourage private sector participation • Restrict Govt. to promoting investment friendly environment
ii.	• Unconvertible Naira and artificial exchange controls; strong currency discourages export and encourages cheap imports.	• Promote convertibility of the Naira • Ensure FX rates are determined solely by market forces and remove all bottlenecks
iii.	• Policy instability; economic growth unlikely without macro-economic stability.	• Encourage policy consistency and macro-economic stability

(b) ***Reformed Fiscal Regime:***

S/N	Findings	Recommendations
i.	• Multiplicity of taxes and levies increases cost of doing business	• Streamline taxes at all levels of government
ii.	• Lack of incentives to encourage the informal sector to cross over to formal sector	• Reduce tax rates for SMEs and provide tax holidays to attract small businesses to tax net
iii.	• Lack of incentives to encourage investments in small businesses	• Tax incentives to investors

(c) Management and Technical Competence:

S/N	Findings	Recommendations
i.	• Limited Managerial and entrepreneurial skills	• Development of subsidized management development programs • Encourage joint ventures and technical services agreements tied to local staff training and development
ii.	• Lack of access to technology	• Fund research programs in targeted areas/sectors and share results of research • Encourage tie-ins, franchises and joint ventures
iii.	• Lack of sufficient skilled labour to support indutrialisation	• Ensure education policy provides for development of technical skills

(d) Developed Financial Institutions:

S/N	Findings	Recommendations
i.	• Lack of access to long term funds	• Manage monetary policies to encourage macro-economic stability and low interest rate regime
ii.	• Lack of viable capital market	• Provide adequate legal/regulatory framework • Reduce cost of raising funds by allowing market determined rates
Iii.	• Some interpret the Trust Act as precluding pension funds from investing in private equity	• Explicitly allow for pension funds to participate in direct private equity investments
iv.	• High net–worth individuals prefer investing outside the country due to political and currency risks	• Encourage stable exchange rate regime and low inflation

(e) Adequate Infrastructure:

S/N	Findings	Recommendations
i.	• High cost of doing business partly due to poor infrastructure	• Privatize public utilities • Encourage business clusters and industrial estates
	• Private sector participation in provision of public utilities constrained by inadequate policies and regulatory constraints	• Provide regulatory framework for clear policies on private sector participation

(f) **Management of Funds**

To ensure efficiency, it is important for banks to:

- Directly manage funds;

- Establish subsidiary or
- Outsource to independent fund managers.

It must be noted that competencies required for equity investment are different from those required for lending.

(g) Support Services

Management & Technical Capacity Building, especially by:

- Providing business education and training under SMIEIS; and
- Encouraging joint ventures, franchising and other arrangements with foreign firms.

Other Recommendations:

In addition to aforementioned, there is the need to:

- Revisit list of moribund projects;
- Establish Guarantee scheme;
- Set up SMIEIS desks in banks;
- Comply with BOFIA on ownership percentage; and
- CBN to champion human capacity development.

Expected Roles of DFIs

- Business Packaging;
- Improve entrepreneur competence;
- Functional industrial parks;
- Intermediation;
- Forging linkages between SMEs and conglomerates.

SME PARTNERSHIP

Objectives:

The primary objective of SME Partnership is to maximize investment returns through long-term capital appreciation.

Secondary objectives are:

- Employment generation;
- Value-added production;
- Encourage equity investment culture

Mission:

The mission of SME Partnership is to:

- Ensure that the SMIEIS funds are professionally managed and deployed in viable businesses in accordance with the SMIEIS guidelines;
- Assist portfolio companies to achieve the objectives of SMIEIS;
- Transfer the knowledge and technology for professional management of equity funds to Nigerians;
- Develop the Private Equity industry in Nigeria;
- Attract long-term funds for equity investments from within and outside Nigeria.

Brief Appraisal:

To date SME PARTNERSHIP has:

- Over N3.4 Billion committed (over 5 years);
- Limited Partnership structure;
- 12 Partners (11 banks plus SME Manager);
- SME Manager = General Partner;
- Well defined investment strategy;
- 2 Committees;
- Advisory Committee;
- Investment Committee;

Furthermore, DEAL FLOW shows that:

- Over 300 deals reviewed;
- About 23 met criteria;
- 7 deals done;
- while 16 look promising;

Partners in SME Partnership

The following banks are the current members of the consortium (Limited Partners):

- Chartered Bank;
- Diamond Bank;

- FBN (Merchant Bankers);
- First Bank Plc;
- First City Monument Bank;
- FSB International;
- INMB Bank;
- Magnum Trust Bank;
- MBC International;
- Stanbic Bank;
- Universal Trust Bank.

General Partner

- SME Manager

Investment Criteria:

Highlights of the investment criteria of the Partnership include:

- **Qualification:** Target companies must be qualified as an SME as defined in the program guidelines.
- **Control:** The Fund will either take majority equity interest or significant minority with strong governance rights (minimum of 25%).
- **Management**: Management of companies should meet specific standards on integrity, capability, experience and must demonstrate commitment to sound financial practices, institution building and staff training and development. The management should be significantly invested relative to their net worth.
- **Return:** Investments will only be made in targets capable of achieving a minimum real IRR of 30% using conservative assumptions.
- **Investment**: The goal is to complete up to 6 - 10 investments in a year.
- **Liquidity/Exit:** Liquidity/exit strategies will be pre-identified for each investment.

Value Enhancement Strategy:

To ensure maximum value addition, the following strategies are adopted:

- Active participation on Boards & executive levels, etc.
- well defined processes for investment monitoring and governance;
- Formulation and execution of business strategy;

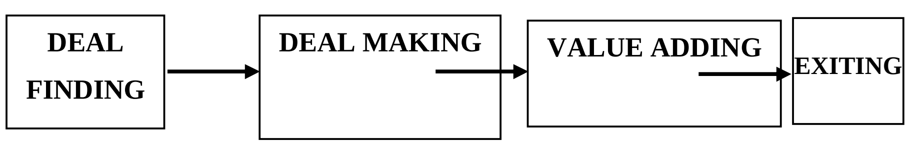
- Active support of institutionalization process;
- Provide market access and credibility;
- Identify and attract technical partners;
- Support interface with environment;
- relationships in government and private sector;
    - market intelligence and network;
    - Assist in recruitment and development of key staff;
- Provide financial advice including M&A advice;
- Prepare for liquidity & exit.

