Pilot Investment Climate Assessment

An Assessment of the Private Sector in Nigeria

Regional Program on Enterprise Development
Africa Private Sector Department
Small and Medium Enterprise Department

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AMSCO	African Management Services Company
APDF	Africa Project Development Facility
BoI	Bank of Industry
BPE	Bureau of Public Enterprises
DFI	Development financial institution
ECOWAS	Economic Commission of West African States
ETM	Citibank Extended Target Market
FDI	Foreign direct investment
FGN	Federal Government of Nigeria
FIAS	Financial Intermediary Advisory Service
GDP	Gross domestic product
GSM	Global System for Mobile Communications
IFC	International Finance Corporation
LCCI	Lagos Chamber of Commerce and Industry
MAN	Manufacturers Association of Nigeria
NACCIMA	Nigerian Association of Chambers of Commerce, Industry, Mines, and Agriculture
NASME	National Association of Small and Medium Enterprises
NASSI	National Association of Small Scale Industries
NBCI	Nigeria Bank for Commerce and Industry
NBWF	Nigerian Business Women Forum
NCC	Nigerian Communications Commission
NCP	National Council on Privatization
NDDC	Niger Delta Development Commission
NECA	Nigeria Employers' Consultative Association
NEPA	National Electric Power Authority
NERFUND	Nigerian Economic Reconstruction Fund
NESG	Nigerian Economic Summit Group
NGOs	Non-Governmental Organizations
NIDB	Nigerian Industrial Development Bank
NIPC	Nigeria Investment Promotion Commission
NITEL	Nigerian Telecommunication Ltd.
NPC	Nominal Protection Coefficient
NNPC	Nigerian National Petroleum Corporation
OMPADEC	Oil Mineral Producing Area Development Commission
OPS	Organized private sector
PBT	Profit Before Tax
PSA	Private Sector Assessment
RPED	Regional Program for Enterprise Development
SEC	Securities and Exchange Commission
SME	Small and Medium Enterprises
SMIEIS	Small and Medium Industry Equity Investment Scheme
STEP	Support and Training Entrepreneurship Program
UNIDO	United Nations Industrial Development Organization
USAID	United States Agency for International Development
WTO	World Trade Organization

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The **Regional Program on Enterprise Development** generated much of the statistical data used in this report during its firm survey exercise in Nigeria (March-April 2001). This survey was designed and implemented by a team led by Tyler Biggs. The RPED report describing the results of this exercise is available separately and is authored by Jean Michel Marchat, John Nasir, Vijaya Ramachandran, Manju Kedia Shah, Gerald Tyler, and Lan Zhao, under the overall leadership of Ibrahim Elbadawi and Demba Ba. Several organizations and researchers in Nigeria helped with the production of the RPED report: the National Association of Chambers of Commerce, Industry, Mining, and Agriculture; the Lagos, Abia, Nnewi, Kano, Kaduna and Port Harcourt Associations of Chambers of Commerce; the National Manufacturing Association of Nigeria and its regional branches; KPMG; and the Nigerian Economic Summit Group, especially Mary Agboli. The PSA team would like to acknowledge all of these groups and individuals in Nigeria. Field research and analysis carried out for the PSA and RPED reports were generously funded by the U.S. Agency for International Development (USAID) and the Department for International Development (UK).

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In recent years, Nigeria has taken various major steps to foster the private sector role in the country's economic and social development. The government has acted to reorient economic policy, stimulate non-oil Small and Medium Enterprise (SME) development, promote foreign investment, reform the financial architecture, and combat corruption. These efforts and the momentum provided to the nation by the return of a democratic government are reflected in the "Improvement and Optimism Indexes" compiled by the World Economic Forum's Africa Competitiveness Report (2000–2001), which ranks Nigeria fourth among 12 African countries in terms of improvement and first in terms of "optimism."

Nigeria has considerable potential for poverty-reducing growth, and while progress has been made, much remains to be done. The economy is severely segmented. The public and oil-related sectors are focused on appropriating returns from the oil economy, while other sectors have been ignored or preyed upon. The disadvantaged sectors often struggle to feed off the margins of the oil industry and with limited means to improve productive competitiveness are often left with little option but to gravitate towards short-term trading rather than productive activities. Overshadowing everything else are several fundamental problems facing all businesses—both domestic and foreign—including weaknesses in infrastructure provision (especially power and telecommunications), a lack of personal and property security, poor governance, and corruption. Without concerted and continued efforts in these areas, efforts on other fronts, however sound, will have a limited impact. Reflecting such major constraints, Nigeria ranked worse than average in the World Bank's Business Environment Survey among 18 African countries surveyed, and bottom or close to bottom in infrastructure, corruption, and street crime. Such a poor environment for business in general makes it difficult for the non-oil private sector in particular to support equitable and sustainable economic development.

The productivity of the private sector has suffered a great deal in the 1990s. Those firms benefiting from high levels of protection had little incentive to raise productivity. Less favored firms suffered from the "transactions costs" entailed in obtaining import licenses and foreign exchange, an erratic supply of highly priced inputs, including spare parts. These disadvantages, which were dramatically evident in the agricultural sector, were not offset by public investments in economic infrastructure. Firms confronted high cost, erratically supplied services for transport, electricity, water, and telecommunications. Consequently, virtually all those in the formal sector have relied on their own generators for reliable, albeit very expensive electricity. The country's telephone density was among the lowest in the world during the 1990s. The port of Lagos required an *average* of 28 days to clear shipments, as opposed to less than two days internationally. It is still considered by many shippers to be one of the most expensive ports in the world. Likewise, the private sector did not benefit significantly from public investments in human resources, despite the relatively large number of professionals in the workforce. This could be due to several reasons. Recent government studies conclude that the *quality* of tertiary education has deteriorated in the past decade; it may also be the case that other obstacles to doing business effectively cancel out the advantages of a skilled workforce. Gross enrollment ratios at the primary and secondary levels vary considerably across the country. Low levels, especially in the north, comprise a major impediment, especially for small- and medium-scale enterprises.

