Financial System Strategy 2020

FSS 2020 International Conference
SME: Issues, Challenges and Prospects
By Prof. Banji Oyelaran-Oyeyinka
Director Monitoring & Research Division (UN-HABITAT)
Visiting Professor, Innovation, Technology & Development, The Open University.
Introduction

- SMEs are a very important part of the Nigerian economy.

- In countries at same levels of development with Nigeria, SMEs contribute a much higher proportion to GDP than currently observed in Nigeria

- Compared to other emerging markets, Nigeria has historically shown lack of commitment to building a strong SME sector;

- These economies have shown consistent commitment to the development of SMEs by implementing: access to finance and financial incentives, basic and technological infrastructure, adequate legal and regulatory framework, and a commitment to building domestic expertise and knowledge

- In light of recent events in the Nigerian macroeconomic environment, SMEs have compelling growth potential and like other emerging economies are likely to constitute a significant portion of GDP in the near future

- In this presentation, we will take a look at SMEs in Nigeria, some of the current challenges being faced and present a case for progress for SMEs in Nigeria
SMEs in Nigeria

- SMEs are broadly defined\(^{(1)}\) as businesses with turnover of less than N100 MM per annum and/or less than 300 employees.

- Studies by the IFC show that approx. 96% of Nigerian businesses are SMEs compared to 53% in the US and 65% in Europe.

- SMEs represent about 90% of the manufacturing/industrial sector in terms of number of enterprises.

- They contribute approx. 1% of GDP compared to 40% in Asian countries and 50% in the US or Europe.

- In Nigeria, SMEs are distributed by clusters within regions.

---

\(^{(1)}\) Definition sums up several Nigerian institution definitions of SMEs, i.e. Central Bank, Fed. Ministry of Industry, NASME.
### Manufactured Exports by SMEs

<table>
<thead>
<tr>
<th>Economy</th>
<th>Year</th>
<th>Definition of an SME (a)</th>
<th>% SME manufacture exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developing Economies</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chinese Taipei</td>
<td>Early 1990s</td>
<td>&lt;100 employees</td>
<td>56</td>
</tr>
<tr>
<td>China</td>
<td>Early 1990s</td>
<td>&lt;100 employees</td>
<td>40-60</td>
</tr>
<tr>
<td>Korea</td>
<td>1995</td>
<td>&lt;300 employees</td>
<td>42.4</td>
</tr>
<tr>
<td>Vietnam</td>
<td>Early 1990s</td>
<td>&lt;200 employees</td>
<td>20</td>
</tr>
<tr>
<td>India</td>
<td>1991/1992</td>
<td>&lt;Rs 30 M investment in plant &amp; machinery</td>
<td>31.5</td>
</tr>
<tr>
<td>Singapore</td>
<td>Early 1990s</td>
<td>&lt;100 employees</td>
<td>16</td>
</tr>
</tbody>
</table>
Selected Regional & Sectoral Distribution of SME Clusters

- Kano: Leather SME Clusters
- Oshogbo: Tie & Dye SME Clusters
- Abeokuta: Tie & Dye SME Clusters
- Lagos: Otigba ICT SME Clusters
- Nnewi: Automotive SME Clusters
### Opportunities

- SMEs have significant untapped growth potential
- Strong export and employment potentials
- SMEs in Nigeria are currently distributed along sectors within regions; creating potential operational and cost synergies
- New growing sectors, such as entertainment and leisure clusters
- Low-Tech Sectors clusters: Footwear, clothing & garment, agro-processing (cassava, oil palm and other oils.
- High Tech clusters: ICTs, Telecom, and Biotechnology (agric and health)

### Challenges

- Huge gaps in infrastructure
- Poor financial support and credit environment
- High levels of unskilled workforce
- Low investment commitment to bring pilot plants to commercial scale
SMEs require improved financial support

Studies show that Nigeria has a low amount of domestic investment through loans vis-à-vis other emerging markets

- Majority of the loans granted are issued to large corporates and governments
- Mostly Informal financing