Sourcing Technical Partners:
SME Manager in recent time has also tried vigorously to:

- Determine the attractive sectors in Nigeria;
- Identify Nigerian entrepreneurs to back; and
- Visited South Africa (SA) to:
    - Identify best players for target industries in SA;
    - Market Nigeria;
    - Market our firm as credible partner to work with;
    - Market the specific projects;
    - Invite potential technical partners to Nigeria;

SME Manager plans to visit the Far East (India, Korea, China etc) in the future to deepen the market.

Private Equity Model:
SME Manager's major involvements in SMIEIS are illustrated graphically below:



In the recognition that partnering plays a major role in achieving global best practices, the firm's approach is depicted in the flowchart below:

PARTNERING

⇓

With Best People/Firms

⇓

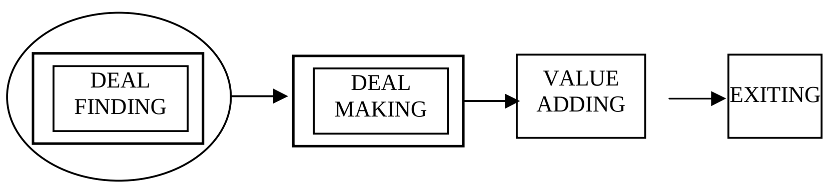
Who know what they are doing

⇓

Who understand clearly what the markets want and why

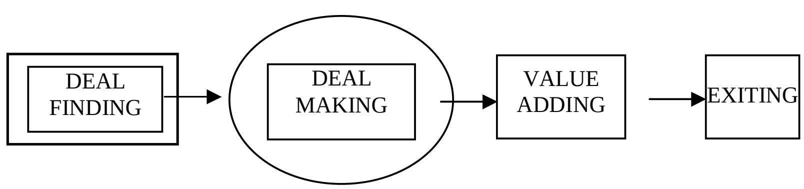
⇓

Who do it really well and consistently exceed expectations



The company also looks for:

- Entrepreneurs with high potential business concepts;
- Professional management track record or technical partner;
- Progressive (modern) business practices;
- Significant capital commitment/interest alignment;
- Willingness to partner and to exit long term.

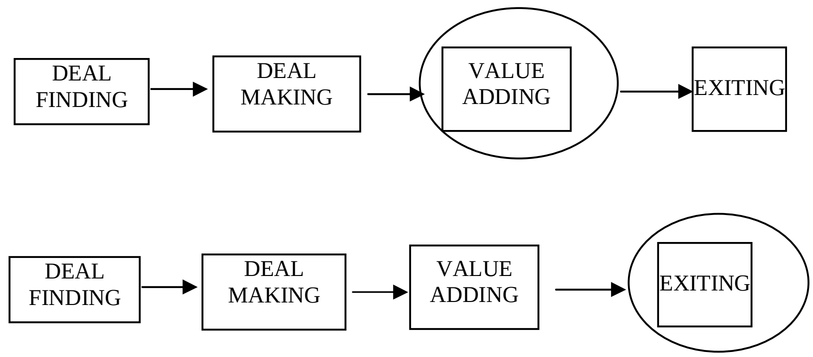


Deal Ingredients:

Key deal making ingredients include:

- High potential business concept embodied in a practical business plan;
- Realistic valuation;

- Right deal structure;
- Governance rights;
- Value Adding Strategy;
- Exit options analyzed.



In all, the company's strategy is to start with the end in mind:

- Various options (IPO, Industry sale, MBO, etc.) are usually explored;
- All options require advance preparation to be ready, must get ready and find the right exit partner/solution from the start;
- Most entrepreneurs don't want to give up control and so they stay small.

Major Findings:

Over the years, SME Manager has discovered that:

- SMEs are traditionally sole proprietorships and are not ready to accept partners, equity nor technical support;
- Entrepreneurs do not provide adequate research/understanding to determine viability;
- Business concepts and strategies are not well defined nor properly articulated; and
- Opportunities to add value unclear.

Other Experiences:

- Lack of understanding of the technology, processes and markets;
- Management skills and processes are inadequate;

- The sole proprietors are not ready to take steps to institutionalize the business;
- Infrastructure does not support investments;
- There are no viable exit options.

Our Response to Amended Guidelines

- Intensify efforts to meet guidelines;
- Involve banks and other stakeholders more deeply;
- Assist in the search for technical partners;
- We are willing to provide our experience & relationships to CBN, Banks, SMEs, OPS, etc
- Let experience of the operators be basis for amendments.

Bankers' Perspective:

Generally, bankers expect:

- Review SMI definition in view of exchange rates fluctuation;
- The tax reforms and incentives proposed for SMIEIS should be implemented as a matter of urgency;
- The sector targets, i.e. Real Sector at least 60%, Services Sector not more than 30% and Micro Enterprises up to 10% should be removed to allow greater avenues and more investments. Requirement to set aside 10% of PBT should be reviewed based on empirical analysis.
- Explore the possibility of utilizing part of the scheme's fund to finance technical skill (capacity building).

CRITICAL SUCCESS FACTORS IN THE IMPLEMENTATION OF SMIEIS

By

Dr Lawrence Osa-Afiana*

INTRODUCTION

I deeply appreciate the invitation given to me to present a paper on a topic, which I consider to be critical to the country's industrialization process. The establishment of Small and Medium Industries Equity Investment Scheme (SMIEIS) was a voluntary initiative of the Bankers' Committee at its 246th meeting held on 21st December, 1999 requiring all commercial and merchant banks to commit 10 per cent of their pre-tax profit to the funding of the equity of small and medium scale industries (SMIs). This is the best that has ever happened to the country's real sector in general and SMI sub-sector in particular. President Olusegun Obasanjo launched the Scheme, which started operation on 19th June 2001, on 21st August 2001.

The significance of the Scheme derives from the critical economic role of the real sector (of which the SMI sub-sector is a major component) in economic growth. The real sector is the prime mover of the economy, being the sector engaged in actual production. Its major segments are agriculture and industry which comprises crude petroleum, manufacturing (including agro-allied industries) and solid minerals. Construction is sometimes grouped with industry.

The real sector is easily distinguishable from services, a sector consisting of such activities as transport, communication, wholesale & retail trade, finance & insurance, hotels & restaurants, and government services. SMIEIS is for the industrial segment of the real sector and specifically for SMIs.

Any economy that is desirous of speedy development cannot afford to neglect its real sector. Capital formation in that sector largely determines the productive capacity of the economy and the pace of economic growth.

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The role of SMI within the sector is critical. The achievement of sustainable industrial development, industrial linkages, expansion of gainful employment, rapid development of indigenous entrepreneurship, poverty eradication and appropriate response to the dynamics of globalization largely depend on the development of SMIs.

