Institute of Social Studies

Graduate School of Development Studies

FINANCING SMEs IN NIGERIA THROUGH EQUITY INVESTMENT SCHEME: A POLICY APPRAISAL

A Research Paper presented by:

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(NIGERIA)

In Partial Fulfillment of the Requirements for Obtaining the Degree of:

Master of Arts in Development Studies

Specialization:

PUBLIC POLICY AND ADMINISTRATION

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The Hague, December 2002

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DEDICATION

To the Glory of the Almighty God

For making the impossible, possible.

ACKNOWLEGDEMENT

What has a beginning surely has an end. I give thanks to God for good health, provision protection and knowledge which enabled me to complete my studies at the ISS. I am grateful to my supervisor, Dr Roger Tangri for his patience at the snail speed at which this work had initially progressed. His candor and counsel proved most helpful in putting my thoughts together. I wish to thank Dr Vasant Moharir for his valuable contributions.

I wish to thank my colleagues in the PPA major for their friendship and the knowledge sharing throughout the duration of our programme. The same goes to the faculty staff. In this regard, I wish to thank Prof Bjorkman, Des Gasper, Joop de wit, Dele Olowu and not in the least Dr Paschal Mihyo for their intellectual investment and the time they shared with us both in and outside the classroom. To dear Maggie Vlot, the programme administrator, thank you very much for all the extra copy card and of course Karin Hirde, our stand by, programme administrator.

I enjoyed the warmth and friendship of a number of people who helped in making the time spent at the Hague thoroughly memorable. To Prof Bas de Gaay Fortman, Ms Matty Klatter, Martin Blok, the incredible Janna, Marianne van Dieren, Mr Plugge, Sylvia of the facility Dept and Gitta of the financial office, Bunmi Toyobo, Ben Ugbe, Femi Adekoya, the Wikinas, the Larrys, olorunshola, Isaac Aleshinloye, Victor Asiboja, Jalele Erega and many others too numerous to mention..

What has an end, sure has a beginning. As I look back to the time preparatory to coming over to the I S S, I realize that I owe a debt of gratitude to the very many people who indeed offered invaluable assistance in one form or the other. I want to thank my former colleagues at the Central Bank of Nigeria. I particularly wish to single out Mr Walter Ahrey, Mustapha Bello, Okor Ezewu, Georglyn Egbutu, Mr Vincent Omoike, Toyin Folami, Mr Julius Afiemo (former Director of Personnel) and Mr Wole Oduyemi (Deputy Governor).

I wish to appreciate from the Nigerian end, my family members (the Abarshi's and the Fatiregun's) whose prayers and moral support have always proved valuable and also the Redeemed Christian Church of God, Pastor Eskor Mfon, Pastor Tony Okeke and other Pastor colleagues.

Finally and most importantly, I want to thank my immediate family for their patient endurance through the times of my being away and the sacrifices of love they have had to bear. To Ebun, A.J and Daniel, by the grace of God, the struggle shall not be in vain.

ACRONYMS

ACA	African capital Alliance
ADCG	African Development Consulting Group
BC	Bankers Committee
CBA	Central Bank of Nigeria
CGT	Capital Gains Tax
IFC	International Finance Corporation
IRR	Investment Return Rate
MAN	Manufacturers Association of Nigeria
NACCIMA	National association of Chambers of commerce, Industry, Mines and Agriculture
NASME	National Association of Small and Medium enterprises
NBCI	Nigerian Bank for Commerce and Industry
NERFUND	National Economic Reconstruction Fund
NGO	Non-governmental Organisation
NIDB	Nigerian Industrial Development Bank
NSE	Nigeria Stock Exchange
OECD	Organisation for economic Co-operation and Development
OPS	Organised Private Sector
PBT	Profit before tax
SEC	Securities and Exchange Commission
SME	Small and Medium Enterprises
SMI	Small and Medium Industries
SMIEIS	small Medium Industry Equity Investments
SSI	Small Scale Industries
SSIC	Small Scale Industries Credit
UNIDO	United Nation Industrial Development Organisation
USAID	United States Agency for International Development

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CHAPTER ONE

INTRODUCTION

1.1. BACKGROUND TO STUDY

The flexibility, adaptability and regenerative tendencies of SMEs to propel economic development have made the sector to be of pivotal interest in the quest of successive governments in Nigeria to promote industrial development. Beside the potential of contributing towards a diversified production base for the economy given the almost total dependence on oil for export earning, SMEs have the accelerative effect in achieving macroeconomic objectives such as full employment, income distribution and the development of local technology (Adebusuyi, 1997). Like wise, SMEs are seen as agents for the diffusion of management skills and the stimulation of indigenous entrepreneurship. In addition, SMEs retain a competitive advantage over large enterprises by serving dispersed markets. They also provide differentiated products with low scale economies for niche markets and often specialize in producing intermediate products for use in large firms thereby contributing to the strengthening of industrial inter-linkages. Furthermore, SMEs are known to adapt with greater ease under difficult and changing circumstances because their typically low capital intensity allow product lines and inputs to be changed at relatively low cost (Oyeyinka, 2000).

The financing of the SME sector in Nigeria poses a lot of challenges partly due to apparent and perceived risks as well as the high opportunity costs involved in lending to SMEs, in view of other profitable alternative ventures competing for funding at any given time (Anyanwu, 1996; Ojo, 2000). Policy makers however, continue to emphasize the need for the SME sector to be well-funded, given the multiplier effect as well as the numerous advantages an efficient and growing SME confers on the economy. The global practice also supports this view, as many governments in both the developed and developing countries have put in place policies and programs targeted at boosting the activities of SMEs (Helmsing & Kolstee, 1993; Cowling, 1999). From the review of numerous programs targeted at promoting SMEs around the world (SSI Study Initiative, 2000), it was found that the impact and degree of success of such programs and policies have tended to generally depend on;

1. The roles of the public and private sectors in such programs
2. The structure of credit/capital provided to the SMEs,
3. The nature of the incentives directed at the SMEs and (investors),
4. The identification and implementation of critical success factors driving such a program.

In overcoming the general apathy of institutional investors to this sector and in order to make the financing of SMEs attractive and rewarding, policy makers are beginning to focus on the provision of an incentive framework that will be attractive both to the SME beneficiaries and the investors. In the case of Nigeria, the failure of several policy initiatives by successive governments to provide adequate and affordable long-term finance to SMEs informed the present government's resolve (through the Central Bank of Nigeria) to dialogue with the banking industry to explore how banks can play a greater role in stimulating the growth of the Nigerian economy by providing SMEs access to long term finance (Adebusuyi, 1997). The banking industry under the aegis of the Banker's Committee at its 246th meeting in December 1999, responded by volunteering to commit ten percent of the profit before tax of every bank to provide long term capital to SMEs. This led to the establishment of the Small and Medium Industry Equity Investment Scheme (SMIEIS) on the 19th June 2001.

1.2. RESEARCH PROBLEM

Unlike previous schemes that mainly focused on the provision of subsidized credit to SMEs either through development finance institutions, specialized financing schemes or through mandatory sectoral credit allocation, the SMIEIS incentive framework attempts to attract and reward both the SMEs and institutional investors. The absence of such a framework had informed the general apathy towards this sector by institutional investors/lenders (Anyanwu, 1996; Olashore, 1985). The scheme also recognizes the roles of both the public and private sector in the realization of the objectives of the scheme by identifying the stakeholders and outlining their respective responsibility. The policy design envisages that equity investment will require new values, skills and institutions, if the scheme is to be successfully implemented.

While acknowledging the novelty of this scheme in its attempt to address the gap in SME financing,[1] there have been misgivings expressed about the feasibility of the scheme, more so, in realizing its main objective of directing more investment into the productive sectors of the economy through equity investment. Some key critics of the policy like the Manufacturer Association of Nigeria (allAfrica.com) and the National Association of Small and Medium Enterprises (NASME) while welcoming the initiative, have however argued that the policy design is faulty because it does not represent the collective interest of the identified stakeholders but mainly the interest of the Bankers Committee. Some have argued that some of the modalities are not SME friendly and gives the participating banks, an overbearing influence in the implementation of the scheme.

However, in recognition of possible implementation difficulties, the policy design provides for a policy review at the end of five year. Although the implementation of the scheme is into its second year, the admission by Dr Joseph Sanusi, the Governor of the Central Bank of Nigeria in March 2002 that only 6 investment deals have been concluded clearly highlights the slow pace of investment. Sanusi also noted that industries which were in dire need of working capital were yet to benefit from the scheme and therefore picked holes in the operational system of the scheme(Okereocha, 2002). As at the 31st of July 2002, the concentration of such investments were on invisible (service) enterprises rather than in the real sector of the economy and this further lends credence to the fears of critics and the calls for an appraisal of the policy informing the scheme (Okereocha, 2002).

1.3. RESEARCH QUESTIONS

1. How appropriate is the policy design of SMIEIS when viewed in line with the policy rationale? Does the policy design take into account, the experiences of other SME financing schemes?

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[1] Nigeria is so far the only country in the world to have adopted a bank led-equity type funding for small and medium enterprises.

2. To what extent are those involved in designing the policy and are also affected by the policy in agreement that it is a good policy? Who was most influential in the policy design and does the policy design address the interest of all stakeholders?

3. How feasible is the policy in terms of its implementation?

4. What has been the experience in the ongoing implementation exercise?

1.4. SOURCES OF DATA

The study relied on published and unpublished qualitative data. The published consisted books, journals, newspaper reports and information sourced from the internet while the unpublished data consisted of policy documents, memorandum, and seminar/workshop papers. Some primary data were sourced and employed in the study through formal, interactive and unstructured interviews with some of the identified stakeholders in the scheme. On the basis of purposive sampling, officials of four (4) banks including the Central Bank of Nigeria were interviewed. Others also interviewed included an official of an Independent Fund Manager (SME Manager Ltd), the Executive Secretary of the National Association of Small and Medium Enterprises and some SME promoters.

