THE SMALL AND MEDIUM SCALE INDUSTRIES EQUITY INVESTMENT SCHEME IN NIGERIA: A CRITIQUE

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Abstract

The introduction of the Small and Medium Scale Industries Equity Investment Scheme in Nigeria represents the most recent experiment aimed at promoting this sector of the economy that is vital for sustained economic development in the country. This paper attempts a critique of this new Scheme. It argues that the main reason why SMEs have been unsuccessful in Nigeria has been because of the unstable macroeconomic environment and the dearth of basic infrastructure. This has made their cost of operations unacceptably high, relative to their capital base. Furthermore, the belief that banks have better management structures and experience is erroneous. Huge bank profits are more a consequence of government subsidy of these banks via the foreign exchange market, rather than the consequence of their sound management. Even banks that have good management skills may not necessarily have the necessary experience to manage SMEs. In fact, this could end up being an unwelcome distraction from their main business of banking.

INTRODUCTION

In 1999, the Bankers Committee, at the instance of the Central Bank of Nigeria introduced the Small and Medium Scale Industries Equity Investments Scheme (SMIEIS) in Nigeria.[1] This essentially made it mandatory for

Part of the materials for this study was gathered while Chibuike Uche was a Visiting Fellow to the African Studies Centre Leiden, the Netherlands (August to September 2004). The support of the centre is gratefully acknowledged.

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[1] This Scheme actually became operational in 2001. According to the Central Bank of Nigeria: "For the purpose of this scheme, a small and medium industry is defined as any enterprise with a maximum asset base of N200 million, excluding land and working capital; with the number of staff employed by the enterprise not less than 10 and not more than 300"(Central Bank of Nigeria, 2003, p. 1). It is however important to note that over the years, various government

all registered banks to invest ten percent of their profits before taxation, on a yearly basis on equities of small and medium scale companies in Nigeria. This represents the latest attempt by the Nigerian Government to promote the activities of these Small and Medium Scale Enterprises (SMEs) in the country. Perhaps, because previous experiences attempting to provide long term loan financing for SMEs failed, the new scheme focuses on the provision of equity financing to SMEs. By doing so, the Government hopes to be able to stimulate employment and economic growth, which are pre requisites for poverty alleviation.[2] Past attempts at promoting this sector by the Government have at best been unsuccessful. Aside from the initial oil boom, which induced increases in this manufacturing sub-sector, from 4% in 1973 to 13% by 1983, its annual growth rate has been on the decrease. It has drastically reduced from 20% recorded in the 1975-79 period, to the negative figures of 2.6% and 0.9% in the 1990-94 and 1995-99 periods respectively.[3]

A major premise of the new scheme is that Small and Medium Scale Enterprise financing has been unattractive to the financial sectors, mainly because of the peculiarities of SMEs which include among others, their lack of accountability and poor corporate governance (especially the inability of owners to separate their business interests from their personal interests). Given the fact that most banks appear to be well run, especially given the comparatively huge profits they declare yearly, Government is hoping that these banks, by participating in the ownership of SMEs, are able to transfer their expert management skills to these SMEs, thus making them profitable in the long run. This paper examines the above premise for the establishment of the SMIEIS in Nigeria. It argues that the main reason why SMEs

agencies have adopted different definitions. It was only in 1992 that the National Council for Industries streamlined the various definitions. At the time, small scale enterprises were defined as those with fixed assets above N1 million but not exceeding N 10m. excluding land, but including working capital. While medium scale enterprises were defined as those institutions with fixed assets, excluding land, but including working capital of between N10 million and N40 million. By 1996, this definition was revised and small scale enterprises were defined as those with fixed assets above N1million, but not exceeding N 40million excluding land but including working capital. Such an enterprise was also required to have a labour size of between 11 and 35 workers. Medium scale enterprises were defined as those institutions with fixed assets, excluding land, but including a working capital between N40 million and N150 million and with a labour size of between 36 and 100 workers (Olorunshola, 2003, p. 35). From the above, it is clear that a key factor that impacts on the changing definitions of SMEs is the impact of inflation on the value of the local currency (Naira).

[2] Sanusi (2003b, p. 1).

[3] Akinowo (2003, p. 5). See also Oyekanmi (2003, p. 68) and Adelaja (2003, p. 101).

have been unsuccessful in Nigeria is because of the unstable macroeconomic environment and the dearth of basic infrastructure.[4] This has made their cost of operations unacceptably high, relative to their capital base. Furthermore, the belief that banks have better management structures and experience is erroneous. Huge bank profits are more a consequence of government subsidy, via the foreign exchange market, rather than the consequence of their sound management. Even the banks that have good management skills may not necessarily have the necessary experience to manage SMEs. In fact, this could end up being an unwelcome distraction from their main business of banking.