This is simply because SMIs are better placed for the maximal exploitation of relative factor endowments and comparative advantage of a developing economy in the interest of international economic competitiveness than large enterprises.

THE FUNDING CONSTRAINT OF THE SMI SUB-SECTOR

While finance is obviously not the only problem militating against the development of the SMI sub-sector, it is certainly the most formidable. SMIEIS has come at a time when the sub-sector is facing a serious financial constraint. Government-sponsored schemes for the concessionary financing of the sub-sector have petered out. The SME II facility had long expired without a successor scheme in place while the National Economic Reconstruction Fund (NERFUND) is currently not in position to finance any project.

Similarly, the two national industrial development finance institutions (DFIs) – the Nigerian Industrial Development Bank Limited (NIDB) and the Nigerian Bank for Commerce and Industry (NBCI) – have become incapable of extending credit and equity finance to industrial enterprises for several years. Indeed, a restructuring exercise has taken place resulting in the reconstruction of NIDB to create the Bank of Industry Limited (BOI) which combines the mandates of NIDB, NBCI and NERFUND. The exercise will finally engender the liquidation of NBCI and NERFUND through the legislative process. Thus, BOI is the only provider of long-term finance to the industrial sector in Nigeria today. Therefore, the SMIEIS must be made to succeed as an indispensable counterpart fund to the sector.

Like other real sector projects, SMIs have relatively long gestation. This is because, unlike trading, investment in SMIs is relatively bulky. In addition to fixed assets such as land, civil works, buildings, machinery & equipment and movable assets, directly involved in production, extra investments are needed to offset the deficiencies in the basic utilities. As a matter of fact, empirical studies have shown that the incidence of such extra outlays is relatively heavier on SMIs than large industries. While they account for about 10.0 per cent of the total cost of machinery and equipment of large industries, they represent about 20.0 per cent of that of SMIs because of the absence of economies of scale.

Therefore, SMIs can best thrive on long-term loans and equity finance. Equity finance is even more basic because it determines the amount of loan that can be raised for any project in view of lenders' application of the debt/equity ratio criterion. Inadequate equity base leads to high gearing of project finance (high amount of loans in relation to equity) resulting in a heavy debt-service burden, which often undermines the viability of projects. The country's low level of income and savings makes it difficult for SMI sponsors to generate adequate equity base for their projects.

Generally, commercial and merchant banks do not have the resource base to extend long-term loans to real sector projects. This is illustrated by the maturity structure of their loans and advances shown in Tables 1 and 2. Loans maturing under 12 months represent the bulk of the banks' credit and those over five years a paltry percentage.

TABLE 1: MATURITY STRUCTURE OF COMMERCIAL BANKS' CREDIT

(N' Billion)

Year	12 months & under		1-5 years		Over 5 years	
	Amount	%	Amount	%	Amount	%
1991	26.16	82.3	4.1	12.8	1.55	4.9
1992	34.7	82.7	4.83	11.5	2.45	5.8
1993	47.5	83.1	6.61	11.6	3.05	5.3
1994	82.5	84.4	10.77	11	4.49	4.6
1995	122.2	84	16.49	11.3	6.87	4.7
1996	137.17	83	19.82	12	8.26	5
1997	171.33	76.1	43.35	19.3	10.32	4.6

Source: CBN, *Statistical Bulletin*, various issues
Note: n.a. = not available

TABLE 2: MATURITY STRUCTURE OF MERCHANT BANKS' CREDIT (N' BILLION)

Year	12 months & under		1-5 years		Over 5 years	
	Amount	%	Amount	%	Amount	%
1991	5.25	53.1	3.51	35.5	1.13	11.4
1992	4.72	41.8	4.92	43.5	1.66	14.7
1993	16.86	59	7.05	24.6	471	16.5
1994	16.34	58.4	11.66	41.6	0	0
1995	16.09	52.4	14.64	47.6	0	0
1996	18.25	62.1	11.16	37.9	0	0
1997	21.95	64.7	11.98	35.3	0	0
1998	28.19	49.5	28.8	50.0	0.5	0.87
1999	34.74	71.1	14.12	28.9	0	0
2000	44.2	80.6	10.7	19.4	0	0

Source: CBN, *Statistical Bulletin*, various issues
Note: n.a. = not available

The indispensability of SMIEIS is also underscored by the fact that the banks' credit delivery discriminates against SMIs. Available information on the share of small-scale enterprises (SSEs) in the total credit of commercial and merchant banks is given in Table 3.

TABLE 3: THE SHARE OF SMALL-SCALE ENTERPRISES (SSES) IN THE LOANS AND ADVANCES OF COMMERCIAL AND MERCHANT BANKS, 1992-1999

Year	% of Commercial Banks' Loans	% of Merchant Banks' Loans
1992	48.8	31.2
1993	32.2	19.5
1994	22.2	18.2
1995	22.9	29.9
1996	25.0	13.6
1997	17.0	13.0
1998	16.5	13.0
1999	11.2	12.9
2000	10.1	11.5

Source: Central Bank of Nigeria (CBN); Statistical Bulletin, various issues.

For commercial banks, the share fell from 48.8 per cent in 1992 to 25.0 percent in 1996 (the year CBN ***Credit Guidelines*** were abolished) and then continued to decline steadily to 10.1 per cent in 2000. For merchant banks, it dropped from 31.2 per cent to 11.5 per cent during the period. The bulk of commercial and merchant banks' lending to the industrial sector is in the form of short-term working capital, which goes mostly to well-entrenched blue-chip industries.

The bias of commercial and merchant banks against SMIs as risky ventures was demonstrated by their preference to pay penalty rather than make risky investments to meet the 20.0 per cent statutory lending to SSEs when the Central Bank's ***Guidelines*** were in force. It is therefore not surprising that their lending to SSEs drastically declined after the abolition of the sectoral allocation of credit.

Besides, even if long-term loans were available in commercial banks, SMIs can scarcely pay the ruling interest rates (since the full deregulation of interest rates in October, 1996) and survive. It is important to note that before the advent of SMIEIS, the banks were not providing any equity finance to industrial projects.

Apart from BOI (which is currently making effort to mobilize resources to fund SMIs at affordable interest charges on loans and also with equity finance), SMIs scarcely have any source of viable financing in the country today. The Nigerian stock market lacks the depth and breadth for adequate funding of the real sector. The new issues market is biased against real sector investments. For instance, the service sector accounted for 58.0 per cent of its 2001 approvals and the real sector only 42.0 per cent. The bond market is yet to grow to play any appreciable role in real sector financing. It could also be a costly source of finance for SMIs.