1.5. LIMITATION OF STUDY

Though a lot has been written on SME financing in Nigeria, the introduction of private equity investment in SME financing is a recent phenomenon and very little has been written on it. This paper is therefore an exploratory study that is focused on assessing the feasibility of this new form of financing. Most of the private equity schemes in the country are at a very early stage of their implementation and the information available is grossly inadequate in arriving at some general conclusions. Secondly, the study while recognizing that the case study (SMIEIS) involves a number of institutional stakeholders nevertheless pays greater attention to the role of the banking industry (represented by the CBN, the Bankers Committee and individual banks) being the initiators of the scheme. Thirdly, the research with regards to the case study required the active support of selected financial intermediaries and SMEs in collating primary data. The time frame required for collating a wide sample of respondents was beyond the time frame available for this study thus necessitating a purposive sampling of some of the stakeholders. Lack of cooperation from some of the sampled respondents limited the scope of access to official information and informed the paucity of official information. This in turn led to the reliance on information relayed through the news media and on the formal, interactive but unstructured interviews. Fourthly, because the study is primarily concern with the problem of SME financing, rather than dwell on the overall macro-economic environment, the study pays greater attention to the domestic monetary and financial policy environment

CHAPTER TWO
ANALYTICAL FRAMEWORK

2.1. INTRODUCTION

There is a growing interest among policymakers on how to promote and improve the performance and social contributions of SMEs. The interest is fuelled by the intertwined processes of globalization, technical progress and increased world trade which has given rise to the removal of protectionist policies, such as trade barriers (tariff and non-tariff) designed to help local industries (Andersson, 2000). Likewise, the changing role of government from being an active and dominant player in the economy to one of facilitating and creating an enabling environment for private sector-led development and growth, has further contributed to this interest (UNIDO, 1999). However, the ineffectiveness of many policies and programs directed at assisting the development of SMEs brings into question the rationale and feasibility of such policies, and reveals that more needs be done in the design, implementation and evaluation of SME policies (Andersson, 2000; Helmsing & Kolstee, 1993).

This chapter begins by offering a conceptual definition to some of the key terms in this study. It then presents a conceptual overview of Hogwood & Gunn's (1984) mixed process and this is followed by the approach to study which details how the framework will be employed in appraising the policy design of the Small and Medium Industries Equity Investment Scheme (SMIEIS).

2. 2 DEFINITION OF CONCEPTS

Small and Medium Enterprises: the concepts of SMEs are relative and dynamic. It changes over a period of time and varies from country to country depending on the level of development. Before 1992, several definitions of SMEs were adopted by various government agencies in Nigeria depending on their policy focus. However, in 1992, the National Council on Industry streamlined the various definitions in order to remove ambiguities. Small-scale enterprises were defined as "those enterprises with fixed assets above one million naira but not exceeding ten million naira, excluding land but including working capital". The medium-scale enterprises were defined as "those with fixed assets excluding land but including working capital, above ten million naira, but not exceeding forty million naira". The definitions were further revised in 1996 and the small-scale was defined as "enterprises with total cost including working capital but excluding cost of land, above one million naira, but not exceeding forty million naira with a workforce of between 11-35 workers". The medium-scale was defined as "those enterprises with total cost, including working capital but excluding cost of land, above forty million, but not exceeding one hundred and fifty million, with a workforce between 36 and 100 workers". However, under the Small and Medium Industries Equity Investment Scheme (2001), one broad definition is given to cover the two categories of enterprises. SMIEIS (2001) defines SMEs, as "any enterprise with a maximum asset base of two hundred (200) 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".

Private Equity Investment: refers to the provision of equity capital to enterprises unlisted at the capital market. This capital is put to use in developing new products and technologies, expanding working capital, making new acquisitions, strengthening a company's balance sheet or facilitating the buy in or buy out of a business by experienced managers. Duncan Randall (2002) highlights the following features which set this form of financing apart from others;

Risk: It is among the riskiest forms of financing. Unlike most debt financing, it is typically unsecured. In the event of liquidation, equity holders occupy the lowest rung in the order of claimants.

Investment Returns: there are no guaranteed investment returns. During the life of an investment, the primary revenue stream earned by shareholders is dividends, which the company is usually under no obligation to declare. This is unlike loan financing which is based on a clearly determined payment schedule.

Investment Exit: Investors (equity holders) earn the bulk of their return on exit i.e. when they sell their shares. How much they earn is obviously dependent on how attractive these shares are to potential buyers i.e. how successful the company has been in growing its profitability and the prospects of it continuing to do so.

Public Policy: may be viewed as a field of activity, an expression of general purpose or desired state of affairs, specific proposals, decisions of government, formal authorization, a programme, as output, as outcome, as a theory or model and/or a process (Hogwood & Gunn, 1984).

2.3. CONCEPTUAL OVERVIEW

Brian Hogwood & Lewis Gunn (1984) provide a mixed process framework that analyses the policy process in terms of a number of stages which are outlined as follows;

Deciding to decide (issue search or agenda-setting): this involves the identification and anticipation of problems or opportunity which suggest the need to consider action.

Deciding how to decide (or issue filtration): this entails making a conscious choice on the basis of explicit criteria of which issues should be handled by the scarce analytical capacity available to an organization.

Issue definition: often what is identified or defined as a policy problem or issue is a combination of problems and the various strands need to be separated and defined.

Forecasting: this entails speculating about alternative possible futures, given different assumptions about the development of the problems and the policies.

Setting objectives and priorities: this entails asking two related questions. What are we trying to do? And how will we know when we have done it?

Options analysis: appraising and comparing options in attempting to achieve any given policy objective.

Policy implementation, monitoring, and control: effective policy implementation requires that potential problems are considered in advance of implementation itself and that appropriate procedures are designed into the programme to monitor its progress and to check whether actual performance is living up to earlier expectations.

Evaluation and review: these will involve asking whether the policy has been successful in achieving the outcomes desired (in contrasts to securing the desired outputs, which is the focus of implementation, monitoring and control). Such review is only possible when it is a part of the policy design and should extend to considerations of whether the policy merits priority or should be downgraded or even terminated.

Policy maintenance, succession, or termination: the chances of a successful succession or termination are enhanced if the possibility of replacing or terminating the policy at some future date was designed into the initial policy.

2.4. APPROACH TO STUDY

This study is essentially a descriptive analysis of a qualitative nature and one of the main reasons for adopting the Hogwood and Gunn's framework is because it is very useful for descriptive and prescriptive analysis as it sets out the policy process in stages. Although in real life, the policy process is not self-contained, nor does any policy episode, comprises a neat cycle of initial, intermediate and culminating events, nevertheless the framework however, provides insight into how policies are actually made and the actions taken by various actors at each stage. It can thus, be employed in assessing specific policies in terms of the extent to which their outcome have achieved the objectives of the policy and in evaluative studies which is aimed at improving the understanding of factors that shape policy. This is without prejudice to the situation where the policy process applied to any given issue may in practice be truncated as the option to do nothing may be what is selected.

Another reason why this framework is considered suitable for this study is because it offers a continuous approach to the policy process with opportunity for feedback at many points in the process. Because of it continuous process, it furthermore lends itself to the identification and study of interactions, not only among the various stages in the process but also among various participating organizations and between organizations and the larger social and economic environment. However, in view of the danger that the use of such a framework with a clearly defined sequence of stages may lead to rationalization even when the acts in question do not lend themselves to such treatment, this study will employ only the following four stages namely; issue search, issue identification, policy objectives and policy implementation, monitoring and control.

In conducting a policy appraisal of the Small and Medium Industries Equity Investment Scheme (SMIEIS), this paper seeks to examine the policy design of the scheme and the policy feasibility within the context of the adopted framework. While the design stage begins with the formulation of a policy proposal and ends with a policy adoption, the implementation stage begins with policy adoption and continues as long as the policy remains in effect (Weimer & Vining, 1989). These two factors which are critical to the conduct of any policy appraisal inform the selection of issue search, issue identification, policy objectives and policy implementation, monitoring and control.

Policy Design: Smith (1989) views the policy design from the perspective of its appropriateness and agreement with its objectives and means. He argues that the clash of values and interests in public policies informs the need to ensure that a policy is based upon an appropriate ideology and acceptable values. For instance, are there moral, political or theoretical grounds upon which a policy is accepted or rejected? In respect of agreement, to what extent are those involved in making, implementing and are affected by the policy in agreement that it is a good policy? What defines or constitutes a good policy?

Andersson (2000) however emphasizes the importance of taking the concept of rationale (objective) seriously in the design of special SME policies or programmes. The argument is that, the design of SME policies should go beyond just trying to help SMEs because of their importance for the economy, to identifying rationale such as market, government or systemic failures. Andersson (2000) observes that in the OECD countries, SME policies are sometimes the problem, rather than the solution and those policies that had sought to protect SMEs from normal business pressures led to their dependence on government programmes which served to diminish their competitiveness and innovativeness, ultimately leading to even greater difficulties.

Thus, given the intensifying globalization, technical progress and increased world trade, Andersson (2000) highlight the need for policymakers to seriously reflect on how SME policies can work alongside open markets, or catalyze efficient markets (where there is none or it is an inefficient one) rather than preventing or circumventing the market. The opening of markets is expected to bring in its wake, both greater risks and greater opportunities and the task is to achieve results which maximizes the opportunities. The bottom line of Andersson's argument is that every policy needs to have a sound basis for the objective(s) which it seeks to achieve and such objectives should clearly relate to problems such as market, government or policy failure. With respect to this case study, the task it would seem is to develop an equity and venture capital market, which can improve risk evaluation and distribute resources more effectively among SMEs. This helps to explain why this paper considers policy objective an importance part of the framework to be used in conducting the policy appraisal of the case study.

In assessing whether a policy would be a good or successful policy in the long run, Moharir (1991) argues that such policy would have to fulfill the test of Effectiveness (degree to which policy objectives are achieved), Efficiency (achievement of objectives in terms of time and cost) and Responsiveness (degree to which clients are satisfied) in some measure or the other. However since the case study is barely 16 months into implementation, no such test will be conducted. On the other hand, since how a policy design is arrived at, is crucial to its implementation, it also could serve as an indicator of whether it would stand to fail or succeed. Smith (1989) argues that policy decisions should not be made only on grounds of 'rationality', or the attempt to achieve effectiveness, efficiency and responsiveness but that premium be placed on the agreement and consensus among participants in the policy making process. Compromise and accommodation becomes the central concerns, as the determination of ends and objectives become tangled with the search for suitable means and alternatives to achieve those objectives. This provides the premise for applying the framework involving issue search and issue identification in establishing how policy agenda are set, why certain issues receive attention and how the policy problems are identified and structured for policy action.

Policy Feasibility: This has to do with how the policy is dealt with, in the context of the policy arena. The pre-occupation here, is with the policy execution and in particular, its implementation, and sustainability because the design and adoption of a policy does not automatically guarantee its implementation success. Since policy implementation is closely related to the feasibility of policies, Smith (1989) argues that some policies might have noble objectives, be based upon adequate theory, have wide support in the community, but be totally unfeasible to implement. This provides the premise for selecting policy implementation, monitoring and control as part of the framework for this study.

Smith attributes the problem of implementation failure to the lack of capacity on the part of implementing organizations to implement e.g. lack of direction, leadership, or shortage of skilled or dedicated manpower. He also argues that the scope for policy distortion is high if those implementing the policy deliberately seek to obstruct, distort or ignore the goals and aims of the policy and also if monitoring and control is ineffective. Besides the failure of implementing organizations, target groups of recipients and beneficiaries also must respond to policy initiatives and their response influences the quality of implementation.