To achieve its aim, this paper is divided into three parts: Part One examines previous attempts by the Government to promote Small and Medium Scale Enterprises in Nigeria, Part Two critiques the structure and operating modalities of the current SMIEIS, while Part Three concludes the paper.

PAST GOVERNMENT SME SUPPORT INITIATIVES

Since the attainment of political Independence in 1960, a major preoccupation of successive Nigerian Governments has been how to support and promote Small and Medium Scale Enterprises in order to make them robust enough to be able to provide employment and economic growth, which are essential ingredients for poverty alleviation. This is not surprising especially given the fact that establishments belonging to this sector constitute more than 90 percent of the institutions belonging to the organised manufacturing sector[5] and accounts for about 70 percent of industrial employments in Nigeria.[6] Furthermore, the earnings of these SMEs support more than 60 percent of the Nigerian population.[7] This is therefore the sector that is most likely to

[4] "Infrastructure is an umbrella term for many activities and basic structures and facilities necessary for a country to function efficiently. They are often referred to in economic parlance as "social overheads." Infrastructure includes public utilities such as buildings, transport, energy resources, roads, telecommunications, pipe borne water supply, railway, urban transport, ports, waterways, airports, etc. It has been designed as the totality of basic physical facilities upon which all other economic activities in a system depend. The availability of efficient infrastructure services is a key requirement for the take-off of private investment. Regular and adequate power supply, good transportation and port facilities, as well as efficient telecommunications services are all necessary to complement private sector initiative in the production and delivery of services" (Ilori, 2004, p. 1).

[5] Akinowo, 2003, p. 2.

[6] Salami, 2003, pp. 52-53.

[7] See Ikwuegbu (2002, pp. 29-30) and Erewuba (2002, p. 48).

be the arrowhead for economic growth and development in Nigeria.[8] It is in the quest for this development that successive Nigerian Governments, since the attainment of political independence, have consistently tried to devise ways of supporting such SMEs.

Perhaps the first post independence attempt by the Government to directly provide for SMEs, in its quest to help accelerate the pace of development in the country, was in 1962. That year, the Nigerian Industrial Development Bank (NIDB) was established. According to its memorandum of association, the main objective of the bank was to assist enterprises engaged in industry, commerce, agriculture, and the exploitation of natural resources in the country. The CBN, the Ministry of Finance and the Ministry of Industry were its supervising agencies. Although its loan portfolio covered mainly large-scale industries, the bank established a special unit to focus on SMEs. In this regard, the bank granted loans to SMEs on relatively softer terms and even had a policy of investing in the equity of some of the companies it financed. Between 1980 and 1988, for instance, the bank disbursed a total of N 174.6 million to SMEs. The bank was also responsible for the bulk of credit delivery to SMEs under the SME II Loan Scheme. In fact, it accounted for more than 80 percent of the total disbursements under the scheme.[9] By the 1990s, poor management and unpredictable economic terrain had seriously impeded the ability of the bank to function effectively.[10]

In 1973, the then Federal Military Government promulgated Decree Number 22, which provided for the setting up of another development bank:

[8] "By their very nature, SMEs constitute the most viable and veritable vehicle for self-sustaining industrial development. From varied experiences, especially in developing countries, SMEs indeed possess enormous capability to grow an indigenous enterprise culture more than any other strategy. It is therefore not unusual that SMEs are generally synonymous with indigenous businesses wherever they exist. From all accounts, SMEs in most developing economies represent the sub-sector of special focus in any meaningful economic restructuring programme that targets employment generation, poverty alleviation, food security, rapid industrialization and reversing rural-urban migration" (Udechukwu, 2003, p. 9). See also Nigerian Investment Promotion Commission (2004, Chapter 3).

[9] "In order to further expand credit allocation to the SMEs, the Federal Government, in 1989, negotiated a programme of financial assistance with the World Bank to complement other sources of funding the SMEs. Altogether, the facility involved a total of US$ 270 million for on lending to the SMEs through the participating banks. The credit components and other related activities of the World Bank loan were administered by the CBN, which in 1990 established an SME apex unit for its efficient implementation. The SME apex office approved loans for 211 projects valued at US$ 132.8 million between 1990 and 1994 when further approvals were stopped" (Sanusi, 2003a, p. 6).

[10] As will be seen later, this bank was later restructured and merged with some other development finance institutions to form what is now the Bank of Industry.

the Nigerian Bank of Commerce and Industry (NBCI). One of the objectives of this institution was to provide financial services to the indigenous business community, especially the Small and Medium Scale Enterprises. The Bank operated as the apex bank for SMEs and administered the SME 1 World bank Loan Scheme of USD 41 million, secured in 1984. Loans under this Scheme had maturity periods ranging from 4 to 10 years, including a moratorium period of 2 to 4 years. The Bank was poorly managed and suffered operational problems. By 1989, it had become severely distressed and existed only in name.[11]

