

Legal Security for Credit and Investment in Small and Medium Scale Industries in Nigeria

Introduction

There is an acknowledgement, worldwide, that the development of any economy is dependent on small and medium scale industries (?SMES?). The advantages of strong SMES include job creation from the grass roots to the urban areas, entrepreneurship with resulting increase in Gross National Product (?GNP?), even distribution of wealth among the populace with resulting economic and physical security in the country, increase in foreign exchange with the exportation of qualitative and competitive products and repatriation of the profits to Nigeria, etc.

In developing countries, the advancement of SMES have been greatly constrained by the non advancement of the economies in these countries and the inability of their Banking sector(s) to extend medium and long term credit facilities to the SMES. This inability and or reluctance by the Banks to extend credit to the SMES have been due largely to the unavailability of credit for long-term investments in these economies and more importantly, for our purpose, the lack of adequate credit collateral/security by the SMES.

The efforts of the Central Bank of Nigeria (?CBN?) and the banking institutions in Nigeria under their umbrella association called the Bankers Committee, to fulfil their statutory and social responsibilities and to also assist in the development of the SMES is commendable. The only concern(s) that have been expressed especially by the SMES through their umbrella association, the National Association of Small and Medium Enterprises (?NASME?) is whether the conditions under which the banking institutions will extend credit facilities to the SMES are favourable and practicable to all the stakeholders concerned?

There is also to this writer the legal question of whether the conditions presently put in place by the Banks and the Bankers Committee to assist the SMES with credit is sufficiently covered by the Law? An attempt will also be made to proffer some suggestions, both legal and practical, on the way forward.

Conditions for the Banks to Participate in the SMES

Some of the conditions under which a majority of the Banks in Nigeria will extend credit facilities

to the SMES include:

- The SMES must be a registered limited liability company that have complied with all corporate and tax laws in Nigeria.
- The SME must have a minimum staff strength of 10 (ten) employees and a maximum of 300 (three hundred) employees.
- The SME must be an enterprise with a minimum and in some cases, a maximum asset base of, excluding land and working capital, =N=200Million (Two Hundred Million Naira) which is the equivalent of over \$1.5Million (One Million Five Hundred Thousand Dollars).
- The ownership structure of the SME will be diluted to the extent of the Bank's investment in the SME with the Bank also having the power to appoint at least one person to an executive director position. There are reports of some Banks owning over fifty percent (50%) equity in some of the SMES.

The Bank is expected, from the guidelines, to exit from the SME investment after three (3) years.

Incentives for Investing in SMES

There is an agreement that all Banks in Nigeria should set aside Ten percent (10%) of their Profit Before Tax for equity investments in the SMES. In return and as incentives for this investment, the following tax reforms and incentives have been proposed:

- The corporate tax for the SMES under the Companies Income Tax (?CITA?) is reduced to 10% (Ten Percent).
- The Bank's contribution to the SME to enjoy 100% (One Hundred Percent) investment allowance.
- Exemption of divested funds under the SMES from the Capital Gains Tax.
- Five (5) years tax holiday to the SMES.

The Law Regulating a Bank's Investment in an SMES

The Banks and Other Financial Institutions Decrees (?BOFID?), now Acts under the 1999 Constitution, provides in Section 21 that a Bank may acquire shares in small and medium scale industries, agricultural enterprises and venture capital companies

provided that the shareholding by the Bank in any such enterprise or any other business shall not

be more than Ten Percent (10%) of the Bank's shareholders fund unimpaired by losses and shall not exceed Forty Percent (40%) of the paid up share capital of the company whose shares are to be acquired.

Section 21(d) of BOFID goes further to provide that the aggregate value of the equity participation of the Bank in an SME should not exceed, in the case of a Commercial Bank, Twenty Percent (20%) of its shareholders fund unimpaired by losses or, in the case of a Merchant Bank, not more than Fifty Percent (50%) of its shareholders fund unimpaired by losses. Of equal interest is Section 21(3) of BOFID, which requires any Bank investing in an SME to notify the Central Bank of Nigeria (?CBN?) within twenty-one days of such an investment. The penalty for a default in not reporting the investment to the CBN is =N=100,000 (One Hundred Thousand Naira) for each day during which the default subsist. See Section 6 of the BOFID (Amendment) Act, 1999.