The dearth of funding from local sources is not by any means ameliorated by foreign direct investment (FDI) or foreign portfolio investment (FPI) as international capital flows continue to be heavily biased against Africa in general and the continent's SMI sub-sector in particular. It is clear from the foregoing that every effort should be made to make SMIEIS a success as an SMI sub-sector funding facility.

IMPLEMENTATION OF SMIEIS THUS FAR

The success or failure of any endeavour can only be meaningfully assessed against its stated objective. Therefore, before considering the factors that are critical to the success of SMIEIS, we need to understand its objective, review its implementation thus far against the objective and then identify any problem areas for future guidance. We need to do this because it is quite possible for the Scheme to be a resounding financial success for the banks involved in it and yet be a colossal failure in relation to the purpose that it is meant to serve.

As noted earlier, SMIEIS is for the financing of the real sector, specifically for equity investment in small and medium industries, i.e., SMIs engaged in those activities belonging to the industrial sector such as manufacturing (including agro-allied industries), mining and mineral beneficiation, and construction. The investment is for the establishment of new SMIs or the reactivation, expansion, modernization or restructuring of existing ones. The whole idea is to relieve SMIs of the burden of interest and other financial charges imposed under normal bank lending and thus contribute to the Federal Government's efforts towards stimulating economic growth, developing local technology and generating employment. Indeed, in addition to providing finance, the SMIEIS initiative expects banks to *identify, develop and package viable industries with enterprising customers… and to* ***jump-start the real sector of the economy*** *by spearheading the establishment or restructuring of existing SMIs, many of which have become moribund …*

Therefore, the only meaningful understanding, which one could have of the expected contributions of SMIEIS to the achievement of national economic aspirations, is that those contributions will come through the stimulation of industrial growth, local industrial technology and industrial employment.

However, the current *modus operandi* of the Scheme is, in a number of ways, not exactly according to this basic understanding of the public and the original conception of CBN, which sponsored it. First, the operators of the Scheme have adopted a definition of SMIs that gives a loophole for either veering away from, or at least diluting, the purpose of the Scheme. Their definition of SMI is as follows:

a small and medium ***industry*** *is defined as* ***any enterprise*** *with a maximum asset base of N200 million excluding land and working capital, and with the number of staff employed by the enterprise not less than 10 and not more than 300*

This definition is an adapted version of the following definitions adopted by the National Council on Industry at its last meeting in Makurdi, Benue State, in July 2001:

Micro/Cottage: a project with capital investment of not more than N1.50 million (excluding land but including working capital) and/or a maximum of 10 workers)

Small-Scale: a project with capital investment of over N1.50 million but not more than N50 million (excluding land but including working capital) and/or work-force range of 11–100

Medium-Scale: a project with capital investment of over N50.00 million but not more than N200.00 million (excluding land but including working capital) and/or work-force range of 101–300

Large Scale: a project with capital investment of over N200.00 million (excluding land but including working capital) and/or work force of over 300

Despite the substitution of ***any enterprise*** for ***industry*** in their own definition, the operators of SMIEIS have in the ***Guidelines for Beneficiaries*** gone on to stress that: *the range of activities in respect of which the funds shall be applied are those in the* ***real sector of the economy.***

Then the following sub-sectors are listed as belonging to the real sector for the purpose of the Scheme:

- Agro-allied
- Information technology and telecommunications
- Manufacturing
- Educational establishments
- Services
- Tourism and leisure
- Solid minerals
- Construction

With this curious mixed bag (which includes information technology, services, educational establishments, tourism and leisure) as constituting the real sector, it is not surprising that investing banks under the Scheme expect their equity investments in SMIs to achieve their purpose within three years such that ***they (the banks) shall remain equity partners in the business enterprises for 3 years after which they may exit from the business***. This indicates that it is either that the banks do not recognize the long gestation nature of real sector investments or they have deliberately decided not to focus on the real sector contrary to the Scheme's clearly enunciated purpose. It also indicates that they expect SMIs financed under the Scheme to be quoted on the Nigerian Stock Exchange for the purpose of easy exit.

In effect, the bias of the Scheme's operators against the real sector has been clearly demonstrated thus far. As at end of May 2003, a total of 81 banks had set aside N14.6 billion under the Scheme out of which only N4.3 billion had been invested in 80 industrial projects. However, available evidence shows that about 75 per cent of the investments were in the service sector while the geographical spread in terms of number and value is highly skewed in favour of Lagos. Numerous industrialists who have applied to benefit under the Scheme have expressed frustration so far by this shift of emphasis to the service sector.

The geographical distribution of the 80 projects financed so far is as follows:

State	**No. of Projects**	**% of Total**
Lagos	60	75
Abuja	1	1.25
Anambra	1	1.25
Enugu	1	1.25
Kaduna	1	1.25
Ondo	1	1.25
Plateau	1	1.25
Akwa Ibom	2	2.5
Rivers	2	2.5
Ogun	3	3.75
Oyo	3	3.75
Delta	4	5.0
Total	**80**	**100**

As many as 60 of the 80 projects (75 per cent) are located in Lagos (Victoria Island and Lagos Island only). This lopsided geographical distribution of beneficiaries from a Scheme expected to promote industrialization throughout the Federation is enough cause for concern. Therefore, it is obvious that while the conception of SMIEIS is sound, its implementation hitherto clearly appears not to be in conformity with the attainment of its declared objective.

CRITICAL SUCCESS FACTORS IN THE IMPLEMENTATION OF SMIEIS

Having discussed SMIEIS' underlying objective and its implementation thus far, we can now more meaningfully highlight the factors, which are considered to be critical to the Scheme's successful implementation. The factors represent the roles that the stakeholders in the Scheme (Government, CBN/Bankers' Committee, individual banks, and SMI promoters) have to play. The following are among the factors:

Enabling Environment:

The physical and policy environment must be made conducive to the success of SMIs to encourage the banks to set aside money and invest. The state of **infrastructural facilities** must be upgraded. Since the cost incidence of compensatory investments for infrastructural deficiencies is heavier on SMIs than large industries, SMIs can scarcely be efficient and competitive within the context of globalization without substantial improvements in the supply of public utilities. One of the ways to address the issue could be the establishment of well-equipped industrial estates for SMIs by all tiers of Government.

The macroeconomic environment must be stable and investment-friendly. Adverse movements in the critical variables affecting industrial operations and viability, such as interest, inflation and exchange rates, must be alleviated.