In 1988, the Nigerian Government established the National Economic Reconstruction Fund (NERFUND). This was essentially a funding mechanism aimed at filling the gap in the provision of local and foreign funds for Small and Medium Scale Enterprises wholly owned by Nigerians. NERFUND was mainly funded by the Federal Government and the Central Bank of Nigeria. It also had external support. For instance, it received US$ 50 million from the Government of the former Czechoslovakia and US$ 230 million from the African Development Bank. Between 1990 and 1996, NERFUND disbursed US$ 114 million (foreign exchange component) and N 3.46 billion (local currency component) loans to support 218 projects. Of these, only 120 projects ever began production.[12]

The abysmal performance of NIDB, NBCI and NERFUND led to their restructuring and merging into one development finance institution: the Bank of Industry in 2000. The bank, which started operations in May 2002, with an initial capital base of N 50 billion., has been mandated to transform Nigeria's industrial sector and integrate it into the global economy by providing cheap financing and business support services to new and existing industries, in order to achieve modern capabilities to produce goods that are attractive to both domestic and external markets. Specifically, the new bank is expected to assist in restructuring ailing industries and promoting new ones in all the geographical zones of the country. Despite its new mandate and the restructuring, the bank is unlikely to meet the new expectations. A recent report of

[11] Olorubshola (2003, p. 39). This perhaps explains why the SME II Loan Scheme was channeled mainly through NIDB.

[12] NERFUND was largely unsuccessful for the following reasons: impact of corruption on the cost of doing business; lack of skilled professionals to manage the businesses; competition from cheaper imports due to the high cost of supplementing the poor infrastructure; poor entrepreneurial skills of project promoters; and, impact of significant devaluation of the local currency on loan servicing. For example, some loans were booked at 4 to the USD while others were booked at10 and 22 respectively. Loan repayments were at current autonomous rates, which was 81 in 1999, and 112 in 2001 (Carpenter, 2001, p. 4).

the African Development Bank on the Bank states that the present corporate governance of the Bank of Industry, as well as its managerial systems, practices and culture need to be improved. Specifically, the Bank lacks modern management systems, policies and procedures in the areas of finance, operations, administration, and human resources in order to be effective. Furthermore, the Bank of Industry lacks sufficient infrastructure by way of information technology and adequately skilled staff to be competitive in the market. The report concludes that for the Bank to effectively carry out its mandate, fundamental institutional and managerial reforms need to be carried out immediately.[13]

One cannot but wonder why the federal government decided to embark on this expensive restructuring exercise, instead of selling off the component parts of the new bank. This is especially so, given the fact that the Government recognises that its ownership and control of the component parts of the new bank was a major factor in their abysmal performance, and now plans to privatise the restructured Bank of Industry.[14]

A major characteristic of all the above schemes is the fact that Government played a dominant role both as the sole owner of these development finance institutions and the major provider of the finance. Remarkably, they all performed below expectation. A major reason for this was the fact that Government owned these institutions. This essentially impacted on their style of management. Because they were mainly Government owned, board and management appointments in these development institutions soon became tools for political patronage, to the detriment of expertise and strong management. Also the federal character philosophy of successive Nigerian Governments has not helped matters. This, at the very least, has contributed to the phenomenon of basing management and board appointments more on state of origin than on competence. It has also promoted the practice of basing agency support for projects more on geographical spread and political allegiances, than economic viability. It was therefore not surprising that at the inauguration of the new Bank of Industry, the President urged the management to rely purely on economic merit and pledged that his government

13 African Development Bank (2004, pp. 1-2).

14 "The Federal Government plans to commercialise and privatise the Bank of Industry in order to improve its efficiency, viability and productivity. To this end, it is offering 51 percent of its shares in the Bank for sale. Because the Bank was formed out of the original merger of three development banks, it is currently the only development bank in the country. For this reason, it stands to operate profitably and has the great potential for future expansion" (Office of Public Communications, State House Abuja, 2003, p. 3).

will protect the institution from political interference.[15] The above arrangements and practices have also encouraged corruption and sometimes outright misunderstanding of the entire SME Scheme. In fact, many applicants see these SME funding as their own share of the "national cake".[16]

Another reason for the failure of the above schemes has been the existence of poor infrastructure for the operations of SMEs. Such infrastructures include basics like: roads, water, security and electricity. As a consequence, these SMEs are forced to add these infrastructure costs to their cost of production, thus making their products very uncompetitive.[17] Furthermore, the issue of multiple taxation has also become a major hindrance to the operations of SMEs in Nigeria. The lack of a national tax policy and the pressure on both states and local governments to develop other sources of income has led to the introduction of all sorts of levies and taxes by these governing units, across the country. This has led to a lot of confusion and has had a negative impact on inter state businesses. It is, for instance, not uncommon for the goods, raw materials and vehicles of SMEs to be seized and detained while operating outside their territory of main activity, by local or state government agents, for frivolous reasons. This scenario led to the recently established Study Group on Nigerian Tax Systems to stress the need for a Nation-