The highly segmented nature of Nigeria's economy has also contributed to the country's current predicament. The oil sector of the economy has in many ways undermined the ability of the federal and state governments to manage a sound economy.

Meanwhile, the non-oil organized private sector has not performed well. Government at all levels is drawn to seek revenues—and rents—off the oil economy. The practice of rent seeking is also widespread in the non-oil sectors, but these sectors are far less able to bear this burden. The four key segments of the economy are: oil-related activities, the public sector (governments and parastatals) that remains heavily dependent on oil, the organized private sector, and the informal sector.

The first segment of economic activity is based upon or centered on oil. The dominance of this sector is reflected by the share of oil revenues as a percentage of exports. In contrast to Nigeria's reliance at independence on agricultural commodities, oil now accounts for over 95 percent of the country's export earnings. A key longer-term goal must be the development of a more diversified range of exports.

The second segment is the public sector whose revenue remains heavily dependent on oil. Furthermore, this revenue remains highly variable to changes in world prices. In the past, Nigerian governments have failed to "sterilize" windfall revenues resulting from major "spikes" in world prices. Consequently, when prices have fallen, they have resorted to borrowing to sustain public expenditure. Such actions have led to many fluctuations in domestic money supply, the rate of inflation, and the cost of credit to the private sector.

The public sector has also been significantly involved in economic production through enterprises owned by states as well as the federal government. These investments have yielded very low and often negative returns, have inhibited the entry of potential private investors, and, in the case of infrastructure, have imposed major costs on the rest of the economy. How government withdraws from such activity will have major implications for the pattern and pace of economic development.

The third segment of the economy is the organized private sector. As noted earlier, for most of the past three decades, it has suffered from inadequate infrastructure, under-investment in human resources, poorly conceived and executed development strategies, major uncertainty concerning the intent and efficacy of public policy, and widespread corruption. A telling indicator in this regard has been the decline of the manufacturing sector from 8.8 percent of gross domestic product (GDP) in 1979 to only 5.4 percent in 1998. This has entailed the withdrawal of long-established firms, with an attendant loss of potential investment and valuable marketing networks and contacts in overseas markets.

The fourth segment, the informal sector, is the source of income and employment for most Nigerians. It has stagnated because of the steady fall in per capita income over more than two decades. Equally disturbing was the slow growth of gross fixed capital formation and private consumption, annually averaging only 1.4 and 2 percent, respectively. Although export earnings, almost entirely reliant on earnings from oil, actually declined annually (in real terms) over the decade, imports continued to expand by almost 7 percent per year. Only government consumption grew significantly, at an average annual rate of almost 22 percent over the 1990s.

With a new, forward-looking government in place, we need to understand the most important challenges facing the Nigerian private sector and what policymakers can do to help the private sector overcome its difficulties. This **Private Sector Assessment** goes into some detail on the practical challenges Nigeria faces on the road to broad-based growth beyond the oil sector. It focuses on how to improve productivity and competitiveness of Nigerian firms in the near future and over the long term.

Several qualifying items are worth noting upfront. The firm-level data collected for this analysis were part of a survey conducted in March-April 2001 and are therefore slightly dated. The survey covered only the manufacturing sector and included interviews with firms in size classes ranging from

10–20 employees to over 500 employees. Also, this document covers some, but not all, of the policy changes made since 2001, and does not cover the public, rural, or informal sectors. These sectors will be covered in forthcoming documents and projects. Finally, the report does not evaluate the impact of privatization on state-owned enterprises, in part because it is too early to do this adequately. Some key privatization efforts are still under way; we will need to wait a while before we can fully assess the results of the various efforts to privatize utilities and other state-owned entities.

This section concentrates on the key challenges to growth in Nigeria. It draws heavily on the firm survey conducted by the Regional Program on Enterprise Development (RPED) and looks at productivity, trade, and infrastructure together with a final subsection on what these challenges mean for the SME sector that must be a major driver of equitable and sustainable non-oil private sector growth in Nigeria.

Productivity of Firms and Labor in Manufacturing

Value added per worker (measured in U.S. dollars), as an approximate measure of productivity, reveals some interesting differences between various types of firms (Table 2.1). Value added per worker is driven by firm size. The smallest firms have the lowest value added and the very large firms have a value added per worker that is significantly greater than other types of firms. Local firms have less than half the value added of firms with foreign equity, and firms owned by indigenous entrepreneurs have a lower value added than firms owned by entrepreneurs of non-African descent.

Value added for the sample as a whole is about $5,000 per worker. However, there is a quite a lot of variance by sector. The food-processing sector has the highest value added—over $9,000 per worker. Value added in other sectors is considerably smaller. It is interesting to note that the mean age range of equipment is fairly high—the mean value is 3.5 on a scale of 1 to 5, which translates to 10–20 years; and capacity utilization hovers around 50 percent with a

Table 2.1. Value Added Per Worker in USD in the Manufacturing Sector

	Value Added/Worker (variance shown in parentheses)	Number of Firms
Local	3,137.52 (3,777.80)	93
Foreign	8,790.12 (9,673.41)	78
Indigenous	4,460.05 (6,081.85)	106
Non-African	7,791.56 (9,433.69)	63
Micro	2,765.58 (5,663.97)	48
Small	3,859.39 (5,529.24)	42
Medium	5,020.36 (7,258.61)	46
Large	4,198.73 (4,401.79)	35
Very Large	11,094.26 (12,767.19)	28

Source: World Bank, RPED Nigeria, 2001.

minimum value in the sample of 26 percent. Average value of sales per firm is around $10 million, which is substantially larger than average value of sales in most countries in Sub-Saharan Africa. The average number of employees in our sample at the time of the survey was 329, with a minimum of 5 and a maximum of almost 5,000. The mean number of employees declined somewhat in the early to mid-1990s and then rose slightly at the end of the decade. Overall, there has been virtually no growth in employment in Nigeria.