To address the above concern, the political and administrative feasibility of a policy needs to be ascertained. Moharir (1991) emphasizes the importance of conducting a political feasibility analysis before the adoption of a policy, while in order to realize what has been adopted, administrative feasibility becomes necessary. I will employ Arnold J Meltsner's (1972) approach to political feasibility which analyses the interplay of the following variables in assessing the political feasibility of a policy namely; The Relevant Environment (Policy Issue Arena), Policy Actors, Motivations, Beliefs, Resources, and Sites. I will however focus only on the first four variables which are more relevant to the case study.

David Weimer and Aidan Vining (1989) 'marriage' approach to implementation would provide the approach on administrative feasibility. Weimer and Vining (1989) identify three major factors which affect the success or failure of policy implementation. These factors are:

Logic of the Policy: Is the theory which underlies the connection between policy and intended outcomes reasonable? A policy is viewed illogical if it is impossible to specify a plausible chain of behaviors that would lead to the desired outcomes.
Assembly: This is based on Eugene Bardach's metaphor (1977) which views implementation as an assembly process involving efforts to secure essential elements from those who control them. It suggest important question to ask when considering the prospect for successful implementation which includes, what elements must be assembled? Who controls these elements? What are their motivations? What resources does the implementer have available to induce them to provide the elements? What consequences will result if the elements can not be obtained either on a timely basis or at all?

Availability of fixers: Who Will Manage the Assembly? In the light of the importance of politics in the implementation process, understanding the motivations and political resources of the implementer is obviously important for predicting the likelihood that the policy will produce the intended consequences. E. C Hargrove (1975) argues that an implementer who views the policy as undesirable or unimportant is less likely to expand personal and organizational resources during the assembly process than one who views the policy more favorably. This is one of the reasons why organizational units are sometimes created to implement new policies as the perception is that the administrators of existing units will not be vigorous implementer because of their commitments to already existing programs. The failings of the implementer can be compensated for by the people, Eugene Bardach (1977) refers to as 'fixers'. Fixers are those who can intervene in the assembly process to help gain needed elements that are withheld. Fixers can be found among interest groups

In summary, Weimer and Vining argue that since policies do not implement themselves, in assessing the chances for successful implementation, the motivation and resources of those who will be managing the implementation should be taken into consideration; and that the role of fixers in mobilizing support for the policy be given due consideration.

CHAPTER THREE
THE POLICY DESIGN OF THE SMALL AND MEDIUM INDUSTRIES EQUITY INVESTMENT SCHEME (SMIEIS).

3.1. INTRODUCTION

This chapter analyses the policy design of the SMIEIS using Hogwood and Gunn's (1984) mixed policy process framework which has been elaborated in the previous chapter. It begins with a review of the multiple problems confronting SMEs and how the issue search has led to the focus on SME financing. The issue definition introduces the dimension of equity investment and the guidelines which defines the scheme being studied. The policy objective is reviewed vis-à-vis the implementation, monitoring, control and evaluation plan of the scheme. The concluding discussion highlights some of the areas where the policy design conflicts with the policy objectives.

3.2 PROBLEMS OF SMEs

Despite the importance attached to the role of SMEs in developing the Nigeria economy, the sector has generally been plagued by any problems which have inhibited its growth. Some of these problems include;

1. Constrained access to Money and Capital Market: the sector has generally been unable to muster sufficient financial resources to aid its operations even when the government has put in place many specialized schemes to provide their financial needs.
2. Lack of Infrastructure: the lack of adequate and basic infrastructures like security, roads, electricity, telephone and water supply remains one of the greatest hindrances to SMEs growth. Private provision of these essential services where available, has been at very prohibitive cost. Studies have revealed that the relative burden for the compensatory provision of basic infrastructures is much heavier on SMEs than on large enterprises.

3. Overbearing Regulatory and Operational Environment: the plethora of regulatory frameworks, multiple taxes, cumbersome importation procedures and unstable macro-economic environment continue to exert serious burden on the operations of SMEs.
4. Poor implementation of Policies: the poor implementation of sound policies and schemes as a result of an inefficient and discriminatory bureaucracy bedeviled by corruption and parochial interests.
5. Poor Management Practices and Low Entrepreneurial Skill: many SMEs are managed by a sole proprietor and such firms are often poorly managed due to lack of planning and proper accounting of transactions. Many lack the innovation and dynamism to meet growing and expanding business challenges.
6. Lack of access to Market: insufficient demand for the products of SMEs is also a major constraint. This can be attributed to low purchasing power arising from the dwindling real income of consumers. The inability to secure new markets further compounds the situation.

3.3. ISSUE SEARCH

One of the major complaints of most small and medium scale industrialists in Nigeria is the problem of finance. Much of the literature on this sector has adduced poor access to institutional credit as one of the major factors inhibiting the growth of the sector. Banks consider SMEs as high-risk venture due to poor project proposals, incomplete financial documentation, inadequate collateral including the inability to raise the required equity contribution, and the absence of a succession plan in the event of the death of the proprietor. These are some of the reasons, why banks shy away from lending to the sector and when they do so, it is often at a very prohibitive interest rate.

The problem of poor access to institutional credit and the lack of adequate credit (when and where available) to finance the growth and development of SMEs is largely attributed to the lending behavior of banks. This has prompted the calls for government intervention through its regulatory agency, the Central Bank of Nigeria. As the chair of the Bankers Committee (the umbrella body of the chief executives of all licensed banks in Nigeria), the Central Bank of Nigeria was thus, instrumental in setting this issue (SME financing and bank's lending behavior) on the agenda of the Bankers Committee.

In order to address the widening financing gaps of SMEs in view of bank's lending rate and behavior, previous policies had encouraged direct government intervention through the provision of subsidized long term credit to SMEs either through mandatory sectoral credit allocation by banks or through development finance institutions and specialized financing schemes. These policies and schemes have proved grossly inadequate in bridging the financing gap of SMEs. For instance, studies (Oyejide, 1993) reveal that under the system of mandatory credit allocation to preferred sectors, given the uneconomic nature and cumbersome administration of such loans, banks preferred to pay penalties rather than channel credit to the SMEs. In 1992, and in line with the policy of deregulation and financial sector reforms, the CBN started the gradual process of dismantling the control regime and the introduction of market instrument for monetary and credit control. Although empirical evidence (Oyejide, 1993) reveal that access to credit by SMEs actually improved in spite of the sharp rise of interest rates, nevertheless, the impact of these reforms on the SMEs engaged in the productive sectors on the whole, were unsalutary as most of them, considered long term credit at prohibitive interest rates in an unstable macro-economic environment unattractive. Thus despite high liquidity and a huge margin between saving and lending rates, long term financing for SMEs by banks remained scarce.

By 1999, the policy environment had somewhat changed with the emergence of a democratic government which had pledged to promote a private sector led development of the economy and was willing to engage the private sector in achieving this objective. The government had accused the banking sector of not contributing to the development of the economy as a result of the regime of very high interest rates and its lending behavior which was unfavorable to the real and productive sector of the economy. In response to the government's concern and deferring to the moral suasion from the Central Bank, the Bankers Committee (BC) in its memorandum submitted for the preparation of the federal Budget for year 2000, appreciated the need for it to play a partner in progress role in the development of the Nigerian economy and volunteered to commit 10% of the profit before tax (PBT) of every bank to provide long term capital to SMEs.

Some of the factors that informed the decision include;

a. The need for banks to address the problem of interest rate burden on SMEs given the cost of credit under normal bank lending
b. The need for banks to offer financial advisory, technical and managerial support.
c. The understanding that the problems of SMEs falls within the wider context of the macro-economic environment and the need for the banks to respond in support of the government's policy measures aimed at promoting the Small and Medium Enterprises.

3.4. ISSUE DEFINITION

The Bankers Committee thereafter, formed a sub-committee to advise it on the design and implementation of a scheme for SMEs in line with its decision to commit 10% of every bank's PBT for long term capital to SMEs. The sub-committee reviewed the experiences of previous SME schemes and in its report presented to the Bankers Committee on 15th February 2000, recommended the *provision of long term risk capital to Small Scale Industries (SSI) in the form of equity investment.* The revised and final report of the sub-committee was submitted on 6th April 2000 and 13th April 2000 respectively. A consulting firm (African Development Consulting Group) was appointed to conduct a program study on the proposed initiative. In conducting the study, ADCG organized brainstorming, interviews and focus group sessions with bankers, SME experts, and identified stakeholders. It carried out interviews and extensive research particularly on the role of banks and other financial institutions in macroeconomic development and also on SME programs in some selected developing and developed countries. The report entitled "SSI Study Initiative (2000)" and submitted in November 2000, supported the proposed equity investment initiative of the Bankers Committee and made recommendations to guide the implementation of the scheme. The recommendations of the ADCG were reviewed and adopted by the Bankers Committee with some minor amendments on February 20, 2001. This formed the basis of the operational guidelines and stakeholders responsibilities establishing SMIEIS.

3.5. POLICY OBJECTIVES

The major objectives of the scheme include;

i. To support the government's effort aimed at stimulating economic growth, developing local technology and generating employment amongst others, by financing the growth and development of SMEs particularly in the value adding sectors of the economy through equity funding.

ii. To facilitate the flow of funds for the establishment of new SMI projects, reactivation, expansion and modernization or restructuring of on going projects by providing incentives to encourage the banking industry to participate in the provision of long term, risk capital in the form of equity investment.

The other objectives which though are not specifically highlighted in the operational guidelines of the scheme but evident within the policy thrust include;

iii. Improving the ability of SMEs to attract debt and further equity capital

iv. Institutionalization of management and financial systems and procedures in SMEs to address moral hazard.

v. Increase entrepreneurship skills and innovation through entrepreneurial development programmes.

vi. To encourage the movement of SMEs operating in the informal sector to the formal sector through the provision of tax incentives and reduced corporate tax

vii. To encourage the development and growth of private equity financing for SMEs through the establishment of Venture Capital firms.

3.6. IMPLEMENTATION GUIDELINES

Small and Medium Enterprises : A small and medium enterprise (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". Under the scheme, the definition is subject to review by the bankers committee from time to time.

Activities covered by the Scheme : The scheme covers the following range of activities with the exclusion of trading; Agro-allied, Information technology and telecommunication, Manufacturing, Educational establishments, Services, Tourism and leisure, Solid Minerals, Construction and any other activity as may be determined from time to time by the Bankers' Committee.

Activities not covered by the scheme

Banks will not invest SMIEIS funds in entities whose principal business involve or comprise the manufacture or supply of, or any activities in the following sectors: Tobacco and Tobacco products; Armaments production (or where 25% or more of the total production output or, turnover of the invested company is derived from military related purposes); Beverages with alcoholic content exceeding 15%; Casino or companies where the principal source of income is gambling; Speculative investments in real estate or commodities; Banking, insurance or financial services; Immoral and illegal activities and Investments that are harmful to the environment.