[15] "When the Obasanjo Administration was inaugurated in 1999, it observed that…. government-owned Development Finance Institutions (DFIs) had not fulfilled the goal of channelling long-term finance to the industrial and agricultural sectors. Apart from being in a very poor financial state, DFIs needed to have their operations rationalised and streamlined to eliminate the duplication of functions. They also needed to refocus their energy and resources to perform more effectively. The poor performance of… DFIs was a major reason for the set up the Bank of Industry. With its establishment, President Obasanjo charged the management of the Bank to avoid the mistakes of the past by ensuring that loans and investments to industrial concerns are based purely on merit and professional consideration. He guaranteed that Government would continue to improve the investment regime in Nigeria by providing it with adequate financial resources as well as protecting it from political interference" (Office of Public Communications, the Presidency Abuja. 2003, p. 2).

[16] Ajekigbe, 2004, p. 4.

[17] Olorunshola (2003, p. 46). A current Deputy Governor of the Central Bank of Nigeria has also recently asserted that: "We need to develop more aggressively good physical infrastructure that is crucial to the success of the SMEs. The high cost of doing business associated with inefficient and expensive infrastructure acts as a strong deterrent to the development of SMEs. Many companies have to incur extra costs in building their own power generators, boreholes, private roads and other items of infrastructure. Since government budgets can no longer support all the needed investment in these areas, we have to move quickly and decisively to allow the private sector to build and operate the required infrastructure. The public sector should concentrate on the provision of basic social services like education, health and the provision of an enabling environment"(Usman, 2001, p. 4).

al Tax Policy. The Study Group, which reviewed the Nation's Tax Policy, regretted that since independence, Nigeria does not have a clear-cut National Policy on Taxation. The non-existence of a clear Policy on Taxation is generally believed to be largely responsible for the incidence of multiple taxation, currently obtainable in the Nigerian economy.[18] Even more worrying, is the method of collecting these levies. In some instances, agents of local governments mount unauthorized road blocks or use force to extract money from citizens in the guise of revenue drive. This has raised concerns even in Government circles.[19]

Yet another reason for the failure of most of the above SME schemes is the unfavorable macroeconomic environment. This makes it difficult for SMEs to meaningfully undertake any economic activity in the country. Take, for instance, the related issues of inflation and foreign exchange rates. Here, the inability of the Government to control its expenditure has continued to endanger the activities of all productive sectors in the economy, including SMEs. This has been the main cause of the perennial double-digit inflation in the economy and has made long term planning and investments very difficult.[20] It is pertinent to note that banks are usually disadvantaged during periods of high inflation. This is because depositors usually prefer to invest their excess funds in assets that have the potential of appreciating with inflation rather than in fixed bank deposits, where they run the risk of earning negative real returns on their investments. Without any regular source of long-term funds for banks, it is not surprising that their investments in medium and long-term loans, as a percentage of their total loans, have continued to decline over the years.[21] The problem of macro economic instability is so serious that the last Governor of the Central Bank of Nigeria, has contended that there can be no economic growth without macroeconomic stability.[22]

Apart from the above wholly owned government institutions, which provided direct finance to SMEs, the Government, in the past, also established specific schemes to reduce the operational difficulties of SMEs. In some cases, the Government encouraged other financial institutions to extend credit

[18] Financial Standard, 28th July 2003.

[19] NewsWatch News Magazine, July 19, 2004.

[20] Uche, 1996, p. 440.

[21] Osa-Afiana (2003, pp. 88-89). Please note that until 1996, banks were mandated to allocate a certain percentage of their loans to SMEs, under the Central Bank of Nigeria Credit Policy Guidelines. Even then, the risk involved made it necessary for: "some banks…. [to] rather pay the penalty for default or "doctor" their returns to the CBN than comply with the guidelines" (Carpenter, 2001, p. 6). See also Udechukwu (2003, p. 13).

[22] Sanusi, 2004, p. 10.

to these SMEs. Interestingly, the above macro economic deficiencies, coupled with poor management, have also played a key role in determining the outcome of these non-direct SME initiatives by the Government.

One of the earliest post-independence attempts by the Government to indirectly aid the development of small and medium scale industries was in 1962, when an Industrial Development Centre was established in Owerri by the then Government of the Eastern Region of Nigeria. Essentially, these IDCs were supposed to provide extension services to SMEs in the areas of project appraisal for loan applications, training of entrepreneurs, managerial assistance, production planning and control and product development. In 1970, the Federal Government took over this scheme and established additional centers in Oshogbo, Maiduguri, Ikorodu, Zaria, Uyo, Benin, Sokoto, Abeokuta, Port Harcourt, Ilorin, Bauchi and Akure. The expected results from this scheme were never derived, mainly because of poor implementation.[23]