Besides, agencies and schemes of Government, which are designed to foster the capacity building and operation of SMIs through technical assistance, must be made fully operational and strengthened. These include the Small and Medium Industries Development Agency (SMIDA), Industrial Development Centres (IDCs), and SMI Credit

Guarantee Scheme which can be extended to cover equity investments under SMIEIS.

Moreover, the tax incentives promised by Government to back up the Scheme must be promptly put in place including the 100.0 per cent investment allowance for the banks' contribution to the Scheme, reduction of SMI's corporate tax to 10.0 per cent, and five years tax holiday to SMIs under the Scheme.

Proper Orientation and Articulation of Guidelines

The Scheme's current guidelines could undermine its success in relation to its underlying objective of promoting real sector development through the financing of SMIs. The existing definition of SMIs under the Scheme and range of activities covered by the Scheme must be drastically reviewed to focus on SMIs engaged in real production. Such non-industrial activities as services and the like have easier access to funds from the banking system because of their quicker returns and lower risk and should not be made to feature in, much less dominate, the Scheme. Since the Scheme is funded from profits rather than from customers' deposits, the banks should exercise the commitment and patience required in real sector financing.

Therefore, the attempt by the Bankers' Committee at its 262nd meeting held on 25th August 2002, to redress the priority given to services to the neglect of real sector projects did not go far enough. The meeting made the following amendments to the ***Guidelines***:

- not less than 60.0 per cent of the fund should go to the real sector;
- not more than 30.0 per cent of the investment should go to services, and
- 10.0 per cent of the investment should go to micro-enterprises

The question is why should not 100.0 per cent of a Scheme designed to finance the real sector not go to the sector rather than 60.0 per cent or 70.0 per cent (assuming the 10.0 per cent for micro-enterprises is for industrial micro outfits)?

Close Monitoring

The Scheme should be closely supervised by CBN and the Bankers' Committee to ensure three things:

- that banks make appropriate contributions to the Scheme;
- that the amount set aside is invested rather than keeping the bulk of it idle, and
- that there is strict compliance by banks with the revised ***Guidelines*** in the implementation of the Scheme.

The recent move by CBN to penalize banks that failed to invest the funds set aside would enhance the effectiveness of the scheme. The directive to pass any amount not invested within the specified period to the Bank of Industry should be strictly enforced.

Channeling Investments Through the Bank of Industry Limited

While conventional banks lack the expertise for industrial financing, it represents BOI's area of core competence. Therefore, BOI is in position to manage the Scheme on behalf of banks. If given the management, BOI will inject into the Scheme the technical and promotional assistance usually required to make the project ideas of SMI entrepreneurs bankable. Projects will be thoroughly appraised, packaged and implemented to ensure viability. They will also be well monitored to ensure good management and handsome returns. The use of BOI would also guarantee that only real sector projects benefit under the Scheme.

Adequate Counterpart Funding

Equity investment by banks can only form part of the financial package of SMIs. Consequently, the Scheme cannot succeed in its objective if SMI promoters do not provide additional equity contribution and long-term lenders, such as BOI, do not provide adequate term financing component. This presupposes that SMI promoters should cultivate the habit of mutual confidence and trust necessary for resource pooling where they cannot single-handedly contribute the required additional share capital. It requires that an institution such as BOI should mobilize adequate resources to provide term loans and also complementary share capital if necessary.

Loan Component Within Scheme

There are cases where SMIs, ongoing and new, have no problem mustering adequate equity base and what is needed is either long-term loan or working capital. Therefore, in order to generate widespread interest in the Scheme and maximize its developmental impact, a reasonable portion of the money set aside should be used to give long-term and working capital loans at interest rates that are in tune with the viability of SMIs.

Capacity Building of SMIs

In addition to providing finance, the Scheme expects banks to undertake promotional activities including the *identification, development and packaging viable industries with enterprising customers in order to jump-start the real sector of the economy*. Besides, business support services would be required to ensure professional and modern managerial practices by SMIs under the Scheme. These are developmental activities that are not directly revenue yielding and which commercial and merchant banks have no expertise to provide. Therefore, a certain portion of the Scheme's fund should be set aside for the procurement of technical assistance and capacity building support to beneficiaries. Expenses in this regard can be capitalized.

Commitment of SMI Promoters

In addition to adequate financial stake in their projects, SMI promoters must also be deeply committed to the success of their industries. They must have the right motivation and eschew the get-rich-quick syndrome, which drives some entrepreneurs to engage in under-hand means, such as over-invoicing of items, to get money to the detriment of their projects. They stand to gain much more if they can nurture their projects to success in order to create wealth for the benefit of the national economy and succeeding generations of Nigerians who will depend on the project for their living. Promoters must do everything possible for their industries to succeed and yield adequate returns on investment, thereby sustaining the interest of banks in SMIEIS.

Competitiveness of SMIs

The profitable operation of SMIs is required to sustain the interest of banks in the Scheme. This cannot occur in the context of increasing globalization unless SMIs are competitive enough in product quality and price for their products to be attractive in both domestic and local markets. We have earlier discussed the need for Government to upgrade infrastructural facilities to reduce capital and operating costs of industrial enterprises.

Besides, there should be an appropriate policy framework for the promotion of sub-contracting and mentoring relationship between SMIs and large industries. Apart from providing a ready market for SMIs, the mentoring role of large industries would enhance the technological know-how and product quality of SMIs. Sub-contracting relationship has been institutionalized in India with the active role of the Small Industry Development Agency of Government.

SMIs themselves should, where possible, engage in collaborative efforts that would reduce cost and avail them of economies of scale. For instance, those in contiguous locations or engaged in similar lines of business, and are therefore faced with the same opportunities and threats, could set up joint facilities for sharing, pool R & D resources for technological improvements and also undertake joint sales promotions to reduce marketing cost. For this purpose, SMI clusters are fast developing in both developing and developed economies to meet the competitive challenges of globalization.

Empirical evidence has shown that SMIs enjoying cluster or sub-contracting relationship have a higher rate of success in the globalized environment than stand-alone SMIs.

Wider Admission of SMIs into the Stock Exchange

The Nigerian Stock Exchange should make conditions more conducive for the admission of SMIs into the stock market. The existing second-tier market does not seem to be fully serving the purpose. The facility for easy exit would no doubt encourage banks in the Scheme. However, the more critical issue is the financial performance of SMIs since it may not be difficult at all to dispose of holdings in any financially buoyant SMI by private placement.