Mode of Funding

To safeguard the scheme from abuse, the following modalities subsist:

a. Funding under the scheme shall be in the form of equity investment in eligible industries. This is to reduce the burden of interest as well as other financial charges expected under normal bank lending, as well as provide financial, advisory, technical and managerial support from the banking industry. The investment decision is the sole prerogative of the participating banks/fund manager(s) and is subject to their investment acceptance criteria.
b. Equity investment may be in the form of fresh cash injection and/or conversion of existing debts.
c. A participating company may obtain more funds by way of loans from banks in addition to equity investment under the scheme.
d. Eligible industries may approach any bank including those they presently have relationship with or the ones they do not have any relationship.

e. Banks may operate the scheme directly, through their wholly-owned subsidiary or through venture capital companies floated by a consortium of banks.

f. Prospective beneficiaries are advised to seek the opinion of third party consultants like lawyers, accountants and valuers in the determination of the values to be placed on the asset and capital of their businesses to enjoy a fair price before and during negotiation with banks.

g. The recommendations of industrial association (e.g. Manufacturer Association of Nigeria (MAN), National Association of Chambers of Commerce, Industry, Mines and Agriculture (NACCIMA), National Association of Small and Medium Enterprises (NASME), and the National Association of Small Scale Industries (NASSI).

h. Membership of recognized NGOs engaged in entrepreneurial development and promotion of small scale industries will be an added advantage.

Eligibility for Funding: SMEs are expected to satisfy the following conditions, in order to be eligible for funding under the scheme;

i. Registered as a limited liability company with the relevant authority (Corporate Affairs Commission) and be in compliance with all the relevant regulations of the Companies and Allied Matters Acts of 1990 such as filing of annual returns, including audited financial statements;

ii. Must be in compliance with all applicable tax laws and regulations and render regular returns to the appropriate authorities, and

iii. Engage or propose to engage in any of the business activities covered by the scheme.

FUNDING TARGET

The annual10% PBT reserves of each bank must be invested within 18 months in the first instance and 12 months for subsequent years. The Bankers Committee will apply sanctions where reserved fund are not utilized within the specified period.

Incentive Framework

Unlike previous schemes that mainly focused on providing incentives to SMEs, the SMIEIS incentive framework attempts to attract and reward both the SMEs and institutional investors. The absence of such a framework had informed the general apathy towards this sector by institutional investors/lenders. The following major incentives are provided under SMIEIS;

- Tax rate of Small and Medium Industries (SMI) reduced to 10%
- Five (5) years tax holiday to Small and Medium Industries
- Banks contribution in SMIEIS to enjoy 100% investment allowance
- Exempt Bank's divested equity funds from Capital Gains Tax (CGT)
- Divested funds shall be ploughed back to shareholders' funds and shall not be subjected to tax.

Identified Key Stakeholders

The scheme identifies the following as key stakeholders: The Federal Government of Nigeria, Central Bank of Nigeria (CBN), Bankers Committee (BC), Individual Banks, Independent Fund Managers, Securities and Exchange Commission (SEC), and Promoters of Small and Medium Industries (SMI).

3.7. MONITORING, CONTROL AND EVALUATION

Both the Central Bank and the Bankers Committee are specifically charged with the responsibility of monitoring the implementation of the scheme although the overall control of the scheme is vested in the Bankers Committee which has the authority to redefine, amend and even review the entire scheme (after 5 years). Thus the responsibility of evaluating the scheme to determine whether the policy has been successful in achieving the outcome desired in contrast to securing the desired output is vested in the Bankers Committee. The Central Bank is however saddled with the responsibility of ensuring compliance with the guidelines of the scheme and the authority to penalize erring banks in accordance with the penalty stipulated for non compliance by the Bankers Committee.

In recognition of the role that the wider macroeconomic environment plays in the overall success of the scheme and the need to involve other identified stakeholders in the implementation phase, the scheme provides for the establishment of a ten (10)member advisory committee from the following institutions:

- Central Bank of Nigeria (Chairman)
- Bankers Committee
- Presidency
- Federal Ministry of Finance
- Federal Ministry of Industry
- Manufacturers Association of Nigeria (MAN)
- National Association of Chambers of Commerce, Industry, Mines and Agriculture (NACCIMA)
- National Association of Small Scale Industries (NASSI)
- Development Finance Department of Central Bank of Nigeria (Secretariat)

The role of the advisory committee is not clearly defined in the policy design. However the committee is expected to provide a forum for consultation, knowledge sharing, stakeholders interaction and the opportunity to advise the Bankers Committee on the implementation of the scheme.

3.8. CONCLUDING DISCUSSION

The idea behind SMIEIS is to enable small and medium enterprises to have better access to capital through equity from the financial (banks) institutions, however the design of the scheme seems to make it even more difficult and the implementation likely to be problematic in addressing the financing needs of most SMEs and in particular the small enterprises. This is so because the policy design seems to address more of the concerns and interests of the bankers than any other perceived stakeholder. From issue search to issue definition and the consideration of policy options aimed at addressing this problem, the Bankers Committee's values and concerns seemingly predominates. After the adoption by the Bankers Committee of the report of its sub-committee on SME which recommended equity investment, all other policy options it would seem, were foreclosed.

In spite of the appointment of a consulting firm to do a detailed study that would guide the Bankers Committee in the design of its SME scheme, the recommendations of the consulting firm were more in line with the interests of the Bankers Committee. There was little or no direct dialogue between the Bankers Committee and the other identified stakeholders prior and during the policy formulation. The discussions, brainstorming and collation of policy input among the identified stake holders was conducted by the consulting firm (ADCG) and when the policy decision leading to the adoption of the scheme was made, it was made solely by the Banker Committee without the participation of the other stake holders.

Though the decision by banks to lay aside 10% of their PBT for the financing of SME was generally welcomed and applauded particularly by government and the organized private sector (OPS), the decision was as a result of the pressure from government and the OPS. Infact the National Association of Small and Medium Enterprises had earlier canvassed for 30% of the profits of banks to be set aside and channeled through a development finance institution like the Bank of Industry for SME financing (Interview with Executive Secretary of NASME). This proposed option is very popular with other industrial organizations like the Manufacturers Association of Nigeria (MAN) and the National Association of Small Scale Industries (NASSI) since it would provide access to more subsidized credit without threatening the ownership structure of their businesses. This option is also favored by these institutions because of a seeming lack of faith in the banks to safeguard their own interest. Against this background, the decision of the Bankers Committee to be the sole initiators of the scheme and therefore responsible for the adoption, implementation, monitoring and evaluation of the scheme is perhaps mainly for the promotion and preservation of their (banks) interests.

The conceptual definition of SMEs in the context of the design is also problematic as it is by Nigerian standard, skewed in favor of medium and even large enterprises and thus excluding the preponderance of SMEs. The ADCG report had recommended that there should be no lower limit for the definition of SMEs. This would have allowed for start-ups and for follow-on funding of businesses as they grow and require more capital funding (to assist in their evolution from small to medium size). This aspect of the recommendation was ignored. The ADCG recommendation was informed by the fact that investible funds that will be available to participating banks will vary significantly (between five million and five hundred million naira) and in order for banks to invest their funds in prudent and deliberate manner, they will need to focus on different sizes of SMEs depending on their capacity to manage these equity investments.

Another problem is the exclusion of the SMEs operating in the informal sector and who constitute the preponderance of SMEs as a result of the conditions stipulated for eligibility for funding under the scheme. The requirement of company registration, annual returns, audited financial statements, tax returns, e.t.c in an environment where the regulatory regime is cumbersome and overbearing and the level of such compliance even among large and well established firms is low brings into question the policy rationale in view of the stated objectives. Similarly, the fact that the investment decision making is the sole prerogative of the participating banks also implies that meeting the requirement for eligibility for funding under the scheme would not automatically translate into access for funding as each bank would still come up with a list of it's investment acceptance criteria which will inform its investment decision (for examples see appendix).

In addition, the investment options which allow banks to invest their SMIEIS funds either directly, or through a venture company wholly owned by the bank or through a venture company owned by a consortium of banks or through the conversion of existing loans to equity has raised a lot of concern not only among SME promoters but also amongst policy analysts. One of the major concerns raised is that Nigerian banks lack the skills required for equity investment as what they are more used to, is lending and credit administration. Thus instead of banking skills, what is required is venture capital investing skills for structuring equity partnership deals. Although the ADCG report highlighted this concern, it did not offer much in terms of recommendation on how to address the skill gap besides the emphasis on capacity building. For instance, how should the bank go about building capacity? How long is it envisaged that the capacity in terms of skills and competencies will be acquired? And what is to be done in the intervening period when they skills are being acquired? On the contrary, the report simply recommends that the banks be given the freedom to manage their fund and determine their investment options whether to invest directly or to outsource this function to independent fund managers on the ground that venture capital investing has a relatively high failure rate and incidence of unsuccessful investments.

Finally, the issue of uninvested reserved fund under the scheme remains a contentious one. The ADCG report highlighted the potential abuse of the fund through delayed investment and recommended the strict usage of the reserved fund for investments in the SMEs and that the return on uninvested should be made unattractive to avoid investment delayed. The report also recommended the withdrawal of tax benefits that would accrue to investments in SMEs, if they remain uninvested. The Bankers Committee is yet to specify the appropriate penalty for such breach and this has attracted the ire of SME promoters.

CHAPTER FOUR

THE FEASIBILITY OF THE SMALL AND MEDIUM INDUSTRIES EQUITY INVESTMENT SCHEME IN NIGERIA

4.1. INTRODUCTION

This chapter focuses on the on-going implementation of the small and medium industries equity investment scheme in Nigeria. It begins by examining some of the constraints faced in implementing SME policies, with a brief reference to previous SME financing schemes in Nigeria. It proceeds to examine both the political and administrative feasibility of the on-going scheme given the identified problems related to the policy design that could pose as constraints in the implementation of the scheme. In conclusion, based on the empirical findings of the implementation of the scheme, the policy performance so far, will be evaluated against the stated objectives of the policy.

4.2. ISSUES IN IMPLEMENTATION

SMIEIS commenced operations on 19th June 2001 but was officially launched by President Olusegun Obasanjo on the 21st August, 2001. Like many other SMEs schemes which preceded it, SMIEIS was launched with a lot of pomp and touted to be the panacea that would help close the gap on SME financing. Before attempting to dwell on the on-going implementation of SMIEIS, it may be helpful to do a brief review of some of previous schemes and their implementation outcomes in order to identify some of the common implementation issues and their implication for implementation success.

Starting from the 1960 and to date, State policies aimed at offering institutional support (particularly financial and technical) to SMEs led to the implementation of several programmes and schemes. The Small Scale Industries Credit (SSIC) schemes established under the regional governments in 1960s with the objectives of stimulating employment, reducing rural-urban migration, mobilizing domestic resources and promoting even dispersal of industries turned out to be largely unsuccessful. Under the Third National Development Plan (1975-1980) the SSIC schemes were transferred to the state governments upon the creation of states and it also suffered from implementation failure. The failure of these schemes was largely because of the dearth of 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 became progressively starved of fund and was halted in 1979.