Examining mobility from one firm size to another over the period from 1990 to 2000, we see that firms have not been stagnating during this period. A majority of firms have moved up from their initial size class in all size categories, except for the large firms. About 37 percent of large firms remained large, but more than 50 percent of them downsized to the lower size classes. Only 11 percent moved up to the largest size class. All three of the smaller size categories *added* employees during this period. Most of the employment losses in manufacturing came from the largest size class. Insofar as the sector was protected and inefficient before liberalization, falling firm size may, in fact, indicate a move toward greater efficiency. Our sector data show that the average firm size in most sectors has declined slightly except for the wood sector where average employment has risen steadily since 1994. The RPED data show that capacity utilization averages around 52 percent for the entire sample, with very large firms using significantly more capacity (66 percent) than other firms. Foreign and non-African owned firms also have greater capacity utilization than local and African-owned firms.

The productivity of Nigerian labor will determine the country's future economic growth. It is useful therefore to compare productivity in Nigeria with that in other countries in Sub-Saharan Africa and Asia. An examination of this wage-to-value-added ratio relative to other countries gives cause for concern.

Table 2.2 describes the ratio of wages to value added for several countries in Asia and Sub-Saharan Africa, including Nigeria in 2001. It is clear that Nigeria's 2001 productivity by this measure is better than that of many other Sub-Saharan African countries' figures for the 1980s, and roughly equal to that of several Asian countries at the very start of their rapid economic growth periods. (Ratios for other countries are historical, but Nigeria still compares relatively well on an absolute basis.) These comparisons suggest that Nigeria has the potential to be competitive in world markets.

Table 2.2. Ratio of Wages to Value Added

Country	Year	Ratio of Wages to Value Added
Africa		
Botswana	1990	0.39
Cameroon	1978	0.39
Cote d'Ivoire	1982	0.31
Ghana	1983	0.23
Kenya	1988	0.41
Madagascar	1984	0.36
Malawi	1983	0.59
Mauritius	1987	0.50
Nigeria	**2001**	**0.26 (0.20 in 1983)**
Senegal	1984	0.43
Sierra Leone	1986	0.31
Tanzania	1985	0.35
Zimbabwe	1987	0.37
Asia		
Indonesia	1981	0.21
South Korea	1963	0.26
Malaysia	1970	0.27
Singapore	1963	0.35
Taiwan	1961	0.16
Thailand	1970	0.24

Source: David Lindauer and Ann Velenchik, "Can African Labor Compete?" in Asia and Africa: Legacies and Opportunities in Development, eds. Lindauer and Roemer (San Francisco, CA: ICS Press, 1994); RPED survey data.

That said, the less positive news is that the ratio of wages to productivity has risen (that is, productivity has deteriorated) for Nigeria itself: In 1983, Nigeria was more competitive than it is now, with a ratio of 0.20. This change has presumably happened because wages have risen more than productivity in the past two decades. At roughly $3 per day, Nigerian wage levels in the manufacturing sector remain substantially above those in many of the export-driven economies of Asia.

A perennial issue about the debate on whether Africa can be globally competitive or not is that of the competitiveness of African labor. Although some researchers believe that Africa can be competitive in international markets, there is compelling evidence to suggest that there are factors unique to Africa that have driven the cost of labor higher there than in other regions.

Typically, unit labor costs are high in countries that have high wages and low labor productivity. Apart from overvalued exchange rates that have hampered Africa's competitiveness, the data on unit labor costs show that Africa has higher ratios of wage to labor productivity relative to Asia at roughly equivalent stages of development. When data from Africa for the 1980s are compared with Asian data from the 1960s and 1970s, it is clear that earnings in Africa are about two-thirds higher than was the case historically in Asia, and African productivity is about one-fourth lower.

Two explanations for the phenomenon of high wages are plausible. One is the effect of unionization and labor regulations that has resulted in high wages in the formal sector, and the other is the low man-to-land ratio in Africa. There is some evidence to back up the theory that non-market forces have resulted in higher wages in Africa, whereas abundant supplies of cheap labor have tempered wage increases in Asia. Thus, the relatively high opportunity cost of labor in African manufacturing raises unit labor costs and reduces manufacturing competitiveness. In this respect, there are obviously large returns to reducing the size of the public sector through continued and aggressive pursuit of privatization and through reducing the size of government *per se*.

Trade and Protection of Manufacturing

Recent efforts to reduce the overall level of protection in Nigeria have succeeded to a degree, but tariffs are still well above world averages. Generally speaking it remains true that trade policy in Nigeria has mainly consisted of translating a strategy of import substitution into tariffs.

A pre-set tariff schedule, introduced in 1995 and valid until 2001, was intended to further decrease existing tariffs and reduce uncertainty for firms. Import liberalization has been pursued to reduce significantly the reliance on quantitative restrictions. Only *ad valorem* tariffs were used in the new pre-set schedule. Import duties consisted of a basic rate of customs duty modified by an annually set rebate, plus a 7 percent surcharge.[1]

The 1995–2001 tariff structure was designed to stimulate competition and efficiency by reducing tariffs on consumer items relative to tariffs on raw materials and intermediate and capital goods. The reduction of tariffs on final consumer goods was expected to expose domestic manufacturers to import competition while the relatively higher tariffs on raw materials were supposed to attract investment into raw material and intermediate goods production.[2] In the course of the reform program, all excise duties levied on domestically produced goods were removed in January 1998. Finally, as of 2000, most bans on imports were abolished.