In 1971, the Federal Government embarked on another policy initiative aimed at helping support the SMEs, and established the Small Scale Industries Credit Scheme (SSICS). A Small Scale Industries Fund (SSIF) was established to support the above Scheme. With this fund, the Federal Government was able to fund SMEs on a matching grant basis, in states that were willing to support the development of SMEs in their territories. Again, the final result of the Scheme was poor. Essentially, its success was constrained by the lack of executive manpower to supervise and monitor projects. As a result, many unviable projects were funded, leading to a massive repayment default.[24]

Another policy initiative aimed at addressing the needs of SMEs, this time through existing commercial banks, was the Rural Banking Scheme, which was established in 1977. Under this scheme, commercial banks were mandated to open up branches in rural areas. Apart from promoting banking habits among the rural population, the scheme also aimed at providing finance for small and medium scale industries in these rural communities. Its secondary aim was to help stem rural urban migration. By 1989, after 12 years of operating the scheme, 756 new rural branches had been opened. Most of them however, were branches just in name. After twelve years of operation, the total amount of deposits collected by all the 756 rural branches, amounted to only N 5.7 billion. This translated to an average of N 7.5 Million per rural branch.[25] Lack of basic infrastructure, low literacy rates and absence of bankable projects made it difficult for these rural branches to make

23 Sanusi, 2003a, p. 4.
24 Sanusi, 2003a, p. 4.
25 Anyanwu, 2003, p. 32.

any positive contribution to their host economies. Despite regulations encouraging local investments of deposits, most of these rural branches simply became conduits for channeling rural savings to urban areas. In other words, rather than aid development, they aided underdevelopment. In 1989, the Central Bank of Nigeria discontinued this scheme.[26]

The Government subsequently introduced the Community Banking Scheme in 1992. These are essentially self sustaining financial institutions owned and managed by a community or a group of communities to provide deposit, credit banking and other financial services to members of the community.[27] At least theoretically, the idea of a bank owned by the members of the community, automatically removes the alien nature of banking from the community itself. Loans issued by such banks will therefore be seen as 'community property' rather than as part of the 'national cake'. Furthermore, owners of such community banks are likely to defend their interests by appointing competent managers. Loan allocation is also more likely to be based on economic logic, rather than on geographical spread or political considerations. Perhaps because of the above theoretical logic, the community-banking scheme was received with enthusiasm throughout the country at its inception. The number of community banks, for instance, rose from 879 in 1993 to 1355 in 1995. Since then, however, the performance of these banks has not matched the theoretical expectations. Distress is now widespread in these community banks. By the end of 2003, only 774 community banks still operated. Of this number, only 283 of them have been fully licensed.[28] The government regulatory authority, the National Board for Community Banks (NBCB), has since passed the blame for failure to the community banks. According to the NBCB, the reasons for the community bank failure include: insider dealings, boardroom squabbles, financial recklessness of some directors and board chairmen, lack of good management, interference by directors in the daily running of the banks and insufficient assets to meet liabilities. Although some of the above allegations are true, they cannot entirely explain the mass failing of community banks. The greatest threats to these community banks have indeed come from outside: political instability, government fiscal indiscipline and inconsistent macroeconomic policies. These have caused a major crisis in the Nigerian financial system. Community banks, being part of the financial system, are not immune from this crisis.[29]

[26] Uche, 1999, pp. 224-5.
[27] National Board of Community Banks, 1992, p. 2.
[28] Central Bank of Nigeria Annual Report, 2003, p. 44.
[29] Uche, 1998, p. 40.

Despite the failures of most of the above mentioned initiatives, the need to put in place a policy framework that will help promote the development of a robust SME sector remain ever present. It is in the search for the above, that the Bankers Committee, with the urging of the central bank, agreed to set up the Small and Medium Scale Industries Equity Investment Scheme.

THE SMALL AND MEDIUM SCALE INDUSTRIES EQUITY INVESTMENT SCHEME

As already mentioned, the Small and Medium Scale Industries Equity Investment Scheme became operational in 2001. The scheme is directed by two main committees: the Bankers Committee on SMIEIS and a Presidential Advisory Committee on SMIEIS.[30] Under the Scheme, banks are mandated to set aside 10 percent of their profits before tax for investments in the equity of small and medium scale enterprises. Specifically, the objectives of the scheme are:

- To facilitate the flow of funds for the establishment of new SMI projects and the reactivation, expansion, modernization or restructuring of ongoing projects;
- To stimulate economic growth, develop local technology and generate employment.