In protecting their investments in the SMES, the Banks' are requesting for a minimum minority equity participation in the SMES. Unfortunately, this is not a sufficient legal cover because in practice, the enforcement of the rights of a minority shareholder as contained in Part X of the Companies and Allied Matters Act, 1990 (?CAMA?) are slow in execution due to our judicial system of administration. Of interest also will be Section 300 of CAMA, which empowers any aggrieved shareholder to apply for an order from the Federal High Court in the form of an injunction restraining his company from:

- Entering into any transaction which is illegal or ultra vires the objects with which the company was incorporated.
- Restraining the taking of actions which requires a special resolution to be passed by the company.
- Committing fraud on either the company or its minority shareholders.
- Restraining the company or another shareholder or director where the director or shareholder is likely to be deprived of profit or benefit, or to have profited or benefited from their negligence or breach of duty.

CAMA has made some other effort aimed at protecting the investors in a company. Some of these protections include:

- Restrictions on the alteration of the Memorandum and Articles of Association of a

company. See Section 44(1) of CAMA.

- Restrictions against insider trading. See Section 614(1) & (2) of CAMA.
- Prohibition of untrue statements in the prospectus of a company. See Section 548(1), 562(1) and 571 of CAMA.
- Statutory requirement for the publication of most information about a company.

The locus classicus on the above is the decision in *Pender v. Lushington* [1877] 6 CH.D 70.

Successes of the SMES & Recommendations

From available reports, the SMES are adversely affected by the conditions for the investments by the Banks. As a result, they have not encouraged or allowed equity participation by the Banks in the SMES. The CBN in turn has discovered that the Banks, to take advantage of the incentives offered by the scheme and as a result of the refusal of the SMES to allow them to invest under the above conditions, have established their own SMES, which are nothing but indirect subsidiaries of the Banks. To protect all the stakeholders, it is suggested that the scheme be reviewed and the following alternatives be considered:

- The Banks should through the Bankers Committee, forward to the National Assembly, private Bill(s), in addition to the one already forwarded to the National Assembly by the President which is on the powers of the CBN, ensuring that the incentives offered to the Banks and the SMES especially under the BOIF, the Companies Income Tax Act, the Capital Gains Tax Act, etc are harmonised and properly protected as the Law, as it presently stands, does not authorise these incentives in their current form.
- The requirement or qualification that the SME must have a minimum (or maximum?) share capital and or asset base of ₦200 Million excluding land and working capital needs an urgent review. This is because a serious enterprise with this kind of asset base in present day Nigeria or in most developed economies should not qualify for categorisation as an SME.
- To increase participation by the SMES in the scheme, the Banks are counselled to encourage the SMES to form and register communal-like co-operative societies under Part C of CAMA. The Trustees to these co-operative societies must be people of credible financial reputation and banking record who in addition to entering into contracts with a Bank for the disbursement of the credit facilities must also give their personal guarantees securing the facilities.

- Another form of practical collateral is the provision by the SME of a fixed and floating charge over all the assets of the SME, to the granting Bank. However, the Banks should exercise more due diligence when executing this and other charges, as there have been reported cases of multiple charges on the same property by some SMES with the suspected connivance of the officials of some Banks.

It is thus suggested that to discourage this terrible practice of multiple charges over the same assets of a company, the Banks should through the Bankers Committee, establish a sort of data bank where these kinds of charges can also be registered in addition to the ones, which should be registered with the Corporate Affairs Commission, Abuja as provided for by Law. (Interestingly, some financial institutions only obtain from the Lender a deposit of title deed without executing and registering a deed). Banks, who are members of the Bankers Committee, can on the Internet, using their security codes and in the spirit of healthy competition, assess this data bank and share confidential information concerning it.

- The current practice of equity participation by the Banks should be more closely reviewed, as the first rule in any enterprise is that an investor should not invest in a venture that he is not proficient in. There is also the problem of well trained man power specialised in investment Banking to supervise the investment of the Banks in the SMES as experience has shown that a business in Nigeria transcends the keeping or monitoring of accounts. After all, the joke is that businessmen worldwide always have multiple accounts for multiple purposes.
- The exit period of three (3) years by the Banks after which they should disinvest from the venture may not be practicable and should be reviewed as it takes a longer period of time, in a volatile environment such as ours, for a venture to make a commercial return on investment. This exit period is a further disincentive by the Banks to provide long-term credit facilities.

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