An analysis of the current level of nominal protection (Table 2.3) in manufacturing raises three broad sets of issues. First of all, it is necessary to assess whether or not the 1995–2001 reform was implemented as expected and whether it reduced tariff uncertainty for firms. Then, the current overall

Table 2.3. Characteristics of the Most Distorted NPCs by Product Category in 2000

Classification	Consolidated NPC Applied by 2000			
	Average NPC *	**Standard Deviation**	**Max. NPC**	**Min. NPC**
24 Tobacco and Manufactured Tobacco Substitutes	1.561	0.358	1.800	1.150
10 Cereals	1.445	0.335	2.000	1.150
22 Beverage, Spirits and Vinegar	1.744	0.287	2.000	1.225
88 Aircraft, Spacecraft and Parts Thereof	1.190	0.204	1.550	1.050
49 Printed Books, Newspapers	1.180	0.198	1.450	1.000
36 Explosives, pyrotechnic products	1.292	0.183	1.600	1.150
05 Products of Animal origin not specified elsewhere	1.386	0.180	1.600	1.100
33 Essential oils and resinoids	1.374	0.171	1.600	1.150
19 Preparation of Cereals	1.410	0.161	1.640	1.200
04 Dairy Produces	1.289	0.157	1.550	1.090
15 Animal or Vegetable Fat and Oils	1.288	0.148	1.650	1.050
69 Ceramic Products	1.355	0.147	1.500	1.067
06 Lives Trees and Others Plants	1.525	0.144	1.650	1.400
58 Special Woven Fabrics	1.365	0.144	1.650	1.250
96 Miscellaneous Manufactured Service	1.285	0.142	1.550	1.050
42 Articles of Leather	1.283	0.140	1.500	1.150
34 Soap, organic surface-active agents	1.286	0.135	1.450	1.150
32 Tannings or dyeing extracts	1.219	0.124	1.450	1.033
55 Man Made Staple Fibres	1.328	0.123	1.500	1.100
51 Wool, Fine or Coarse Animal Hair	1.277	0.120	1.450	1.150
50 Silk	1.257	0.113	1.450	1.150
17 Sugar and Sugar Confectionnery	1.245	0.108	1.400	1.150
52 Cotton	1.439	0.108	1.560	1.300
11 Products of the milling industry	1.418	0.103	1.600	1.200
67 Prepared Feather and Down	1.350	0.100	1.400	1.200

** Non-Weighted*
Source: Computations on the basis of FGN (2001).

level of nominal protection can be estimated and compared with other countries. As a final step, it is thus necessary to compute firm-level indexes to take into account the fact that firms have multiple outputs and inputs, often subject to different tariffs. Each of these problems is addressed in turn.

In effect, for many product categories the dispersion in the Nominal Protection Coefficient (NPC) is still high and actually was increased by the various yearly changes.

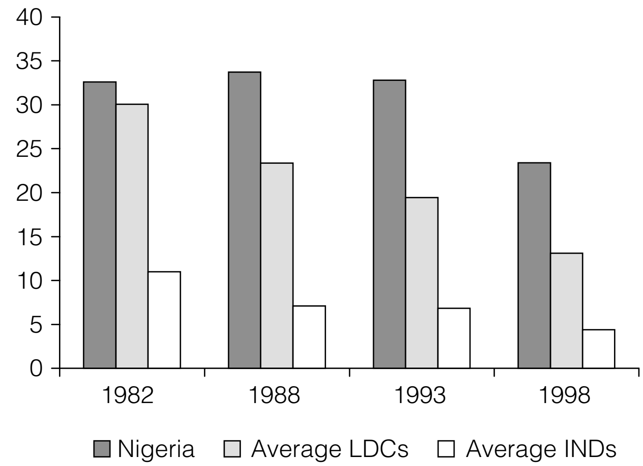
It seems unlikely that the pre-set tariff schedule of 1995–2001 was implemented in a consistent manner. Even though about 38 percent of the categories at the two-digit level of classification remained unchanged as of 2000 compared to what was planned for 2000 in 1995, still 23 percent of the tariff categories had increases and almost 39 percent had decreases. Moreover, the average decrease in the latter was smaller than the average increase in the former. While the dispersion in rates was small for those categories with tariff decreases, the situation was the opposite for the products whose nominal protection increased, where the dispersion remained large.

The Federal Government of Nigeria (FGN) also increased nominal protection for more than a fifth of the tariff categories. Moreover, the nominal protection from which firms benefit is usually higher than what is predicted by computations on the basis of the customs book, because they often produce a wide range of products subject to varying tariffs. As before, raw materials tend to be less protected than final products. All of this translates into a very uneven structure of effective protection.

The frequent adjustments in rates imply a non-negligible deviation of the tariff structure in 2000 at the two-digit level compared to the initial schedule devised in 1995. However, at a global level, there is virtually no change between the ex-ante and ex-post average NPCs computed on the entire tariff schedule. As of 2000, their respective values were 1.2543 and 1.2524. Hence, deviations from the planned schedule did not really affect the overall level of protection targeted for 2000.

On the positive side, it must be noted that the global level of nominal protection has indeed decreased since the 1995 reforms. World Trade Organization (WTO) data indicate that in 1994, just before the new round of reforms, the average unweighted tariff was around 30 percent and had reached about 25 percent in 2000. Yet, was this decrease large enough to bring Nigeria in line with the current protection trends worldwide? It seems that the answer is no. Since 1982, Nigerian tariffs have been constantly above the average tariffs applied by industrialized and least developed economies. Although data reported in Figure 2.1 do not go beyond 1998, it is unlikely that the trend of reduction

Figure 2.1. Nigeria and Worldwide Trends in Protection (unweighted tariffs in percentage)



Source: World Trade Organization database.

of average tariffs in developing countries and industrialized countries was reversed. Hence, in 2000, protection in Nigeria was still well above the level of other countries.