With the failure of the SSIC schemes, the Federal Government in 1973 established the Nigerian Bank for Commerce and Industry in 1973 to cater for the credit provision of SMEs and operated as the apex institution for SMEs. Its administration of the SME 1 World Bank loan scheme experienced implementation failure as many of the approved projects were later cancelled due to the failure of project sponsors to contribute their counterpart funding. From 1989, the NBCI suffered a series of operational and liquidity problems attributed to reduced government funding and poor loans repayment by SMEs. It was finally merged with NERFUND (National Economic Reconstruction Fund) and the NIDB (Nigeria Industrial Development Bank) to form the Bank of Industry in 2001.

The NERFUND had earlier been established in 1989 to provide soft, medium to long term funds for wholly-owned Nigerian SMEs. Because NERFUND provided only capital cost, it tended to favor mainly new ventures and this was considered to be one of its major weaknesses. Some of the major implementation difficulties faced by the NERFUND scheme have been summarized by Oyelaran-Oyeyinka (2000) as follows;
The scheme required the prospective enterprise to put forward a minimum of 25% of the project cost. Many of the beneficiaries were hard pressed to fulfill this obligation leading sometimes to delay in loan disbursement, even after approval has been given.

A large number of beneficiaries were indisposed to ownership dilution (a large hangover of sole proprietorship) and as such suffered under capitalization. Additionally, they shy from information disclosure and hardly keep accurate accounts of business.

The scheme has also been criticized for unclear distinction between 'small' and 'medium', and more so for fixing what small –scale trade groups considered an unrealistic upper limit of (equivalence of $1 million dollar) on project cost for SMEs.

4.3. THE POLITICAL FEASIBILITY OF SMIEIS

The need to examine the political feasibility of the Small and Medium Industries Equity Investment Scheme (SMIEIS) is anchored on the fact of its novelty and in order to establish its implementability. The scheme is the first of its kind in the world since no country has adopted a similar bank-led equity type funding program for small and medium enterprises. Secondly, it represents the first major domestic and private sector led initiative aimed at financing the growth and development of the SME sector. Since policies are not adopted and implemented in a vacuum, the political environment in which a policy will be implemented is considered very important to its success or failure. That is why policy option(s) chosen should be acceptable to concerned stakeholders. In the case of SMIEIS, the political environment operates at both the macro and the micro level. The macro level has to do with the governmental level providing an enabling environment outside the level of the individual enterprise (SMEs) and the scheme, while the micro or enterprise level has to do with specific policy options aimed at stakeholders within the scheme.

The policy design of SMIEIS recognizes the importance of addressing the problems and constraints which may arise at both the macro and micro levels simultaneously and comprehensively in order to avoid implementation failure. Thus the success of the scheme is to a greater extent made dependent upon the key stakeholders in the scheme (Government and the Banking Industry) and the level of their cooperation in this regard. This does not however, exclude the role and contribution of other stakeholders. In analyzing the political feasibility of SMIEIS, I will employ the following checklist of information provided by Meltsner (1972) which are as follows; in what relevant political environment are decisions to be made? Who are the relevant actors (stakeholders)? What are their motivations and beliefs? And what are their political resources? The response to these checklists is informed by the literature, the SSI study initiative (2000) report conducted by ADCG on behalf of the Bankers Committee, newspaper reports and commentaries, unstructured interview that I conducted with some of the stakeholders and policy statements of the government.

Relevant Environmental Factors

The following six environmental factors reflecting both the macro and micro environments are from the literature, considered critical to the success of the scheme;

1. Stable macroeconomic environment: This has to do with state policies which have overall bearing on the economy. The government has a vital role to play in the creation of a stable macroeconomic environment.

2. Conducive legal and regulatory framework: This has to do with the adoption of business friendly regulatory environment which will engender better public-private partnerships.

3. Modern infrastructure: This has to do with the provision of basic, modern infrastructures such as regular power supply, efficient telecommunication services, good road network etc and the development of industrial estates and business clusters to lessen the business cost of SMEs.

4. Enabling fiscal regime: The provision of tax incentives to priority sectors of the economy and in this regard, the SMEs. There is also the rationalization of the tax system to eliminate multiplicity of taxes at all level of governments including corporate registration cost and the reduction of corporate tax rates on SMEs. The provision of tax holidays to encourage SMEs in the informal sector to cross over to the formal sector.

5. Developed financial systems: This has to do with establishing a competitive and sound banking system. This will involve improving the Central Banks supervisory and monitoring mechanisms, and isolating weak/distressed banks. It also requires the active encouragement of the entrance of foreign financial institutions into the financial sector to break the oligopoly of a few banks that is prevalent in the sector. Further more, it requires the establishment of a vibrant capital market by reducing the charges levied by the Securities Exchange Commission (SEC) and Nigerian Stock Exchange (NSE) on both primary and secondary market activities to enable the participation of SMEs.

6. Modern management and technical competence: This has to do with Enterprise Support Services. It involves promoting business education and training to support

SMEs. It requires government to increase investment in education particularly, in science and technology, technical trades and skills, bookkeeping, accounting, legal, financial and marketing skills. It also requires joint ventures and alliance arrangements which links SMEs and business/industrial associations with strategic partners from centers of excellence. A number of banks have formed a consortium to offer Enterprise Support Service and Entrepreneurial Training.

Identified Key Stakeholders

Based on the foregoing six environmental factors, the scheme identifies the following as stakeholders with the following assigned responsibility;

Government: the provision of stable macro-economic environment, stable and reliable regulatory and legal framework; adequate physical infrastructure, prudent fiscal regime and capacity building. More specifically with respect to SMIEIS, to pass the enabling tax reforms and incentives legislation to provide 100% investment allowance for banks contribution to the scheme, reduce tax paid by SMEs to 10%, provide five (5) years tax holiday to SMEs under the scheme and to exempt divested funds under the scheme from capital gains tax.

Central Bank of Nigeria: Ensure 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; ensure each bank's compliance with the guidelines of the scheme and penalize erring banks in accordance with the penalty stipulated for non –compliance. Further more, the CBN is required to liaise with the Securities and Exchange Commission (SEC) to facilitate and simplify the registration of venture capital operators, ensure capacity building, disseminate information on the scheme to SMI and the larger public, prepare annual progress report and provide data for the review of the scheme after 5 years for the Bankers' Committee.

Bankers Committee: Obtain the co-operation of major stakeholders, disseminate information on the scheme to SMI promoters and the larger public; oversee joint collaborative efforts under the scheme, capacity building and the review of the scheme after 5years.

Individual Banks: Provide funding for equity investment in Small and Medium Industries, comply with the guidelines of the scheme, and report their activities under the scheme on quarterly basis to the Development Finance Department of the Central Bank of Nigeria which serves as the secretariat of the scheme. They are also expected to engage in capacity building.

Independent Fund Managers: manage equity investment in SMEs on behalf of banks, report on the activities of the investment to the banks on a monthly basis, provide strategic support to SMEs to minimize the risk of the investment, exit the investment at the instance of the bank, comply with the guidelines of the scheme and be registered with the Securities and Exchange Commission (SEC).

Securities and Exchange Commission (SEC): facilitate and simplify the registration of Venture Capital Operators, provide enabling environment, specifically, the development of the capital market and liaise with other arms of government to reform the capital market and ensure that SMEs have access to the market.

Promoters of Small and Medium Industries (SMI): They are to ensure prudent utilization of funds, keep up to date records on project activities for inspection by the appropriate authorities when required, and comply with the guidelines of the scheme and provide monthly financial and operational reports to the investing banks before the 15th of the next succeeding month.

Motivation of Stakeholders

Though the motivation of the different stakeholders may vary, what is certain is that each stakeholder has a range of needs, desires, goals and objectives, all of which drive them to assert their policy preferences or respond to the policy preferences of others. In the case of the government, the prospects of job creation, revitalization of moribund industries particularly in the real (productive) sector like the manufacturing and agro-allied sectors, promotion of entrepreneurship and innovation, and a greater involvement of the private sector in wealth creation are some of the major motivations. The government hopes to achieve greater social and political stability through the achievement of these goals. The banks while seeking to be socially responsible and relevant are also driven by the desire to maximize the benefits of tax reforms and incentives to make successful investments in an otherwise very risky sector. A successful program would effectively represent a strategic investment in promoting successful small and medium sized businesses and thus creating future customers. Further more, the experience stands to provide them with a greater knowledge of a key but ignored part of the economy which has vast potentials.

The motivation of SMEs lies in the prospect of better access to long term funding, access to other critical non-money resources (technical and financial advisory), enterprise support services, and the added tax incentives to the sector under SMIEIS e.g. tax break. The prospect of greater visibility and access to other key stakeholders in the economy, in particular, the opportunity to cross over from the informal to the formal sector is considered an attraction for some of the SMEs since it could provide access to additional funding from the capital market.

The Beliefs of Stakeholders

The belief system of stakeholders according to Meltsner is also an important factor in analyzing the political feasibility of a policy. In the context of the SMIEIS, the changing belief of government with regards to the economy being state controlled and the increasing acceptance of the need for the economy to be private sector led is behind the government's support for a private sector led initiative and more so since it relieves the government from the burden of directly financing the SME sector. The banking Industry is generally known to be averse to risk and long term financing particularly of SMEs because of the high default rate in repayment which a lot of the time has to do with moral hazards and the low margin of profitability associated with the sector. This is as a result of the unstable macro-economic environment in which they operate, the high cost of doing business due to multiple taxes and the absence of infrastructure which adds to their overhead costs. The banking industry is also wary of government with regards to its unstable macroeconomic policies which does impact the financial sector. For instance monetary policies have suffered due to the dominance of fiscal policies in the economy. The impact of such dominance is often reflected on the interest rate, exchange rate, inflation rate amongst other monetary targets that overall contribute to price stability. In spite of all these observations, the banks are not only supportive but are the initiators of the scheme. The support of the banks to the scheme is anchored on the control they exercise over the scheme.

The SMEs on their part are also wary of banks and doubt the ability of the banks to be transparent in the administration of the scheme. There is mutual distrust between the banks and the SMEs. As earlier highlighted in the previous chapter, there is a marked disagreement because the SME promoters and the banks on the modalities of the scheme. This disagreement is anchored on their respective beliefs. For instance, most SMEs believe in sole proprietorship and are averse to ownership dilution while the banks strongly believe that moral hazards witnessed in previous schemes that failed, is attributable to the lack of accountability and full disclosure that is rampant under sole proprietorship. The involvement of government through the aegis of the CBN in the scheme provides the basis of SMEs support for the scheme, with the assurance that government's commitment to promote and develop the SME sector will help to ensure that the objectives of the scheme is realized.