CONCLUSION

SMIEIS is an innovative way of financing the real sector and it has a considerable developmental potential. It is a laudable experiment the success of which should not be allowed to be undermined by faulty implementation. The nation cannot afford the failure of such an auspicious development. Considering Nigeria's prodigious industrial resource potential, the prospects for the achievement of the Scheme's underlying objective are very bright, given an enabling physical and policy environment as well as the sincerity of purpose, commitment and collaborative spirit on the part of all the parties involved in the Scheme.
On its part, BOI will do its utmost in playing the financial and technical role required for the success of the Scheme. If these necessary conditions for Scheme's success can be met, the country should be celebrating the Scheme in the not-too-distant future as the best thing that ever happened to her industrialization process.

Thank you for your attention.

FINANCING SMALL AND MEDIUM ENTERPRISES UNDER SMIEIS: *OPERATORS' PERSPECTIVES*

By

B. O. Adelaja*

INTRODUCTION

The role of Small and Medium Enterprises in the developing and emerging economies has assumed a major significance in recent years, particularly as the changing world economy calls for more articulate policies in these countries.

Most of these economies are characterized by a large number of micro and medium businesses mainly in the informal sector. In many economies, they account for a large segment of the productive population, Nigeria falls within this latter category of economies. Micro, Small and Medium enterprises (SMEs) in Nigeria account for over 95 percent of non-oil productive activities outside agriculture. In recent years, SMEs have emerged as strong agents of economic growth and sustainable development.

Globally, the definition of SMEs varies from country to country, depending on parameters considered best suitable to promote the sub-sector in each country.

In most developing countries, the promotion of Micro, Small and Medium Enterprises (MSMEs) has become an important part of the process of reform and restructuring that are inevitable in large-scale industries. This position is now glaring in Nigeria as the impact and contribution of SMEs to the industrialization of the country has become highly noticeable. Many developed and developing countries have recorded an impressive economic growth and Nigeria is set to learn from such experience.

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Overview of Small and Medium Enterprises (SMEs) Financing in Nigeria

Access to institutional finance has always constituted a pandemic problem for SME development in Nigeria. In the past, a number of schemes have been put in place to provide special credit lines/windows for SMEs but this achieved very limited impact for various reasons.

The funding schemes included the:

Small Scale Industries Credit Scheme, which operated in the 1960's and 1970's;
The Nigeria Bank for Commerce and Industries (established in 1973)
The World Bank Assisted SME I (1985) and SME II (1986)
The National Economic Reconstruction Fund (NERFUND) (established in 1986)/African Development Bank-Export Stimulation Loan Scheme (ADB-ESL)
The Peoples Bank, The Community Bank, and Family Economic Advancement Programme (FEAP) 1997.
Most of these schemes have either expired or withdrawn but banks are still currently managing some of the projects under the schemes.

After a comprehensive review of the programme of the Public Development Finance Institutions (DFIs), the present administration decided to merge the three major DFIs, which have been saddled with the responsibility of providing medium/long term loanable funds to SME sub-sector. These banks, are the Nigerian Industrial Development Bank (NIDB), the Nigerian Bank for Commerce and Industries (NBCI) and the National Economic Reconstruction Fund (NERFUND). All these are now merged under a new name known as Bank of Industry (BOI).

In addition to the efforts being made by the Nigerian Government to improve on industrial development, Foreign or International Agencies like World Bank – International Finance Corporation, UNDP, UNICEF, etc. regularly fund projects for Community and Social developments in Nigeria. Failure of these efforts prompted the new initiative of Bankers Committee/CBN on SMIEIS.

Characteristics of Small and Medium Enterprises

SMEs may be conducted in the following forms:

(i) As a proprietorship – single ownership

(ii) As a partnership – where between 2 and 20 people pooled their resources together

(iii) As a legally incorporated entity, having the characteristics of a legal person and this could be a private limited liability company.

However, in Nigeria, more than 83% of the SMEs are operated under the first two business types, while the third one operated mainly as family businesses.

In any economy where SMEs are encouraged, certain characteristics are common to the enterprises. They include:

(i) Personal commitment of the proprietors whose life savings usually form the start-up capital;

(ii) Low initial capital requirement;

(iii) Ease of entry and exit;

(iv) Availability of business advisory services;

(v) Availability of less complex technology;

(vi) High content of local inputs in the production process;

(vii) High potential for employment opportunities.

Problems Militating Against Small and Medium Enterprises

Promoters of Small and Medium Industries are people with ideas, dreams and imaginations but majority of the entrepreneurs lack the needed financial means to translate their dreams and aspirations into concrete materials, to create value/services that will earn them the desired wealth.
In spite of the roles played by SMEs in Nigerian economy, the sub-sector has continued to suffer from other myriad of problems, which include:

(1) Pre-Investment Phase

(i) Inadequate planning information on market: features, price competition, segments, etc, technical issues e.g. input – output coefficients and general economic environment.

(ii) Non-availability of information in the form directly useful to SMEs;

(iii) Inability of SMEs to understand, appreciate and utilise available information for projects selection (opportunity, pre-feasibility and feasibility studies).

(iv) Inability of SMEs to appreciate and pay for the services of good consultants.

(2) Investment Phase

a. Lack of access to finance due to:

- Lack of suitable collateral security
- High cost of preparing acceptable feasibility report
- Inadequate equity contribution of project cost by SMEs (say 25%) as stipulated worldwide.
- High cost of production and overheads due to spiral inflation/and non-availability of infrastructures.
- Long delays in granting approval and disbursement due to poor packaging of request and/or non-availability of information/materials to enable Banks process request immediately.

b. Lack of domestic equipment design and fabrication capability resulting from:

- Inadequate indigenous technical expertise
- Inadequate fabrication facilities
- Lack of encouragement to our indigenous fabricators for improved performance.
- Expensive foreign exchange to acquire equipment
- Lack of indigenous equipment installation expertise thereby resulting in delays to rectify faulty equipment, and production stoppages.

(3) Operational Phase

- Inadequate domestic supply of raw materials required in terms of quality and prices.
- Weak/poor managerial capabilities of promoters/ management team
- Low productivity due to inadequate working capital
- Lack competitive advantage in view of low quality of products
- Dumping of foreign goods

- Poor staff motivation, training and development facilities
- Poor state of infrastructures
- Financial indiscipline among the promoters by mixing personal fund with company's fund.
- Lack of suitable marketing plan and distribution strategy

(4) Other Social and Environmental Problems

- Problems and costs of business registration, land acquisition and other peculiar problems;
- High rate of business failures due to state of economy;
- Attitudinal disposition of Nigerians toward made-in-Nigeria goods;
- Some Promoters' low educational background, lack of management and entrepreneurial skills.