Infrastructure and the Cost of Electricity

Manufacturing firms in Nigeria consider inadequate infrastructure, particularly power, as their most severe constraint. Dealing with the inadequate power supply and other infrastructure problems absorbs far more of the management's attention than any other business problem. This is a key conclusion of the RPED survey of Nigerian manufacturing. When asked to identify their three biggest problems, it became clear that managers considered infrastructure to be more than twice as large a problem as either of the next two problems, namely access to credit or general uncertainty. This result holds for all types of firms (for example, large, SME, foreign) and across all regions of the country. The prominence of infrastructure is remarkably different from the results in most other countries surveyed by RPED, including the most recent cases of Mozambique and Nepal.

Managers of businesses in Nigeria report that although all aspects of infrastructure are a constraint to doing business, the biggest infrastructure problem is electricity. In considering the cost of electricity, one has to bear in mind that in the case of both publicly and privately provided power, the prices are distorted by government subsidies. In the case of publicly provided power, it is reported that the National Electric Power Authority (NEPA) produces electricity at a relatively high cost of 11 USCents/KwH compared to an international average of about 5–6 cents/KwH. The company is allowed to charge only 3.5 cents/KwH, and is supposed to receive the rest as a government subsidy. Yet NEPA's accounts receivable run into billions of Naira. Private and public consumers sometimes fail to pay due to frustrations with the poor service and frequently inaccurate billing."[3] In the case of privately provided electricity, the government subsidizes the cost of fuel (which represents 75 percent of the cost of electricity).

Virtually all the firms have the facility to generate their own power, as shown in Table 2.4. In fact, infrastructure problems are rated as nearly two-and-a-half times worse than the next biggest problem, access to finance.

Deficient supply of electricity is by far the biggest infrastructure problem faced by firms. Overall, some 94 percent of firms reported this is the case.

There are four ways in which firms might respond to infrastructural deficiencies: (1) relocation, (2) factor substitution, (3) private provision, and (4) output reduction. In our study, we found that there exists an additional response mechanism: product substitution. Each of these response mechanisms is discussed below.

- *Relocation*. There was no evidence of firms relocating to other areas to obtain an improved electricity supply. Electricity problems are widespread.
- *Factor substitution*. There was much evidence of factor substitution, for example, adjusting the mode of production in favor of less electricity-intensive inputs, usually with sub-optimal technology.
- *Private provision.* As noted earlier, nearly all Nigerian firms have private sources of electricity generation and supply to substitute for public provision. It is not uncommon for firms to operate their generators even when the public supply is available (for example, a continuous manufacturing process is sometimes required and the switch-over process from one power source to

Table 2.4. Percentage of Firms with Private Generators

	Location			
Number of Employees	**East**	**North**	**South**	**All**
20–49	93.3	91.7	94.1	93.4
50–99	100.0	100.0	94.2	97.4
100–199	100.0	100.0	100.0	100.0
200–499	100.0	100.0	100.0	100.0
500–999	100.0	100.0	100.0	100.0
1,000 and over	66.7 [a]	100.0	100.0	94.1
All	95.7	98.2	97.7	97.4

[a] *One of the four firms in this category did not have a generator for production but for other purposes.*

another would damage the material being processed). It is becoming more difficult for firms to provide their own power because they now have to get permission from NEPA to import generators.

- *Output reduction.* Firms commonly reported output reductions due to deficiencies in the public provision of electricity. A loss of up to 30 percent is not uncommon.
- *Product substitution.* Several firms noted that the mix of products they produced was influenced at least in part by the power deficiencies. (For example, a pharmaceutical company switched to products for which the demands of refrigerated storage were less critical.)

Firms are spending a considerable amount of capital on the private provision of electricity. On average, generators and accessories such as cabling represent some 22 percent of the total value of equipment and machinery. Firms also bear extra ongoing capital costs for the maintenance of their equipment and machinery because of power fluctuations and cessations. On average, damage to equipment and machinery accounts for 3.3 percent of total value of equipment and machinery.

There is a substantial difference between the costs of publicly and privately provided electricity. On average, the cost of privately provided electricity is 2.42 times more than that provided by NEPA—N19.05 per KwH compared with N7.86 per KwH.[4] Both costs can vary considerably. The variation of the cost per KwH of publicly provided electricity is due to the "demand charge" that can vary from 5 to 461 percent of the consumption charge. The highest cost of electricity per KwH is 3.89 times the lowest cost, while the highest cost of privately provided electricity is 4.4 times the lowest cost. Variation in the cost of privately provided electricity depends mostly on the variation in the cost of fuel and the efficiency of the generators, which is heavily dependent on the age of the generator and the quality of the servicing and operation.

Access to Finance

In a continent where finance is a major constraint on development everywhere, the problem confronting the private sector in Nigeria—above all SMEs—stands out. Enterprises suffer from high interest rates, terms of rarely more than one year, collateral requirements that are heavy and exacerbated by land-titling problems and an absence of equity capital. Other financial instruments, such as leasing, remain underdeveloped.

Most large-scale enterprises in Nigeria have reduced their borrowings from banks due to high interest rates and the short-term nature of available loans. At the same time, banks are unwilling to lend to the SME sector with its high perceived risks. They are not actively lending to the real sector, and loanable funds are currently used to finance primarily consumer imports and to speculate in foreign exchange markets.

The Enterprise Perspective

Two recent analyses that have looked at the issue of access to finance for the private sector are the SME Map and the RPED Survey of Nigeria. The SME Map focused specifically on SMEs using an interview and focus group methodology, whereas the RPED Survey used structured questionnaire interviews and included larger firms and foreign firms in its survey of 232 companies in the manufacturing sector.

According to the findings of the RPED Survey, inadequate access to finance ranked as the third most important constraint on the activity of private firms after infrastructure problems and the general uncertainty in the business environment. The high costs and limited availability of credit is a major factor that raises the cost of doing business and lowers the competitiveness of the Nigerian private sector.