Furthermore, taking up equity investments in SMEs is expected to drastically reduce the burden of interests and other financial charges, usually borne by SMEs under a normal bank lending scenario. Banks are also expected to provide these SMEs with financial, advisory, management and technical support. Bank equity participation in small and medium scale enterprises is limited to the following industries: agro allied, manufacturing, informa-

[30] "From the beginning, the bankers Committee set up a sub committee on SMIEIS, comprising representatives of the Central Bank of Nigeria and the Deposit Money Banks. This sub committee articulated the scheme, interviewed and selected the Consultant that carried out the study and prepared the guidelines for its operations. All these were approved by the Bankers Committee. Since the Scheme came into being, the sub-committee has been responsible for monitoring the implementation of the scheme and makes recommendations to the Bankers Committee. There is also a Presidential Advisory Committee on SMIEIS, comprising representatives of the Federal Ministry of Industry, the organised private sector, the Office of the Secretary to the Government of the Federation and the Bankers Committee. The Committee is charged with the responsibility of advising the Government and submitting periodic assessments on the scheme" (Sanusi, 2003a, p. 16).

tion technology and telecommunications, educational establishments, services, tourism and leisure, solid minerals and construction.[31]

In order for a company to be eligible for equity funding under the scheme, it must:

- Comply with all relevant regulations of the Companies and Allied Matters Act (CAMA) of 1990, such as the filing of annual returns including audited financial statements;
- Comply with all applicable tax laws and regulations and render regular returns to the appropriate authorities.

However, prospective beneficiaries are encouraged to seek the opinion of third party consultants such as lawyers, accountants and values in determining the value to be placed on the assets and capital of their businesses. This is to ensure that they get a fair price during negotiations with investing banks.

The guideline further provides that equity investment under the scheme could be in form of fresh cash injection or conversion of existing debts owed to a participating bank. In other words, banks are given the chance of recovering their bad and unsettled debts by converting such debts into equity and providing management and technical advice to the debtor company. Under the guideline, it is also possible for banks to be equity investors as well as creditors to a participating SME. Under the scheme, banks can either invest in these SMEs directly or through a venture capital company.[32] Banks are also allowed to team up and form a venture capital company for the purposes of investing in these SMEs. Furthermore, recipient SMEs are expected to:

- Ensure prudent use of funds;
- Keep up to date records on the companies' activities under the scheme;
- Comply with the guidelines of the Scheme
- Make companies' books, records and structures available for inspection by the appropriate authorities (including banks and CBN), when required;

[31] Banks are prohibited from investing 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 percent or more of the total production output or turnover of the investee company is derived from military related purposes; beverages with alcoholic content exceeding 15 percent; casinos or companies where the principal source of income is gambling; speculative investments in real estates or commodities; banking, insurance or financial services; immoral and illegal activities and; investments that are harmful to the environment.

[32] "Venture capital is defined as a relatively high risk investment in support of business creation or expansion. Put differently, it is the investment in the equity shares of new or existing companies who lack sufficient collateral to borrow from conventional sources but who demonstrate high profit potentials" (Ikwuegbu, 2002, p. 29).

- Provide monthly financial and operational records to investing banks, before the 15th of each month.

The guideline also recognizes the importance of the role of the Government in the success of the scheme and assigns it the following functions: a stable macroeconomic environment, a stable and reliable regulatory and legal framework, an adequate physical infrastructure and a prudent fiscal regime. The Government is also required to pass enabling legislations in order to be able to provide the following incentives to the scheme: make the banks' contributions to the scheme enjoy 100 percent investment allowance, reduce tax paid by SMEs to 10 percent, provide 5 years tax holidays to the SME under the scheme and finally, exempt divested funds under the scheme from Capital Gains Tax.[33]

As an incentive for banks to appropriate all the funds set aside, Funds appropriated after 18 months of being set aside will be transferred to the Central Bank of Nigeria. Thereafter, if the fund still remains unutilized, it will be transferred to the newly established Bank of Industry. More recently, however, bank investments in SMEs have been stratified. Banks are now required to invest at least 60 percent of SMIEIS funds set aside in the real sector. Also, not more than 30 percent should be invested in the services sector. Banks are also required to invest 10 percent of their SMIEIS funds in micro enterprises.[34] The need to include micro enterprises as beneficiaries of the scheme is mainly because of their importance in the economy. It is for instance estimated that these micro enterprises control about 40 percent of the entire commerce of the country.[35]

Despite the above regulations, banks have not easily found suitable outlets for their set aside funds. According to the Central Bank of Nigeria, the total funds set aside by banks under the SMIEIS has continued to significantly progress in terms of growth, far ahead of investments by banks.[36] From

[33] The minimum time banks are allowed to hold on to their investments under the scheme before divesting is 3 years.

[34] "In order to encourage more viable investments of the SMIEIS funds, the Bankers' Committee approved a micro-credit window for micro entrepreneurs under the SMIEIS. Under this arrangement, 10 percent of funds set aside by the participating banks under the SMIEIS would be earmarked for micro-credit investment which would be disbursed through micro-finance institutions and other participating institutions to be approved for the purpose" (Central Bank Annual Report, 2003, p. 20).

[35] ThisDay, 3rd July 2002.