Success Factors for the SMEs

Four major success factors have been identified to have a great impact on SME survival and strength. These are:

- Existence of business opportunity
- Adequacy of capital and credit
- Ingenuity and ability of management
- Application of modern technology for cost and competitive effectiveness

Need for special Financing Schemes for Small and Medium Enterprises Development

It is in the bid to find solution to some of the problems of lack of access to finance and other typical problems that Central Bank of Nigeria (CBN) with concerted effort of the Bankers Committee decided to establish the SME funding window termed SMIEIS.

The Small and Medium Industries Equity Investment Scheme (SMIEIS) was initiated by the Bankers Committee, which observed that the dearth of long-term finance was a bottleneck to Small and Medium Scale enterprises development in Nigeria. The Bankers' Committee therefore proposed that banks could contribute certain percentage of their profit annually for the promotion of Small and Medium Industries (SMI).

As a result, the Bankers' Committee at its 246th meeting held on December, 21st 1999 then took a decision to the effect that 10% of profit before tax of banks should be channeled into equity investments in Small and Medium Industries (SMI). The operational guidelines for the scheme was later approved by the Bankers' Committee on June 19, 2001 and had since been released for implementation.

Features of the Small and Medium Industries Equity Investment Scheme (SMIEIS) Through this Scheme, banks are expected to jump-start the real sector of the economy by spear heading the restructuring and financing of SMIs, many of which, have become moribund, owing partly to poor funding.

Definition of SMI

A Small and Medium Industry is defined for this scheme, as any enterprise with a maximum asset base of ₦200 million, excluding land and working capital, with the number of staff employed by the enterprise not less than 10 and not more than 300.

Objectives

The specific objectives of the scheme are:

(i) To facilitate the flow of funds for the establishment of new SMI projects, reactivation, expansion and modernization or restructuring of on going projects.

(ii) To stimulate economic growth, develop local technology and generate employment.

Purpose of the Scheme

The 10% profit before tax (PBT) to be set aside annually shall be invested as Equity in Small and Medium Industries.

This is to eliminate the burden of interest and other financial charges experienced under normal bank lending, as well as provides financial, advisory, technical, and managerial support from the banking industry.

Activities Covered by the Scheme

The ranges of activities in respect of which the funds shall be applied are those in the real sector of the economy as listed below, with the exclusion of trading.

- Agro-allied
- Information technology and telecommunication
- Manufacturing
- Educational establishments
- Services
- Tourism and Leisure
- Solid Minerals
- Construction
- Any other activity as may be determined from time to time by the Bankers' Committee.

Eligibility for Funding

To be eligible for equity funding under the scheme, a prospective beneficiary shall:

- be registered as a limited liability company with the Corporate Affairs Commission (CAC) and comply with all relevant regulations of the Companies and Allied Matters Act (1990); such as filing of annual returns, including audited financial statements; and
- comply with all applicable tax laws and regulations and render regular returns to the appropriate authorities

Modalities of the Scheme

- Banks shall invest the fund in eligible industries in the form of equity investment;
- Equity investments under the scheme may be in the form of fresh cash injection and/or conversion of existing debts owed to a participating bank.
- Eligible industry may also obtain more funds by way of loans from banks in addition to equity investment, but this is outside the scheme.
- Eligible industries are free to approach any bank, including those they presently have relationship with to seek funding.
- Prospective beneficiaries should note that the banks may invest directly or through Venture Capital Companies to be floated by consortia of banks.

Investment Exit
Timing of investment exit shall be a minimum of 3 years after which divestment may be considered.

Roles of Beneficiary
Beneficiaries will be expected to:
- ensure prudent utilization of funds
- keep up-to-date records on the companies' activities
- make the companies books, records and structures available for inspection by the appropriate authorities (including banks, CBN, etc) when required
- comply with guidelines of the scheme
- provide monthly financial and operational reports to the investing banks before 15th of the next succeeding month.

Benefits derivable under the Scheme
- Ailing Business/Turnaround projects that have no technical problem but require injection of limited funds, equity and/or management will be brought back to life.
- Some Entrepreneurs may want outright sell, or some businesses in certain circumstances may not be performing adequately. Acquisition of such business either by existing management (Management-Buy-Out) (MBO) or outside (Management-Buy-In) (MBI) may in specific cases revert the fortunes of such business.
- Expansion: There are existing businesses waiting to diversify into related product area and businesses wanting to expand by setting up additional production lines but which funds constitute constraint.
- Start-ups: The introduction of a new industry or product, either as existing but new business or as the first of its kind. It will boost technology driven investment opportunities for credible, honest and dedicated high net worth investors.
- Capital market opportunities on maturity.
- High export potential.
- Competitive advantage through quality of product.
- Accessibility to Business Development Services such as training etc. and other support services.
- Access to competent manpower
- Strategic approach to rehabilitation of sick projects.

- Access to Technical expertise in the specific area of the business.

Roles of Banks and other Financial Institutions under the Scheme

(a) **<u>Banks</u>**

(i) Provide funding for equity investment for new and ailing SMIs directly or through Venture Capital approach.

(ii) Source project to be funded

(iii) Appraise, develop and package the project for funding which cover the following:

- In-house
  - Verification of documents
  - Verification of market, equipment cost, etc.
- External Consultant
  - Due Diligence Study
  - Machinery Status
  - Property Evaluation
- Technical Feasibility
- Financial Viability
- Product Market
- Management Team
- Economic Viability – e.g. return on investments, employment generation, wealth creation, etc.

(iv) Monitors and manages the investment projects

- Seat on the board of all projects
- Monthly reports of management accounts
- Minutes of board meetings
- Right to be involved, and a right of veto on important company business decisions (e.g. major capital purchase, changes in strategic direction, business acquisition and disposal, appointment of directors, additional borrowing, etc.)

(v) Ensure greater probability of success of SMI investment by determining funding and management of the projects

(vi). Financing Structure

- Equity
- Stage financing:
- Pilot scale production
- Test marketing
- Equity can be by:

- Preference shares
- Ordinary shares

(vii). Review Business plan in the areas of:

- Background/History of project
- Corporate objectives
- Products
- Markets and Marketing
- Manufacturing and Operations/Technical details
- Management
- Financing plan
- Financial Projections/Analysis
- Risk and Reward of the Investment
- Economic justifications (development impact)

Some of the issues in the business plan need to be briefly explained:

The Product

This should be of high standard quality that would have competitive edge/compare favourably among others in the Local and International markets.