The survey reports that 38.5 percent of the full sample of firms considered themselves to be credit constrained (see Table 2.5). Predictably, a breakdown reveals that the proportion is higher the smaller the

Table 2.5. Percentage of Firms Reporting Being Credit Constrained*

Group	Percentage
Full Sample	38.5
Micro	48.2
Small	38.6
Medium	36.7
Large	36.1
Very Large	25.0
Foreign Owned	33.3
Indigenous	42.5

Definitions used: micro (<50 employees), small (50–99 employees), medium (100–200 employees); and large firms (200–499 employees).

size of firm with 48 percent of microenterprises viewing credit as a constraint, but only 25 percent of very large enterprises. Also, indigenous companies were far more credit constrained than were foreign companies.

These proportions could easily have been higher. The findings, however, may reflect such issues as a lack of awareness among entrepreneurs of how greater access to capital might be effectively mobilized or their access to finance is something of a moot issue given other problems of uncertainty and poor infrastructure. For example, 50 percent of surveyed firms said they had never applied for a loan—over half of whom did not cite high interest rates, heavy collateral requirements, or expectation of rejection as a reason.

Seventy percent of the RPED survey sample had access to overdraft facilities, and most bank debt takes this form. Overdrafts are commonly rolled over (unless a borrower's financial situation changes) and are often used to finance longer-term investments. Overdrafts must be fully collateralized, and interest rates range from 25 percent for small and micro firms to roughly 21 percent for large firms. Short-term loans have similar interest rates, and many firms treat these interchangeably. Short-term loans, based on the survey sample, typically required 151 percent of the loan value in collateral, thus tying up substantial assets.

Long-term finance is very rare and only the most creditworthy have access to it. Less than 16 percent of the sample reported having loans of more than one year in term, mainly medium and large firms. Service sector companies such as hotels have better access to long-term loans because of collateral availability.

Another source of external finance for Nigerian companies is trade credit, that is, short-term credit extended by companies to their suppliers, and by companies to their customers. Seventy-five to 80 percent of the RPED sample reported giving or receiving trade credit. However, the practice is not as widespread as it could or should be, with trade credit being extended only to the most valued and trusted customers due to the lack of confidence in the legal system to enforce contracts. Among SMEs there is anecdotal evidence of widespread "reverse" credit with larger companies effectively using suppliers as a source of credit, receiving goods and not paying for them for extended periods.

Financial Institutions' Perspective

Banks insist that they would like to make more loans to industry, but there is a common belief among many that lending to the manufacturing sector is not justified in terms of balancing risk and cost. This perceived risk is attributable to a number of factors:

- There is difficulty in obtaining accurate and reliable information on a firm's true financial condition and performance.
- The judicial system makes contract enforcement difficult.
- Shareholders naturally expect that banks will pursue the best absolute and risk-adjusted returns

whether through government paper or quick-turnover loans against shipments of imported products.

- The risky, uncertain business environment leads to the fear that firms will not be able to repay debt, and this is reinforced by a history of SME non-repayment
- Loan officers are not sufficiently trained in the skills and methodologies for discriminating between high- and low-risk SMEs.

Consequently, banks charge high interest rates, demand high levels of collateral, and make few loans of more than a year in term. The authorities in Nigeria are working to tackle some of these problems. This includes the recently launched Small and Medium Industry Equity Investment Scheme (or SMIEIS, under which 10 percent of commercial banks' pre-tax profits will be earmarked for equity investments in SMEs) that the banking industry is supporting. Implementation of these various schemes will need to be carefully handled to realize the objectives laid out for them.

There are, currently, some market pressures to downscale lending on the part of the banks. This stems from the fact that most large enterprises have reduced their borrowings from banks due to high interest rates and short terms. As things stand, a number of banks are chasing after a dwindling amount of low-risk, high-return business, and margins are falling. The declining amount of real sector business from large companies could result in more speculative activity such as foreign exchange "round-tripping," consumer import financing, or purchases of high interest rate treasuries issued by the government to mop up excess liquidity and support the exchange rate. Additionally, over time, more of the larger firms may be able to raise necessary finance from the equity (or bond) markets, especially with the advance of the privatization program. Development of the insurance and pension industries also needs to be encouraged to channel this natural source of long-term funds into the domestic financial system.

If bank incentives to look to less traditional markets, including possible downscaling their lending activity to SMEs, is to be effective, banks and other financial institutions will need to develop a greater capacity to assess SME credit risk and manage SME portfolios. This translates into a great need for training of loan officers and equity managers and for introducing best practice mechanisms for assessing SME risk, such as credit scoring and credit bureaus. The capable and viable SMEs themselves also need to learn to differentiate themselves from their less-able counterparts. Entrepreneurs will need to be trained in how to manage credit effectively. Finally, it is worth noting that the governor of the Central Bank is well aware of these problems and is trying to address the issues discussed above. Legislation regarding the reform of the financial sector is pending; this legislation is certainly a step in the right direction.

Privatization Effort

Previous attempts to improve public enterprises in Nigeria had been ineffective. Recognizing this, the FGN passed the Privatization and Commercialization Act of 1999. This act was based on the government's realization that far-reaching, market-oriented reforms were necessary to achieve the efficiency gains of private participation. The act established the National Council on Privatization (NCP), chaired by the vice president, to oversee the privatization program. It also stipulated that the Bureau of Public Enterprises (BPE) be the implementation agency and secretariat to the NCP. In July 1999, the FGN adopted a three-phased privatization program for the 1999–2004 period:

Phase 1: Full divestiture of FGN's shares in banks, cement companies, and oil marketing firms listed on the Nigerian Stock Exchange;

Phase 2: Full divestiture of FGN ownership in hotels, vehicle assembly plants, and other industrial, agricultural, and service sector enterprises operating in competitive markets; and

Phase 3: Partial divestiture of FGN shares in major public enterprises operating in non-competitive, but potentially competitive, sectors such as the telecommunication company (NITEL), the national power company (NEPA), Nigerian Airways, and the oil refineries, as well as privatization of two major fertilizer companies.