**Total Loans as % of GDP (BMI, 2006)**

<table>
<thead>
<tr>
<th></th>
<th>Nigeria</th>
<th>Kazakh</th>
<th>Egypt</th>
<th>South Africa</th>
<th>Eurozone</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount</td>
<td>19.7</td>
<td>47.2</td>
<td>54.3</td>
<td>94.0</td>
<td>104.1</td>
</tr>
</tbody>
</table>

**2005 Survey: Lagos ICT & Nnewi Auto Clusters**

<table>
<thead>
<tr>
<th>Sources of Funding</th>
<th>Lagos</th>
<th>Nnewi</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private Banks</td>
<td>18%</td>
<td>19%</td>
<td>Weak</td>
</tr>
<tr>
<td>Development Banks</td>
<td>21%</td>
<td>29%</td>
<td>Weak</td>
</tr>
<tr>
<td>Govt. Credit</td>
<td>29%</td>
<td>0%</td>
<td>Weak</td>
</tr>
<tr>
<td>Friends</td>
<td>31%</td>
<td>38%</td>
<td>NA</td>
</tr>
<tr>
<td>Personal</td>
<td>50%</td>
<td>76%</td>
<td>NA</td>
</tr>
</tbody>
</table>
“It is a lack of investment in human capital, not a lack of investment in physical capital alone, which prevents poor countries from catching up with rich ones. Educational attainment and public spending on education are correlated positively to economic growth” – Benhabib and Spiegel, 1994

Import of physical capital is less costly than the domestic development of human capital and technical expertise

### R&D as % of GDP

<table>
<thead>
<tr>
<th>Country</th>
<th>R&amp;D as % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nigeria</td>
<td>0.3</td>
</tr>
<tr>
<td>Singapore</td>
<td>1.8</td>
</tr>
<tr>
<td>Taiwan</td>
<td>2.1</td>
</tr>
<tr>
<td>Korea</td>
<td>2.7</td>
</tr>
</tbody>
</table>

### 2005 Survey: Lagos ICT & Nnewi Auto Clusters

<table>
<thead>
<tr>
<th>Human Capital Support</th>
<th>Lagos</th>
<th>Nnewi</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Secondary Education</td>
<td>Weak</td>
<td>Weak</td>
<td>Weak</td>
</tr>
<tr>
<td>Tertiary Education</td>
<td>Weak</td>
<td>Weak</td>
<td>Weak</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>Weak</td>
<td>Weak</td>
<td>Weak</td>
</tr>
<tr>
<td>Training</td>
<td>Weak</td>
<td>Weak</td>
<td>Weak</td>
</tr>
<tr>
<td>Skilled Manpower</td>
<td>Weak</td>
<td>Weak</td>
<td>Weak</td>
</tr>
</tbody>
</table>

1 2007 IMF estimates
“Given adequate levels of investment in human capital, strong correlations exist between the rapid rates of industrialisation over the long term and the investments in physical capital” – Sanberg, 1962

Majority of private sector led initiatives outperform public sector led ones

---

1 Paraphrased
Ratings of Infrastructure

Ratings by Otigba SMEs

Assessment of Physical Infrastructure Provision

- Internet
- Telephone
- Roads
- Water
- Electricity

Categories:
- Bad
- Fair
- Good
Where we Are: Government Input

- Vital role of Government in providing an enabling environment for SMEs can’t be overemphasized
- The more successful emerging markets have high rankings as a result of government support in enabling the private sector, and SMEs specifically
- SMEs surveys show weak overall support from Government

<table>
<thead>
<tr>
<th>Support Systems</th>
<th>Lagos</th>
<th>Nnewi</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Govt. Incentives</td>
<td>Weak</td>
<td>Weak</td>
<td>Weak</td>
</tr>
<tr>
<td>Innovation</td>
<td>Weak</td>
<td>Weak</td>
<td>Weak</td>
</tr>
<tr>
<td>IT Support</td>
<td>Fair</td>
<td>Weak</td>
<td>Weak</td>
</tr>
<tr>
<td>Intellectual Property</td>
<td>Weak</td>
<td>Weak</td>
<td>Weak</td>
</tr>
<tr>
<td>Venture Capital</td>
<td>Weak</td>
<td>Weak</td>
<td>Weak</td>
</tr>
</tbody>
</table>