The Resources of Stakeholders

The resources available to the different stakeholders involved in the scheme have contributed to a large extent in determining who is defining the scheme and its direction. The fact that they banks are the initiators and financiers of the scheme informs the dominant role of the Bankers Committee in the design and implementation of the scheme. In deploying their considerable financial resources to the SME sector, it has afforded them the opportunity to shape policies in this sector. However, the SMEs under their various umbrella industrial associations like NASME, MAN, NASSI etc, employ political and advocacy resources to lobby for either policy adoptions or policy reviews that reflects the interests of its membership. For instance, the Executive Secretary of NASME in a formal interview I conducted with him in August 2002 said that the establishment of SMIEIS was in itself, a product of their lobby with both the federal government and the Central bank. The governments resources in this context lies chiefly in its ability to offer incentives and to initiate policies that would provide an enabling environment for the growth and development of the private sector in the realization of its own macroeconomic objectives.

Overall, in spite of differences in beliefs, motivations and resources, there is a general consensus that private sector funding for SMEs is very important and that the SMIEIS is timely and welcomed. There is the willingness to support the scheme although there still remain major areas of disagreement between the Bankers and SMEs promoters

4.4. THE ADMINISTRATIVE FEASIBILITY OF SMIEIS

The policy design of SMIEIS envisages that equity investment will require new values, skills and institutions, if the scheme is to be successfully implemented. In analyzing the administrative feasibility of the scheme, it is necessary to assess what provisions are made under the scheme to enable the acquisition of the skills, values and the establishment of institutions or units that would facilitate implementation. Smith (1989) argues that some policies might have noble objectives, be based upon adequate theory, have wide support in the community, but be totally unfeasible to implement. He said such failure could be attributed to the lack of capacity on the part of implementing organizations e.g. lack of direction, leadership, or shortage of skilled or dedicated manpower. Studies have revealed that one of the major causes of failure in previous SME financing schemes in Nigeria was largely the dearth of capacity to appraise, supervise and monitor projects. As a result, many unviable projects were funded which led to massive loan repayment default.

Under SMIEIS, the overall administration of the scheme is under the control and direction of the Bankers Committee although the CBN is specifically charged with the responsibility of monitoring the implementation of the scheme and ensuring that each bank complies with the scheme's operational guidelines. This is in consonance with the CBN's regulatory role in the financial sector although in this case, it is required to periodically report back to the Bankers Committee on compliance and offer input for possible policy fine-tuning. The Bankers Committee which is made up of the chief executive of all licensed banks and related banking institutions, serves as the policymaking organ of the scheme. The actual implementation is however the responsibility of individual banks that by the provision of the guidelines, are free to decide on how their funds are to be managed. Each bank is free to either manage such funds directly or to outsource this function to independent fund managers. The banks in managing the funds could either do so by creating an SME unit if such is not in existence, or by creating a venture capital subsidiary to do so.

DIRECT MANAGEMENT OF FUNDS BY BANKS

The SMIEIS operational guidelines does not specify what type of structures should be put in place by the banks in the event of their direct management of the fund although the ADCG's SSI Initiative Study (2000) recommended that banks develop the most appropriate structures in the administration of the scheme. One of the major points of contention between banks and SME promoters with regards to this scheme has been the issue of the management of the SMIEIS fund. The question is whether it is administratively feasible for each bank to manage its SME fund. Tied to the management of the funds, are other issues like investment criteria, investment decision, reporting requirements, auditing of fund and compliance measures.

As earlier discussed in the previous chapter, the major argument leveled against banks in the management of the SME fund is that the banks lack the skills and competencies for equity investment and that this acknowledged deficiency would adversely affect the implementation and ultimately, the realization of the objectives of the scheme. The ongoing implementation of the scheme seems to be confirming this fear. For instance while underscoring the slow pace of investment 10 months after the commencement of the scheme, the CBN governor, Dr Sanusi explained that venture capital investing is a new concept to banks and said, "they (banks) are still putting in place necessary structures for channeling investments as well as undertaking preliminary assessment of potential beneficiaries". Interestingly, the story hasn't changed after 16 months of implementing a scheme which is designed to run for 60 months (5 years) before being subjected to a major review.

Unlike in credit administration where the credit approval system can process the application relatively faster once collateral has been offered, the decision process for making a private equity investment is quite different from that used to make a loan and it is considerably time consuming. Given the high risk associated with equity investment, a more thorough approval process will require a comprehensive business plan and rigorous due diligence to be conducted to ensure that enterprises for which equity is sought, will not be liquidated before the exit of the investment. It is also expected that it will be profitable enough to generate the cash to pay regular and significant dividends, and most importantly, make the company as attractive as possible to potential purchasers of the private equity investor's stake. The riskiness of private equity investment prompts investors to be closely involved in their investment in order to provide management and strategic support to ensure that the required returns on investment are realized.

Given the rigorous and disciplined investment process required in arranging equity deals, the absence of the requisite skills and attitude for risk investment amongst Nigerian banks has grave implications for the implementation success of the equity investment scheme in view of their management of the fund. For instance, there could be possible failure of investments due to lack of venture capital management competence though a bank may have theoretical knowledge of managing such investments. It also could lead to the diversion of key managerial staff and other resources from the core functions of the bank. This could have adverse effect on the bank's core function. Likewise, the bank may lack the ability to attain optimal portfolio diversification compared to independent venture capital fund due to lower fund availability and narrower deal flow than a pooled venture capital fund. There is also the potential of conflict of interest with regular banking business since the two don't belong to the same domain.

Furthermore, what is worrying is the transparency of the investment process in view of the potential for conflict of interest. Since the bank have the prerogative to make their own investment decision, how can insider abuse be averted to ensure that the eligible SMEs whose business plans satisfies the investment criteria of the banks benefit from these source of funding. This is more so, when viewed from the history of corporate misgovernvance associated with the Nigerian banks although the CBN has lately, strengthen its supervisory and monitoring control over the banks to reduce such incidence. Lastly, in the event that the banks will want to wait until they have all the skills, values and structures in place, how long shall be the waiting period for prospective SMEs given the short term objectives of the scheme? What happens to the banks uninvested SME fund? This perhaps explains why the scheme has made provision for independent fund managers in order to ensure that a bank which lacks the resources and ability to administer the fund is able to channel such fund to the independent fund managers.

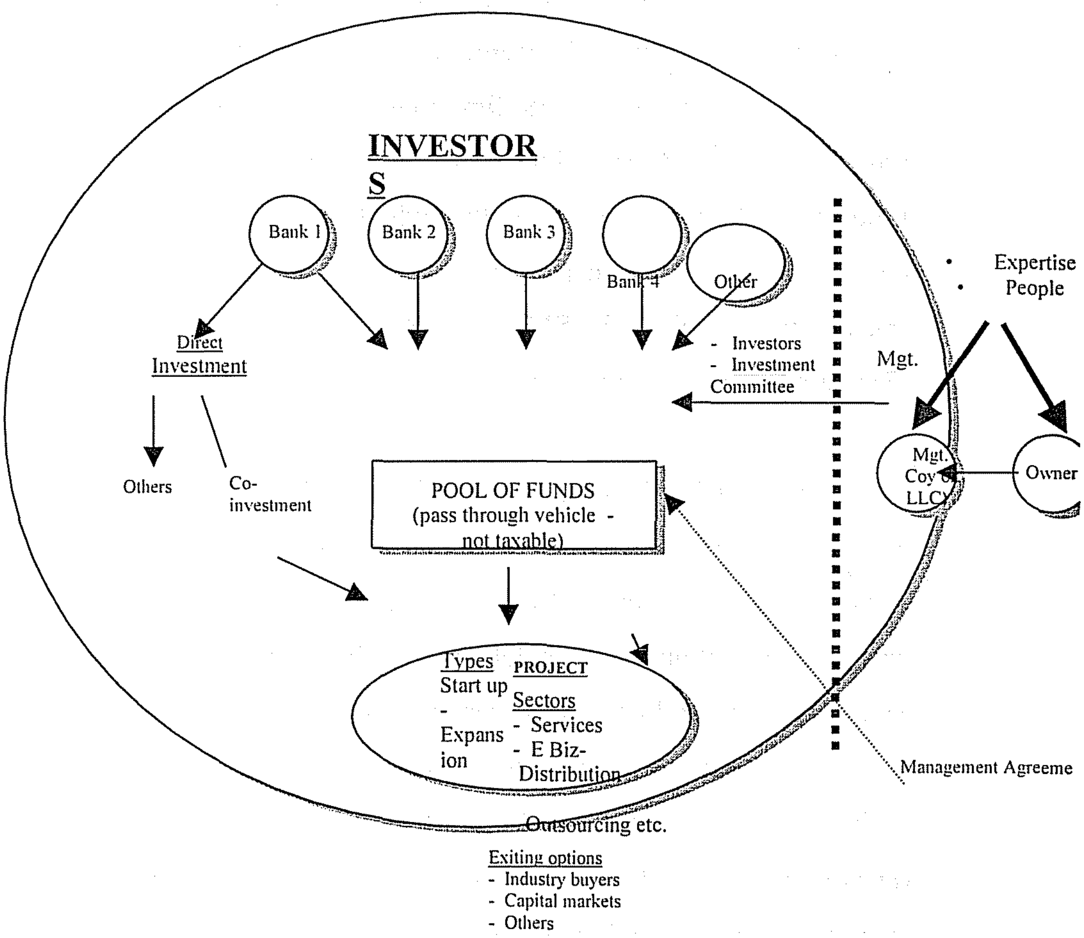
INDEPENDENT MANAGEMENT OF FUNDS BY VENTURE CAPITAL MANAGER

SMIEIS provides for and encourages the establishment of a consortium of banks whose funds will be pooled together in order to achieve critical mass and diversification in investments. The banks could form a venture capital firm or appoint an independent fund manager that is not limited to the banks but is also able to attract funds from other traditional sources of long term funds such as pension funds, insurance companies' etc. This option seems more feasible and less controversial, particularly as it stands the chance of developing a self- sustaining scheme for funding investments in SMEs. More over, the skills and hands-on experience for risk (venture) capital investing are likely to be more situated in such outfit and the prospects for better management of the investment funds are greater since there will be little or no conflict of business and that of private interests. One of the major problems faced by this option is the laborious registration procedure for venture capital fund manager (see Appendix for registration guidelines). One of the responsibilities of the CBN as a stakeholder is to ensure that this laborious procedure is streamlined and that the process of registration with SEC is made easier for prospective venture capital fund managers.

The diagram below illustrates a typical model of an independent venture capital operation.