Phase 1 is now nearing completion after delays due to problems in completing the sales of some companies jointly owned with state governments, notably in the cement sector. Of 100 private enterprises in the FGN's privatization program, over 50 are in phase 2. The FGN has also advanced the privatization of selected private enterprises from phase 3, notably those representing the most pressing constraints to the economy and requiring major sector policy reforms. However, the privatization of NITEL has run into difficulties, which are described in detail in the appendix to this document.

Overall Program Objectives

The objectives and specific goals for achieving progress in privatization during the next several years are outlined below.

- *Expanded private investment, productivity, and employment*: Under the FGN's privatization program during 2001–2005, about one hundred private enterprises in industry, agriculture, services and infrastructure will be transferred to private ownership. This will reduce fiscal drain to PEs and is expected to accelerate economic growth through significant improvements in output, investment, efficiency, and employment in the privatized and liberalized sectors. In addition, privatization will contribute to capital market expansion.
- *Increased private participation and efficiency in infrastructure:* In the telecommunications area, licenses for mobile telephony have begun to be sold. In electric power, NEPA will be restructured from a fully integrated utility into separate business units for transmission, generation, and distribution by the end of 2002. Some generation plants are being concessioned to private operators during 2001 and 2002, distribution entities will be privatized in 2003 and 2004, and some generation plants will be sold to private investors and operators from 2003 to 2006. In the Lagos State water sector, an international tender for private sector participation through concessions took place at the end of 2001.
- *Creation of competitive and transparent markets and regulatory frameworks in infrastructure:* The FGN will create pro-competitive regulatory frameworks, with cost-effective institutional setups, for the principal infrastructure sectors to be privatized. This will permit entry of new private operators to a competitive, level playing field. In telecommunications and electric power, FGN has adopted policy statements that clearly differentiate the public and private roles and responsibilities in terms of policy making, regulation, and ownership. Based on these statements, new telecommunications and electricity laws were presented to the National Assembly for approval. The Nigerian Communications Commission (NCC), as an independent agency, will extend its mandate to regulate all telecommunication services and infrastructure providers. A new independent agency will be established to regulate the power sector.
- *Increased basic infrastructure and utilities in rural and urban areas:* The Privatization Support Project supports expanded and lower cost access to

basic infrastructure services, through expanded private participation in these sectors:

(a) *Telecommunications:* Tele-density will be increased to over one line per 100 inhabitants by 2003; and the number of villages with access to communication facilities will be doubled by 2005. In combination with Global System for Mobile Communications (GSM) lines (800,000 of which are already in place), there could be a real revolution in the telecommunications sector. It is worth noting that GSM technology has already vastly improved telephone access and doubled capacity in many areas of the country.
(b) *Electric power:* Metered connections will be increased by 1 million households by 2006, from the present level of about 2.5 million, and operational generation capacity and revenues earned will be increased substantially. BPE's intention is to disaggregate NEPA into generation, distribution, and marketing entities and to privatize the power sector altogether. The government hopes to disengage from the power sector completely while simultaneously breaking NEPA's monopoly on production. Eventually, Nigeria plans to be part of an Economic Commission of West African States (ECOWAS) power grid, where multiple sources will be connected to supply power to much of West Africa.
(c) *Water:* Water production by Lagos State Water Corporation (LSWC) will double by end-2005 through the efficiency gains of private operators in terms of market coverage, reduced technical losses and customer billings and collections (which will increase by 50 percent).

- *Reduced public deficit for private enterprises, notably in infrastructure:* The fiscal drain from private enterprise claims on FGN's budget will be reduced in two areas: (a) in telecommunications, tax revenues from service providers will substantially increase; and (b) in electric power, FGN funding for rehabilitating NEPA's generation and distribution facilities will cease from 2003. In the Lagos State water sector, government subsidies will cease, but concessional finance will be sought and on-lent to private operators.

Finally, it is worth noting that BPE has made a strong effort to engage in a public dialogue regarding privatization. BPE has been involved in high profile events including events in London and other cities abroad to inform potential investors regarding investment opportunities in Nigeria.

Corruption and Administrative Barriers

Corruption

This is perhaps Nigeria's most debilitating problem. In recent years, the country has consistently been placed at or near the bottom of corruption surveys such as that of Transparency International.[5] However, it must be emphasized that the current government has made fighting corruption a priority and has taken significant steps to curtail the problem. These have included passing the Corrupt Practices Act and establishing the Independent Corrupt Practices and Other Related Offences Commission, which was called for in the legislation. In so doing, it has also begun to tackle the perception of the acceptability of corrupt practices, which most Nigerians have grown to view simply as a fact of life. But this remains a huge challenge for the country, and progress has been modest. For example, it took over a year until the commission came into operation in late 2001. The inevitable delays in moving from institutional investments to change on the ground have resulted in very little change in the attitude of the private sector. From their perspective, the new thrust of the government does not appear to have changed the reality on the ground for most businesses, where corruption remains a fact of life. It will probably be a while before the government's actions have an impact on the private sector. Success in this very important area will most likely be gradual.

Corruption has a direct effect on the private sector, in that it makes participation in corrupt practices some of the most lucrative forms of business. It fosters non-productive pursuits such as brokering contracts, providing middleman services in the diversion of funds, and developing uncompetitive firms in construction and other services that rely on patronage in winning contracts rather than their capacity to perform, cost-effectiveness, and efficiency. Those administrative procedures most susceptible to corruption are also listed as major obstacles to doing business in Nigeria. These include customs, obtaining investment incentives, administration of taxes, obtaining duty exemptions, and government regulation. The legal and judicial system is another area highlighted by firms as being a significant brake on business activity and subject to corrupt behavior.