1 Ranking index is based on overall Govt support through: Financing, Infrastructure, Knowledge, Policy
SMEs Severely Constrained

- Need for Policy Support

Constraints Faced By Nnewi SMEs Cluster
Need for Policy Support

**SMEs Constrained**

![Bar chart showing constraints faced by SME firms in Aba Shoe Cluster](chart.png)
• Manufacturing as % GDP in Nigeria has averaged 3–7% over the last few decades

• Fierce competition for the Nigerian manufacturing sector come predominantly from Asia

• Manufacturing amongst Asian competitors account for 30-40% of GDP today

• SMEs today account for approx. 1% of total GDP and approx. 14% of total manufacturing contribution to GDP

• Studies show that <20% of SME manufacturers export
  - Majority of exporters are experiencing decreasing levels of exporting due to competitive pressures from Asian counterparts
Where We Are

- In the private sector, there is a two-stage lag behind these other countries in developing capabilities for competitiveness.

  - Knowledge-resource accumulation is lagging 15 - 30 years behind depending on which country;

  - There is the more obvious 20-25-year lag in general economic development.
The Asian Challenge

Effect of Asian Challenge on Otigba Cluster

- Very severe
- Severe
- Fairly severe
- Weak severe
- Not severe

percent
## The Asian Challenge

### Perception of SMEs

<table>
<thead>
<tr>
<th>Perceptions of Market Access Strategies (%)</th>
<th>Asia's Challenge</th>
<th>Strategy of Enterprises in Otigba</th>
</tr>
</thead>
<tbody>
<tr>
<td>Design (superior)</td>
<td>87.07</td>
<td>12.93</td>
</tr>
<tr>
<td>Quality (high)</td>
<td>85.10</td>
<td>14.90</td>
</tr>
<tr>
<td>Price (lower)</td>
<td>90.00</td>
<td>10.00</td>
</tr>
<tr>
<td>Reliability in delivery/supply</td>
<td>70.11</td>
<td>29.89</td>
</tr>
<tr>
<td>Introduction of new products</td>
<td>87.31</td>
<td>19.69</td>
</tr>
</tbody>
</table>

Banji Oyelaran-Oyeyinka
Ranking on Innovation CI

The image shows a bar chart ranking countries based on their innovation knowledge index. The countries are ranked from highest to lowest, with the United States at the top and a few countries at the bottom. The chart uses a horizontal bar graph format to display the relative innovation index of each country.
Where We Are on CI

Competitiveness rating

Source: Oyelaran-Oyeyinka (2006)
Africa Compared
How To Compete: The China Example

Create Enabling Financial Incentives and Policies

**Tax Policy**
- Four targeted electronics products
- Exemption of production taxes, half of the income taxes and tariffs of key equipments
- Pick up 10% of R&D expenses
- Exemption of importation taxes on significant imported projects

**Development Fund**
- Allocation of RMB100 million per year to support technology adaptation, technology and commercialization of the above four products
- Used as fund for several start ups

**Subsidies**
- Allocation RMB200 million as loan subsidies to support the application of computers

**Licences**
- Importation licence management on computer and components

Increase Investment in Infrastructure (2002 -03)

- % Growth of total investments in infrastructure

- Iron/ Steel: 93
- Cement: 122
- Automobile: 87
- Textile: 80
- Coal: 52

- Strong commitment to core industries
- Increasing investments by almost 80% from the late 90s

Increase Investment in Knowledge (RMB MM)

- Total R&D Investment

- 1997: 1,000
- 1999: 2,000
- 2001: 3,000
- 2003: 4,000
- 2005: 5,000

Banji Oyelaran-Oyeyinka
Following Figures show that wealth generation is:

- Inversely proportional to employment in agriculture;
- Positively related to technical enrolment in universities;
- Positively related to knowledge infrastructure (Internet users);
- Internet users are highly correlated with telephone use;
- Internet use is positively related to computer use.
Figure: Agricultural Labour in GDP and per Capital Income
Figure: Technical Subjects Enrolment in Universities and per Capital Income
Figure: Internet use and GDP per capita in USD (2000)
Figure: Internet use and telephone density (2000)

\[ R^2 = 0.9346 \]
Current Initiatives Poised to Drive Growth

- Government deregulation of the real sector
- Directive to increase National content
- Creation of free trade zones (Calabar and Lekki)
- Commissioning of several transport projects
- Development of credit bureau
- EFCC, NAFDAC, NEITI
- Privatisation of Government assets
- Regulatory bank capital allocation for SMEs
- CBN led African Financial Corporation initiative
- NEEDS
But Require Systemic SME Business Framework

- Key building blocks for an enabling SME business environment include:
  - Basic science and technology Knowledge Base
  - Legal and regulatory structure
  - Basic Physical and technological infrastructure
  - Financial and incentive structures

- In Nigeria today, significant leadership is particularly required in these areas
Systemic Functions for Supporting SMEs

1) Knowledge Support including targeted R&D and Design;

2) Competence building: formal and non-formal training in educational institutions and training of technical manpower in firms and organizations;

3) Supply of inputs, particularly finance for production and innovation and for the development of scientific, technical and managerial manpower; flow of Foreign Direct Investment FDIs, venture capital and loans;

4) Provision of regulatory frameworks and measures, standards and quality functions (such as product quality tests) and provision of incentives to develop new products and services;
Systemic Functions for Supporting SMEs

5) Facilitation of the exchange and dissemination of knowledge and information;

6) Stimulation of demand and creation of markets through govt procurement policies;

7) Reduction of uncertainties and resolution of conflicts through appropriate institutions, such as industrial arbitration.
National Economic System for Production and Innovation

Framework Conditions

- Science policy
- Innovation policy

Financial System
- Intermediaries
- Education & Training
- Human capital

Firms system
- Large, small, MNCs, NTBFs, ...

Rules & Regulations
- Incubators, Mentoring...

MARKETS
- Business support

Venture Capital
- Firms R&D

Human capital
Proposal: Broad Vision

1. Nurture 200 manufactured export SMEs distributed across sectors by 2020;

2. SMEs to contribute to increased employment, national income generation and export revenues: raise manufactured exports of SMEs to 10% by 2010; 20% by 2015; and 25% by 2020;

3. Expand domestic oriented SME, through:
   – The creation of new and innovative firms; and
   – The graduation of as many informal enterprises as possible into the formal sector.
Recommendations and Proposals

(1) Short Time Must Do Now!

Basic Infrastructure that is targeted;

- Designate SME Clusters as Priority Economic Zones (PEZs) for Infrastructure support including power, water and broadband.

These include traditional technology clusters: leather works, agro-processing (cassava, oil palm, automotive components etc.

High-tech clusters include ICTs, biotechnology for specific products to solve health and food problems
Promote High-Tech Industrial Clusters

- Establish a framework and A Fund Mechanism to raise the capability of local computer component assemblers;
- With private actors build high tech parks for hardware and computer software;
- Build Model technology Incubators within parks;
- Build on existing institutions such as NIPRID, SHEDCO etc to spin-off SMEs that draw on research from these organizations.
- Framework to move research into market using SMEs
Better Systems Coordination

- Establish a National Foundation for Innovation, and Competitiveness (NAFIC). It will comprise the CBN, Ministries of S&T, Industry, Finance, SMEDAN and NPC and located in the presidency;

- The NFIC will include representatives of the private sector as well as international and national individuals appointed on their merit;

- Malaysia, the UK, India and Hong Kong among others have such bodies.
Knowledge of Sector

In collaboration with other agencies:

- Deepen the knowledge of the sector through surveys and studies of SMEs;
- Organize periodic fora to bring together sectoral SME groups with suppliers, buyers etc..
- Organize the Nigeria “SMEs on the Web” Project
SMEs can Replicate Other Success Stories

- Tremendous growth in the SME sector can be achieved, with the right amount of economic enabling

- Successful case studies from the banking and telecom sectors show the growth potential inherent in unreformed business sectors

- Further impetus within the broader Nigerian socioeconomic environment provide a compelling case for the SME sector growth potential, such as aforementioned initiatives driving growth
In Conclusion

... Nigeria is on the right track, but much still needs to be done to promote SMEs ...
Thank You