[36] This has been so, despite the fact that the Central bank of Nigeria, at the beginning of the Scheme, circulated to all banks a list of all existing industries in Nigeria with problems of working capital. This was to serve as a working guide (Small and Medium Enterprises, 2002, p. 9).

the inception of the program in June 2001 to 31st December 2002, for instance, 80 banks out of the 90 existing, set aside a total of N 13.07 billion for equity investments under the scheme. Out of this amount, only N 1.73 billion was invested in 36 SMI projects by 19 banks.[37] This represented 13.2 percent of the total funds set aside during the period. As of February 2005, a total of N 30.9 billion had been set aside by banks. Of this amount, only N 8.9 billion had been invested in 180 projects. This represents 30 percent of the total funds set aside during the period. In other words, banks were unable to invest 70 percent of the funds set aside during the said period.[38]

On the Sectoral allocation of the investments, as of February 2005, N 5.8 billion, representing 64.9 percent of total SMIEIS investments were invested in 121 projects or enterprises in the real sector. Investments in service related enterprises amounted to N 3.1 billion in 58 projects. This represents 35.1 percent of total investments. The micro enterprises sub sector recorded no investment at all.[39] Geographically, 58.7 percent of total investments were concentrated in Lagos State alone. Only four other states (Abia, Delta, Rivers and Ogun) recorded more than 3 percent of total investments. Fourteen of the 36 States recorded no investments at all.[40]

The slow pace of investments in these SMEs is clear evidence that banks have little expertise in investing in SMEs. Despite previous involvement in SME financing, most banks lack the requisite skills required for equity financing in diverse small and medium scale entities.[41] To expect SME schemes to now work simply because banks have an equity stake in them, is nothing but

[37] Central Bank of Nigeria (2003, p. 1).

[38] Central Bank of Nigeria (2005, p. 1).

[39] Central Bank of Nigeria (2005, pp. 1-2)

[40] Central Bank of Nigeria (2005, pp. 1-2). According to the immediate past Governor o the Central Bank of Nigeria: “The reasons for this slow pace are not far fetched. First, equity investment requires skill sets with are quite different from what the banks are familiar with in credit appraisal and management. Secondly, at the time the scheme took off in 2001, the necessary structures for the investing banks to effectively administer the scheme were not in place… Thirdly, the dearth of attractive projects in which banks can invest, owing to poor record keeping, poor managerial capability and lack of business packaging skills remains a limiting factor. Fourthly, there was resistance from the entrepreneurs who were reluctant to dilute their shareholding. It took them time to accept the idea of patronising equity investments instead of loans. The main resistance was the unwillingness to accept discipline resulting from sharing control. They wish to persist in the sort of indiscipline that made some of the SMEs fail in the first place. It has taken sometime to effect a paradigm shift and for them to appreciate that it is better to own 10 percent of a successful and profitable business than to own 100 percent of a moribund business. Last, but not the least, is the issue of poor infrastructure which is constantly recurring” (Sanusi, 2003c, pp. 2-3).

[41] Udechukwu, 2003, p. 15.

an illusion. This is because banks, as lenders, usually have the power to insist on good corporate governance, accountability and even the disbursement and direction of loan funds. Despite this, they have a poor record of success with SME funding, which is one of the reasons banks are reluctant to deal with SMEs. The reason for this reluctance and for the poor performance of SMEs is the fact that the investment climate in the country is simply not friendly. High inflation, policy inconsistency, poor security, corruption, and dearth of requisite infrastructure are all hallmarks of the Nigerian economic environment. This makes it difficult for long-term survival of SMEs in the country. This fact cannot change radically just because banks are now involved in the management of SMEs.

Interestingly, existing regulations limit the amount of investments a bank can make in any one SME, even under the SMIEIS. The Nigerian Banks and Other Financial Institutions Act of 1991 (BOFIA) states that a bank may acquire or hold part of the share capital of any agricultural, industrial or venture capital company. This is however on the condition that the shareholding by the bank, approved by the Central Bank of Nigeria, shall not be more than ten percent of the bank's shareholders funds unimpaired by losses and shall not exceed forty percent of the paid-up share capital of the acquired company.[42]

The implication of the above provision is that investing banks are unable to take effective control of the enterprises they are supposed to invest in. This is particularly so, because most SMEs are family businesses and thus do not have diverse shareholding. Limiting bank investments in such enterprises is likely going to limit their influence in shaping the future direction of such enterprises.[43]

A possible danger of not allowing banks to have effective control over the SMEs they invest in is that banks will take the easy way out by investing in only successful SMEs. Despite the various difficulties SMEs face, some of them are still well run and profitable. Such SMEs usually have good relationships with commercial banks. Given the pressure on banks to invest their

[42] Section 21 (1).