(Culled from SSI Initiative Study (2000))

VENTURE CAPITAL MODEL



Since the equity market is just starting and there is hardly any reputable and established venture capital managers operating in Nigeria, the policy design stipulates that each venture fund (at least for the purpose of this scheme) should have its specific investment objectives defined and agreed by the investors. The fund size should be a pre-determined amount targeted to be raised through offer for subscription from potential investors within a specified time frame and that the fund should be structured into Investment Holding Fund and Commitment Fund. While investment holding fund is the fixed amount committed by an investor and which is entirely transferred to the fund manager on subscription, commitment funds requires investors to commit to a fixed amount of funds on subscription which are only called for by the manager when needed. The management agreement between the fund and the manager is expected to stipulate clearly, the fees payable to the fund manager, the specific investment objectives, mode of governance of the fund and the reporting requirement. Further more, it is required that the fund should have a fixed life within which, the fund may be redeemable or irredeemable depending on whether it is structured as an investment trust fund or not.. However the operational guideline for SMIEIS clearly stipulates an irredeemable fixed term of three (3) years before the options of exit or continuing with the investment can be considered.

4.5. MONITORING AND COMPLIANCE MEASURES

The responsibility for monitoring and evaluating the implementation of the scheme is vested in both the Central Bank and the Bankers Committee while the responsibility for enforcing compliance rests solely on the CBN. This is by virtue of its statutory role as the regulator of the industry which enables it, to exercise overall responsibility for ensuring that banks adhere to its monetary and other fiscal guidelines. With respect to this scheme, all banks are required to send reports to the CBN on the status of their overall portfolio on a quarterly basis for both statistical and monitoring purposes through the Development Finance Department which serves as the secretariat of the scheme.

The different approaches (models) of fund management under the current operational guidelines of SMIEIS raises concern with regards to the administrative capability of the CBN to monitor the scheme particularly in view of the problem of bad governance prevalent in most banks. Does the CBN have the requisite skilled manpower and tools to effectively monitor the scheme? Does it have a defined criterion for monitoring compliance and evaluating the realization of the objectives? Apart from the quarterly reports forwarded by the banks, would site inspection of beneficiary SMEs be undertaken by CBN to ascertain that actual investment has taken place?

In response to this questions, my visit to the scheme's secretariat at the CBN, Abuja in August 2002 seems to cast a doubt on the CBN's preparedness to play this role. The secretariat (a unit of the Development Finance Department) was not only poorly staffed, it lacked basic I.T functionality to enable it collate efficiently and monitor effectively, the reports of participating banks. Although the secretariat in conjunction with industrial associations like NASME has been very involved in media campaigns to sensitize and raise the awareness of the SMEs and the general public to the provisions of the scheme, yet the bank's major role besides mediating between the government and the banking Industry, lies in the effective monitoring of the scheme in order to realize the objectives of the scheme.

As at the time of my visit in August 2002, about 39 deals in different SME projects by 21 banks had been concluded and reported to the CBN but none had been inspected nor the genuineness of the deals verified. Such inspection is necessary because the reporting format mainly highlights the name of the bank, the amount so far set aside, the amount so far invested, name of industry, product/activity, location and a column for other remarks in which it is specified whether the investment is a debt-equity swap or a fresh investment etc. It is reasonably clear from the reporting format what CBN sets out to monitor which is mainly; how much fund has been raised by individual banks and collectively, how much funds have been invested by the individual banks and collectively, in what industries, products, activities and the locations of the investment in order to measure the impact of the scheme.

The CBN is yet to impose any sanction on any bank for non –compliance with the guidelines of the scheme though there exist clear cases of such breaches. For instance, there are well established cases where bank's investments were greatly out of proportion with the SME promoter's contribution and yet no sanctions were imposed. Likewise, it is not all licensed banks that have made returns on their SME fund. Some that have made returns and have adopted an investment strategy are yet to make any investment decisions. Infact two banks actually informed me that they were yet to come away with an investment strategy more than a year after the commencement of the scheme.

4.6. A BRIEF PERFORMANCE REPORT ON THE IMPLEMENTATION OF THE SMALL MEDIUM INDUSTRIES EQUITY INVESTMENT SCHEME

This performance report is a brief but general assessment on the implementation of the scheme in the last sixteen (16) months based on unpublished reports from several sources, the comments and information conveyed by the CBN and the Bankers Committee as reported by the media and from interviews conducted with some four (4) banks, one Fund Manager, the Executive secretary of the National Association of Small and Medium Enterprises and some SME promoters. The interviews were conducted in August 2002. There is paucity of official information on the scheme and the Central Bank is yet to issue its one year progress report on the implementation of the scheme. The assessment will therefore examine the performance of selected stakeholders in the implementation of the scheme.

Government: The government is yet to make any tangible progress in term of passing the necessary legislation with regards to the tax reforms and incentives provided under this scheme. The macro-economic environment is still unstable while the regulatory regime remains burdensome. The exchange rate after a series of downward plunge is now beginning to stabilize although the rate still remains high. The interest rate after rising up to 40% has been brought as low as 22.5% effective from 1st Nov 2002. There has been some improvement in terms of infrastructure particularly in the power and telecommunication sectors. In terms of corporate governance, corruption has remained endemic and this has adversely affected the cost of doing business particularly for the small businesses.

Central Bank: The CBN has strengthened its surveillance activities in the financial sector and is increasingly becoming proactive in dealing with systemic weaknesses. Beside the use of moral persuasion in carrying out her regulatory responsibilities, owning to it operational and instrument autonomy, the bank is increasingly demonstrating it ability to enforce compliance with its monetary and other fiscal policy guidelines. The bank has raised the stake against insider abuse by instituting a code on good governance practice in the banks and thus promoting better accountability and transparency. In terms of the SMIEIS, its negotiations for the granting of tax concessions under the scheme with the relevant organs of government are yet to be approved and passed into law. In fact in March 2002, the CBN Governor was reported to have said that the bank (CBN) was holding talks with the Federal Inland Revenue Services, which had submitted their recommendations for the tax concessions through the Federal Ministry of Finance to the council of ministers for approval. Likewise, the co-operation it has allegedly sought and obtained with the Securities and Exchange Commission is yet to enhance the registration of venture capital companies which are being set up by banks to facilitate their participation in the equity investment scheme.

The Bankers Committee: The Bankers Committee which meets bi-monthly has been proactive in monitoring and reviewing the implementation of the scheme to ensure the realization of its stated objectives. In particular, its sub-committee on SMIEIS which meets more frequently has consistently been monitoring and reporting developments with respect to the fund. For instance, at the 262nd meeting of the Bankers Committee, the sub-committee reported that a total sum of N10.76 billion has been pooled from banks between June 2001 and August 2002 but noted with alarm, the rate at which banks were flouting the operational guidelines of the scheme. The sub-committee highlighted that as at 8th August, 2002, only 15.5% or approximately N1.67 billion of the amount pooled was actually invested. The amounts invested were in 39 projects and out of which 35 were located in Lagos with a majority of them situated in the same part of the city

(Victoria Island). The sub-committee also found that about 70% of the investments made were banking industry-related, in contravention of the guidelines of the scheme. In addition, the sub-committee found that only 21 of the 87 banks that had set aside funds under the scheme had invested in one or more projects. In effect 66 banks were yet to make any investment under the scheme. Another major breach identified, involves the practice whereby banks' investment were grossly out of proportion with the promoter's contribution. This practice does not only contravene the objectives of the scheme but also the provision of section 21(c) of the Banks and Other Financial Institution Act (BOFIA). Thus in order to ensure that the above breaches do not continue, and so as not to negate the objectives of the scheme and attract in due course, negative publicity to the banks, the sub-committee suggested that 60% of each banks investment should be in the real sector (manufacturing and agro-allied), 30% should go to the service sector while the remaining 10% should be channeled to micro-enterprises through NGO's. However, as at the time of writing this paper, this recommendation was yet to be approved.

Individual Banks: After the adoption of SMIEIS by the Bankers Committee on 20th February 2001, the proposed implementation plan required the banks prior to the commencement of the scheme (within the period of six (6) months) to set-up in house committee to develop implementation strategy, implementation timetable and also determine the mode of management of its fund. In addition, the banks were within that period expected to create required internal structures and processes (covering operations, monitoring and reporting), to support the adopted mode of management of funds. Further more, the banks were also expected to identify suitable candidates (internal or external and /or independent venture capital firm(s) to oversee the management of funds.
Although most of these requirements are yet to be implemented by a number of the banks, 87 banks have so far set aside funds under the scheme. The mode of management of the funds however varies. While some have formed a consortium to float a venture capital firm, others like Chartered Bank, Diamond Bank and FSB International have channeled their funds as part of a consortium to an independent fund manager. The majority of banks are however managing their funds directly. Amongst the last group are some of the biggest banks like United Bank for Africa (UBA), First Bank and Union

Bank which have opted to float a wholly owned (subsidiary) venture capital firm and are currently processing their registration with the Securities and Exchange Commission.

As earlier mentioned, only 21 banks have invested under the scheme in 39 projects that are predominantly in the service sector and these were mostly related to the banking industry. The banks have argued that there is a need to maintain a healthy balance between the service sector and the real sector. According to Ladi Balogun, the managing director, First City Monument Bank, '' most of the people here (banking) have built their careers in the service sector and I think the multiplier effect it has created can be as strong". Rotimi Oyekanmi, CEO, SME Managers Ltd (an independent venture capital firm)argues that the high cost of doing business in Nigeria makes investment in the real sector to be unviable and that the quality versus quantity factor is a major factor in deciding the direction of investments. So far most of the banks are yet to set up separate SMIEIS desks to handle enquiries and to disseminate information. In most of the banks, there is a dearth of staff with the requisite skills and competencies to handle equity investments except for the leading banks like Citi-Bank, Guaranty Trust and Diamond bank.

Independent Fund Managers: While there are several on going initiatives to incorporate venture capital firms, the most prominent initiative has been the establishment of the SME Manager Limited in 2001. It is a subsidiary of African Capital Alliance (ACA) and was formed to manage SMIEIS funds for banks. ACA is primarily involved in promoting private sector –led investments in Nigeria and is focused on mobilizing capital and know –how to tap the emerging private equity investment opportunities in Nigeria.

SME PARTNERSHIP: The SME partnership includes eleven (11) banks as limited partners while ACA through the SME Manager is the general partner. The eleven banks include Chartered bank, Diamond bank, FBN (merchant bank), First city monument bank, First bank, FSB international, MBC international, Magnum trust bank, INMB bank, Stanbic bank, and Universal trust bank.