The Market/Marketing

Detailed market study indicating size of market and trends. Market estimates' assumptions and data source should be clearly stated and verified. The marketing opportunities and issues on pricing competition (local and international).

Manufacturing and Operations/Technical details

Location with description of infrastructure available
Logistics and accessibility
The production process, chosen technology, quality control method
Main and auxiliary equipment required, utilities
Availability of raw materials and pricing
Management and Manpower requirements.

Financing Plan

The issue of financing is of paramount importance for the timely implementation of a project and hence its success. Ensure the financing plan is in agreement with the project cost and of the correct mix.

- Equity
- Long Term Loan
- Overdraft

There must be due diligence to establish the capabilities of all parties to provide counterpart funds when required as this has often led to several abandoned projects, and work out acceptable Debt Equity Ratio.

Risk of the Financing

- Period
- Interest Rate
- Terms
- Disbursement pattern, and
- Repayment term s (will there be any grace period?)

Financial Projections/Analysis

There should be thorough analysis of financial projections to be checked with the industry standard to ensure that they are realistic and achievable.

Such financial indicators should include:

(i) Profitability Analysis
  - projected profit and loss
  - cash flow projections
  - key ratios e.g. ROCE, ROI, Net profit margin, Gross profit margin, P/E, EPS, DPS, etc.
  - Projected NPV, IRR
  - Break-even point

(ii) Financial Stability Analysis
  - Long Term Debt/Equity ratios
  - Liquidity ratios
  - Debt service covers

(iii) Sensitivity Analysis
Select most likely variables to change e.g. sales price, production cost, production volumes, change in foreign exchange rate, etc.

(iv) Implementation Schedule
- State how project will be implemented.
- Identify the full implementation key steps.
- Timing of key steps must be realistic and of logical sequence.

(v) Exit Route, minimum of 3 years
Types of exit
- Trade Sale – to another industrial company.
- Repurchase – of shares by the project's other promoters.
- Re-financing – purchase by a long-term investment institution.
- Stock market listing – sale of shares, partial stock or total to the public.

(vi) Other issues:
- To know how much funding is required and at what times.
- Details of application of funds requested.
- How the company plans to achieve its objectives.
- The expected financial returns.
- To know whether the projects have a competitive edge to establish itself in the market.

(b) Securities and Exchange Commission (SEC)

1. Facilitate and simplify registration of Venture Capitalist
2. Provide enabling environment, specifically, the development of the capital market.
3. Liaise with other arms of government to reform the capital market to ensure that SMIs have access to the market.
4. Work closely with the Banks to develop smooth exist strategies on maturity of SMEs.

5. Adopt concessionary cost of raising funds strategies to encourage SMEs.

UBN PLC's Experience

Union Bank has been in the forefront of SME financing since 1989 to-date. Despite all the associated risks of SME financing, the bank continues to efficiently manage its deposit base to accommodate this highly risky sub-sector of the economy.

The bank, which had supported the sub-sector and suffered losses on lending to SMEs, also embarked the new initiative (SMIEIS), which among the objectives is to energize the economy by processing requests from entrepreneurs who require start-ups, rehabilitation and expansion funding. We had set aside the sum of ₦1.455 billion as at 31/3/2002 under the Scheme.

	No.	Amount (₦)	%
Our Current Exposure to SMEs (as at 31/12/2002)	35	1,248,851,348	53.30
Non Performing Accounts to date	20	927,373,163	39.58
Accounts transferred to Line (Corporate Banking Group/Operations Up-Country)	3	166,686,284	7.12
Total Commitment	58	2,342,910,795	100

STATISTICS OF SMIEIS

	Amount (₦)	No. of Accounts
Disbursement Made	250m	3
Approved Awaiting Disbursement	249m	4
Being Processed for Final Approval	777.43m	14
Being Processed for In-principle Approval	985.069m	15
	2261.499m	36

Practical Operational-Related problems of SMIEIS faced by our Bank

- Lack of proper and accurate accounting records keeping that will give reliable financial state of affairs of the enterprise.
- Fear of dominance or hijacking by banks thus making the promoters to resist dilution of control.
- Non-segregation of personal assets from that of the Company thereby making the valuation of Company difficult especially property of the promoters being used for the business and which had been recorded in the Company's financial statements.
- Preference for normal bank lending to equity participation by entrepreneurs to enable them manage the Company in their own way.
- Low capital base/value of enterprises inhibit the bank from injecting adequate equity funding to meet the financial requirement. This is due to the 40% maximum shareholding stipulated for the investing Bank.
- Inability of the entrepreneurs to provide timely and accurate information/documents that will facilitate the processing of their request.
- Absence of good corporate governance on the part of SME Management/Promoters.
- Over bearing influence of the Promoters/Shareholders who would want to intimidate the Executive Management.

The Way Forward

To resolve the issues of financing and avoidance of inappropriate behaviour of Enterprises (good management), this new scheme might just do the trick in view of the enormous benefits associated with the scheme. SMIEIS financing is fundamentally structured to see that an enterprise does not take the fund and walk away to do as it pleases.

The Bank "<u>Looks over</u>" the entrepreneur's head closely, and has considerable interest in the "<u>governance</u>" of the enterprise <u>without</u> wanting to take over the company.

The Bank, as investor, has a strong say in how the business is run, yet has no interest in running the company because it brings:

- Strong managerial knowledge;

- Network of contracts;
- Strategic approach to rehabilitating the sick projects;
- The use of Consultants to provide business development support services to ensure success of the project, etc.

In this capacity, the bank will monitor the business and add managerial know-how, which the entrepreneur lacks that helps ensure a greater probability of success of the enterprise through its nominee/representative who will take charge of the finance functions.

Nonetheless, there is the need for greater attention to the limitations and constraints of our business environment viz:

- the characteristics of the projects to be generated,
- size and purchasing power of the domestic markets,
- supply of skilled manpower,
- entrepreneurs attitudes towards sharing control and
- divestment opportunity and a not too developed exist mechanism channel.

To achieve these, government must do more to assist other stakeholders in the following areas:

- stable macro-economic environment
- stable and reliable regulatory and legal frame work
- adequate physical infrastructure
- prudent fiscal regime
- capacity building

It is my believe that if all the stakeholders display transparency, accountability and sense of responsibility, this Scheme will achieve the desired results by bringing the Nigeria economy to be less import dependent.

Thank you and God bless.