[43] Interestingly, the Bankers' Committee does not appear to appreciate this point. It is instead, asking the Central bank of Nigeria to remind banks of the existence of this regulation and insist on its enforcement. According to a recent news report, the Bankers Committee: "expressed concern about the structure of investment of most of the banks that have so far participated in the scheme… In some cases, up to 90 percent or more of the funds set aside has been invested in a single project which was much more than 40 percent of the of paid up capital of the company into which the fund was invested…. Given the scenario, the committee suggested that the Development Finance Department of the CBN should write to the affected banks with disproportionate equity participation to comply with the provision of BOFIA" (ThisDay, July 3, 2002).

SMEs funds, there is a clear incentive to fund these successful SMEs through the SMIEIS, rather than the usual loans and advances. This would clearly not be in line with the spirit of the SMIEIS.[44]

At another level, a further danger of this scheme is that it might divert bankers from their main purpose of business. Over the years, the Central Bank of Nigeria has consistently insisted that banks should focus on their core area of competence and avoid distractions. In a circular to all banks titled 'Direct Involvement in Trading Activities by Banks', and dated June 26th 2001, the CBN advised all banks to "limit their activities to core banking functions and save themselves the hazards and risks associated with direct trading".[45] Paradoxically, it is the same Central Bank that is now insisting that banks become business entrepreneurs.

Furthermore, the idea that banks have the competent organizational skills to make this sector work is not always correct. It is based on the erroneous concept that banks are profitable because of their strategic and management skills. There is no doubt that banking is one of the most profitable industries in the Nigerian economy. This is however more due to the structural deficiencies in the Nigerian economy than their ingenuity. Most of the bank profits in Nigeria are foreign exchange induced. The fact that banks have the monopoly of participating in the government controlled lucrative foreign exchange market is the real reason for their mega profits. A close look at the accounts of Nigerian banks suspended from the foreign exchange market clearly shows that on every occasion, such banks witness material reductions in their profit levels.[46] There is thus the need for us to look more closely at the real reasons why SMEs have largely remained unprofitable, if we are to ever derive the expected benefits from these enterprises.

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[44] "In addition to providing finance, the SMIEIS initiative expects banks to…. identify develop and package viable industries with enterprising customers… and to jump start the real sector of the economy by spearheading the establishment or restructuring of existing SMIs, many of which have become moribund" (Osa-Afiana, 2003, p. 91).

[45] Central Bank of Nigeria Circular to all Banks on: Direct Involvement in Trading Activities by Banks dated June 26, 2001.

[46] "In 2002, for instance, 20 banks were suspended from the foreign exchange market all for round-tripping. Admittedly, some banks have challenged the accusations of the Central Bank in both judicial courts and the court of public opinion. What is however not in doubt is the impact of such suspensions on the profitability of banks. Take for instance, the case of Universal Trust Bank (UTB), which was in 2002 suspended from the Inter bank Foreign Exchange Market. In its recently released annual report and accounts for the year ended 31st March 2003, its profit before tax dropped from N1.544 bn to N547m. This represents a drop of almost N1bn [65 percent]. According to its Managing Director, the bank's non participation in foreign exchange market was a major cause of this drop" (Uche, 2004). See also Soludo (2004, p. 5).

CONCLUSIONS

The SMIEIS is a unique scheme representing a genuine attempt by Nigerian banks to contribute to the industrial and economic development of the country. Despite its noble objectives, its future remains bleak. Operationally, it is erroneous to expect banks to directly participate in the management of SMEs. Not only do these banks lack the expertise required for the management of such institutions, they also risk being distracted from their core business activity, which is banking. There is thus the need to make it mandatory for all bank investments in SMEs to be channeled through venture capital companies. Interestingly, some banks have already incorporated venture capital companies and are already channeling the bulk of their SME investments through these companies.[47] Such arrangements however, cannot always guarantee the success of the SMIEIS. This is because the major reasons for the failure of past SME assistance programs, i.e., dearth of infrastructure and absence of a stable macroeconomic environment, remain ever present. Although the Government is aware that it is responsible for improving the nation's infrastructure and ensuring the existence of a stable macroeconomic environment, very little has been done in this regard.[48] Unless there is a drastic improvement in the operating environment of these SMEs, bank investments in such enterprises are unlikely to earn competitive economic returns in the future. While the SMIEIS funds have been accumulating at a very encouraging rate, the real test of the success of the scheme will be the rate of return on the investments from these SMIEIS funds.

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Résumé

L'introduction du système d'investissement en capital des petites-moyennes industries au Nigeria représente la première expérimentation pour la promotion de ce secteur qui est vital pour le développement. L'article propose une critique de ce système en soutenant que la faiblesse des petites et moyennes entreprises (PME) au Nigeria est due à l'environnement macroéconomique instable et à l'absence d'infrastructures de base, ce qui a augmenté les coûts opérationnels. En plus, la conviction que les banques ont une meilleure gestion et expérience est erronée ; les profits élevés des banques sont dû plutôt aux subventions étatiques à travers les taux d'échange. Même les banques bien gérées risquent de ne pas avoir les compétences pour suivre les PME. En effet, cela peut représenter une distraction de leur activité principale.