KEY FEATURES: The key feature of the partnership includes;

Partnership Description: An aggregate commitment of 5 billion naira

Target Investment Size: 50-200 million naira

Typical Equity Ownership: 5%- over 50%

Minimum Investment Return: 30% IRR in real terms

Geographic Focus: Nigeria

INVESTMENT FOCUS: The Company's investment focus is high growth industries based on sound business models and established companies with sound track record and positive cash flows on the threshold of expansion. In addition, a company involved in outsourcing/outside contracting to Nigeria's leading sectors such as petroleum, financial services, premier industrial organizations and multilateral agencies etc. Further more, the company is interested in opportunities for niche businesses in deregulating industries and also in firms supplying services and products to multinational companies and other blue-chip businesses. The businesses that are capable of effectively utilizing franchising model and also those that are globally competitive and offer opportunities for export in global and regional markets are equally preferred.

INVESTMENT CRITERIA: The following are the investment criteria;

Qualification: Target companies are required to be qualified as an SME under the SMIEIS operational guidelines.

Control: The Partnership intends on taking either majority equity interest or a significant minority with strong governance rights (range of 25%to over 50%).

Management: Specific standards on integrity, capability, experience and demonstrated commitment to sound financial practices, institution building and staff training development are required from the management of a prospective SME.

Return: Investments will only be made in targets capable of achieving a minimum real IRR of 30% using conservative assumptions.

Investment Size: Targets investment size of between N50-N200 million per year. The goal is to complete between 5-7 investments in a year.

Liquidity/Exit: The liquidity/exit strategies are pre-identified for each investment

.

METHODOLOGY FOR VALUE ENHANCEMENT: As part of its strategy for the enhancement of the value of its equity investments, SME Manager Ltd ensures the formulation and execution of a business strategy; provides support for institutionalization process, actively participate on the board and executive management, and provide financial advice.

Further more, SME manager aims to provide market access and credibility, help in identifying and attracting technical partners and assisting in the recruitment and development of key staff.

PARTICIPATION UNDER SMIEIS: As at 20th August 2002, SME Manager Ltd had received 200 applications for equity investment. Some of the request came via some of their participating banks while some came directly to them. Out of these numbers, only two (2) applications have been approved while nine (9) are awaiting approvals. Three of the applications awaiting approval are from the manufacturing sector (clay brick, aluminum and plastic industry). None of the application had been rejected and none was considered pending.

SME Promoters: SME promoters under the umbrella of NASME have been involved in the nation wide sensitization exercise organized in respect of the equity investment scheme. The awareness exercise was conducted by NASME in conjunction with the CBN and the Bankers Committee and focused on SMIEIS and other financing windows available to them and how to package SMEs in order to benefit from the different financing windows. In spite of these campaigns, the majority of SMEs remain indisposed to equity financing. As at August 2002, only 20 SMEs had in line with the operational guideline on SMIEIS been recommended to some of the participating bank but none of the applications has been approved nor returned. Perhaps it is too early to say that the banks are not giving consideration to the recommendations of the industrial association. The idea of the recommendation in the first place, is to ensure that only genuine and credible companies are patronized.

CHAPTER FIVE
FINDINGS AND CONCLUSION

5.1. INTRODUCTION

This chapter reviews the discussions in the previous chapters and proceeds to summarize the general findings and make its conclusion. Chapter 1 identified and provided the background to the research focus of this paper and indicated the limitations to this study. Chapter 2 provided some key definitional concepts and the analytical framework adopted. The core of this paper's discourse however lays in the chapters 3 and 4. Chapter 3 addressed the issue of the policy design of SMIEIS highlighting that there still exist major areas of disagreement between SME promoters and the Bankers. Chapter 4 focused on the feasibility of the scheme and highlighted the general acceptability of a private sector led financing in spite of the differences as to how such a scheme should operate. Its examination of organizational structure of the implementing agencies highlighted the deficiencies which will militates its effective implementation particularly in the light of the equity financing models being adopted.

5.2. SUMMARY OF FINDINGS.

One of the interesting findings of this study is that while the objective of providing a pool of funding to SMEs stands to be realized under this scheme, the problem of access to these funds remains a dogged one. For instance, barely fifteen months after it was launched, the scheme has been able to realize over 11 billion naira. This makes the target of 57 billion naira over five years to look very achievable (ADCG, 2000). However the greatest threat to the realization of the objectives of the scheme lies more with the actual process of investing in the SMEs because within the same period of time, only about 15.5% of this amount had been invested and infact the invested sums when into questionable transaction. Equity investment which is meant to provide SMEs with a relief from the burden of high interest rate, short term financing, strict repayment conditions and pressures on their cash flow has not elicited the kind of response expected from the SMEs by the initiators of the scheme (Bankers Committee).

In designing this scheme, it is obvious that the initiators did not give serious consideration to the long standing culture of sole proprietorship common among SMEs and their aversion to ownership dilution which is well documented in the literature and has been identified as one of the causes of failure in previous schemes. What is also interesting from the ongoing implementation experience is the belief by the Bankers Committee that a more aggressive enlightenment campaign would 'over night' change an attitude and culture that took long in building. The SME promoters and their respective industrial organizations have strenuously opposed the equity investment option and have repeatedly indicated their preference for subsidized credits (loans) in order to avoid ownership dilution. They are also averse to the demand for full disclosure under equity investment as it will eliminate their ability to evade tax.

The banks on the contrary do not conceive of the scheme as a government bonanza or a charity fund for SMEs but rather an attempt to explore opportunities in a high risk market but with the prospect of making very good profit for their shareholders (Adedoyin, 2002). This interest may have informed the carefully designed exclusion of the preponderance of SMEs from the scheme either because they do not fall within the limits of the scheme's definition of SMEs or because they do no not satisfy the eligibility conditions for funding under the scheme since most of the SMEs operates in the informal sector. As earlier mentioned in chapter 3, the requirement of company registration, annual returns, audited financial statements, tax returns, etc in an environment where the regulatory regime is cumbersome and overbearing and the level of such compliance even among large and well established firms is suspect, brings into question the rationale behind these conditions in view of the stated objectives of the scheme. The government is however, somewhere in between the banks and the SMEs. The government seems more concerned with achieving its macro economic objectives of stimulating economic growth, developing local technology and creating employment and less concerned with the finer details of how the SMEs and banks engaged themselves in helping to realize these objectives. The government seems content with using the scheme to make policy claims concerning its achievement in stimulating the economy and promoting economic growth.

In terms of implementation, the findings relating to the large number of banks yet to devise a strategy for implementing the scheme sixteen (16) months after it was launched, clearly reveals that the banks, lack the skills and attitudinal orientation for equity investment and that they are very slow at building capacity in this area. The implications are that the banks may have been rushed into implementing the scheme without having sufficient time to create the necessary structures, acquire the necessary skills and competencies for risk taking, value adding, and long term investing particularly, in an environment requiring strategic decision making in structuring equity partnership deals.

Most banks and independent fund managers in order to generate high returns (at least IRR of 30%), prefer to target large sized investment (50-200 million), in high growth sectors such as telecommunications, oil and gas etc, and in companies with strong management teams that have deep technical skills, business acumen and track record (Okubadejo, 2002). On the other hand, the average investment requirement of most SMEs fall below this range as very few of them can be found in high growth sectors. Also they are mostly staffed by low skilled and inexperienced managers lacking a proven track record and they are unlikely to generate the returns necessary to justify the capital investment made into them. In addition, the transaction cost of investing in an SME under equity financing is as high as those incurred in larger firm because a more thorough investment approval process and a more intensive management are required. Further more, the higher risk profile of the SMEs increases the cost of capital significantly.

Some of the other problems identified include that of equity contribution particularly for start-up SME ventures. Most SMEs promoters of startup ventures find it difficult to muster the required equity. Likewise, the absence of a clearly defined business plan is a major hindrance for most SMEs seeking equity investment as there is the difficulty of ascertaining the opportunities available for adding value to their business. Assets and share valuation remains a thorny issue. SMEs are averse to such rigors and where they are willing to undertake them, they can not afford the services. In the case of debt-equity swap under SMIEIS, some of the pertinent questions raised by the Manufacturers Association of Nigeria (MAN) are;

"What would be the point of entry of banks to the equity base of the company given that the component of the indebtedness includes principal loan, and other disputed interest elements? In the event of disagreement between the bank and the SME on the valuation of assets for the purpose of debt-equity swap, who is to arbitrate?" (allAfrica.com)

By far of weightier consideration however for the banks and fund managers is the challenge of finding an effective and efficient SME private equity model that will not only make the emerging equity market viable but will sustain it and also create viable exit options for equity investments. At present, there are three different models of fund management under SMIEIS and each has its own implications. Because the implementation of these models only started recently there is little information available to empirically analyze them to know what model is most appropriate.

5.3. CONCLUSION

Given the novelty of this scheme (SMIEIS) and the pool of funds it stands to generate, there is the possibility and that is if the problems identified above can be tackled, that the scheme could prove to be a veritable source of funding for SMEs. There is obviously a need for a model that can guarantee funding in a win-win situation for the key stakeholders. Such a model would have to find a creative way of managing high transaction and investment management costs. In this regard, government should do more by way of subsidizing such costs which relates to Enterprises Development Services as this will help in hiring consultants who will help in the valuation of assets and liabilities, the drawing up of business plans and the conduct of due diligence for SMEs. Infact donor assistance from agencies like USAID and I.F.C can and should be sought. In the light of experiences from more developed equity markets like South Africa, encouraging the consortium model in private equity financing will also help to deal with the twin factors of human and capital constraints. It will also allow for sharing of transaction cost and investment management costs and foster cooperation which is atypical in a competitive mainstream private equity market.

The model should also find ways of dealing with the risks that are inherent in investing in SMEs. One of the greatest risks is that of market, as the emerging SMEs may find it extremely difficult to compete against established players in the market. One method that has proved effective from experience in addressing this type of risk is for a company to secure a medium to long term contract to ensure that there is a predetermined revenue stream which will provide protection for the company from the vagaries of the market and the threat of competition. When this is done, the company can then focus on managing its cost base and ensuring it delivers on its contract. For instance in the high growth sectors of the oil and gas services industry, construction industry, etc, the government can legislate into law, provisions that makes it mandatory for certain services to be provided only by indigenous SMEs. Another way is to identify industrial clusters e.g. Nnewi in Eastern Nigeria that is popularly referred to, as the African Taiwan due to the ability of the entrepreneurs to copy and imitate the products from the Far East Asia. Such clusters noted for their technology and industry need to be supported in order to improve their technological innovativeness (Oyeyinka, 1997).

Since most SMEs growth potentials are low, an appropriate private equity model may need to focus first on those playing in the contract markets that have tremendous growth potentials, particularly those having business linkages with large firms. Discovering them and providing them with significant enterprise development is critical. It is therefore necessary for banks and other fund managers to become more proactive in this regard. In conclusion, there are both tremendous opportunities and formidable challenges in the introduction of private equity investment to the SME market. Hopefully, as the macroeconomic environment becomes more stable and the financial sector is able to minimize the threat of distress and systemic weaknesses in a more policy prescriptive environment, there remains a possibility that the networking and collaboration between the public and private sector in the SME market will help achieve the objectives of SMIEIS.

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