Firms' complaints about corruption often depended upon the degree to which their activities were subject to extensive regulation, such as in telecommunications, or depended upon frequent interfaces with government services, such as customs. While more optimistic that the new government was serious about combating corruption, many firms found no improvement over the past year in this regard. These informal results were mirrored as well in the RPED survey of manufacturing firms. Here the largest problem associated with taxes, for example, was that the system of administration encouraged simple harassment of formal sector firms because they were visible targets for tax inspectors, consultants, and others looking for a bribe. The uncertainty and multiplicity of "visits" by tax authorities was much more of a negative factor than the ultimate tax burden. Furthermore, firms reported that they disregarded most tax incentive programs because it was possible to negotiate one's own "tax incentives."[6] The firms surveyed reported similar problems in other matters including parastatal utility services. Corruption in Nigeria has, over the longer term, led to a long list of impacts on the private sector:

- **Public policy:** The impact of corruption and poor governance under the succession of military regimes has created deep-seated anomalies in the business environment and undermined the effectiveness of traditional policy instruments.
- **Infrastructure:** The poor state of infrastructure in Nigeria can largely be attributed to mismanagement by parastatal monopolies.
- **Undermining public institutions:** Rent-seeking activities within public sector organizations have compromised their credibility and encouraged firms, unable to exploit the situation, increasingly into informal sector practices.
- **Undermining of legitimate public sector functions—taxation:** The ability to circumvent payment of taxes through payment of bribes, compounded by the lack of institutional capacity in the public sector, has led to widespread and recognized evasion. During interviews conducted for the survey, the level of tax rates was identified by only a small number of firms as a constraint. Most admitted non-payment of corporate profits taxes, with the exception of banks and listed companies.
- **Undermining of legitimate public sector functions—trade policy:** As noted above, levels of protection in Nigeria are relatively high, and for some sectors, extremely high. Yet, whatever the wisdom of a protectionist trade policy, it is undermined by widespread smuggling and duty evasion. The textile industry, for example, complains of the barrage of legal and illegal imports that pay no duties, against which domestic firms cannot compete. In petroleum products, subsidized prices have meant large profits for those who can ship products across the border into neighboring countries to sell them at world prices, so that Nigerian consumers get no

benefits while the government directly supports the profits of the smugglers. While porous borders are a common phenomenon in West Africa, the degree of smuggling and evasion of duties appear to be more elevated, in particular due to the high tariff levels and the persistence of subsidies, as in petroleum products. In an attempt to reduce duty evasion, the government recently instituted a 100 percent inspection requirement at the port of Lagos. This has simply raised the stakes in the game and in the process significantly increased congestion and delays associated with clearing imports.

- **Undermining of legitimate public sector functions—business regulation:** Beyond taxes and customs, many business regulations also suffer from uneven enforcement. For example, environmental regulations are poorly enforced, even though there has been a great deal of effort placed in developing those regulations. In other areas such as labor regulation, a similar situation prevails where there is little enforcement, and attempts at such can be routinely evaded by paying bribes.
- **Discrimination against SMEs:** Corruption in Nigeria has meant that smaller firms are routinely disadvantaged compared to larger competitors. This is a direct factor in procurement, especially at the state level where SMEs are competing, and where larger competitors with better connections and more experience can effectively shut them out in arranging government contracts.
- **Barrier to entry for potential foreign investors:** Corruption constitutes a significant barrier to entry for new foreign investors, who may not have political connections, or cannot be sure that those they establish will be sufficient to navigate the complicated maze of doing business in the country.
- **Business ethics:** There has been a breakdown in private business ethics that further complicates standard business operations in the country.

A related factor is the lack of physical security and high crime rates in Nigeria. Crime and security were ranked as a major constraint (in the top three) by 15 percent of the firms in the RPED survey; however this was much higher in Lagos than in other regions. The lack of security generally in society has several impacts on business operations. These include the obvious excessive security costs, but there are also indirect costs. These indirect costs are exemplified in the inability to travel easily at nighttime, the higher cost of attracting and housing expatriates, high risks to keeping cash on hand (in an economy that functions largely on cash), and difficulties extending distribution areas due to the threat of robbery. Concerns over the problems associated with security and crime were greater with foreign firms in the RPED survey.

Administrative Barriers

Companies in Nigeria, whether foreign or domestic, face numerous administrative barriers or red tape as they seek to establish and operate businesses. Such barriers typically result from a combination of unnecessarily complex procedures and the aforementioned corruption that those procedures invite and sustain. The Technical Paper on the Business Environment, as well as the Financial Intermediary Advisory Service (FIAS) report and the U.S. Agency for International Development (USAID) Administrative Barriers Study on which it draws, gives an exhaustive account of these barriers.

In many cases, Nigerian laws are of good quality. It is their enforcement through the legal and judicial system or their implementation through the administrative system that is, inadequate. Nigeria's legal and judicial environment is in desperate need of reform. The commercial legal framework—especially the ability to enforce property rights, contracts, and have an accessible and impartial venue for dispute resolution—is a key element of an enabling environment for private sector development. The legal and judicial system is important both in terms of resolving disputes among private parties, but also in those between private sector and government. Given the scale of government in Nigeria and the legacy of poor governance, the latter is especially important.

Businesses must run a gauntlet of administrative procedures to establish and operate a business, and invariably complain about the very poor quality of government services. Mid-level and front-line civil servants tend to unwilling to take responsibility or make decisions, slow to process routine applications, and often looking for rent-seeking opportunities. Reportedly, personal influence and monetary inducements play a very important role in determining the speed and outcome of a bureaucratic approval. The inadequate telephone system, poor service in government agencies, and the difficulties that many business people experience arranging appointments with public officials make consultation and problem resolution difficult and time consuming. All in all, without contacts and the lubricant of bribes, projects typically fall behind schedule and run over budget for large companies. The effect of such rent seeking and delays on SMEs, who rarely have the resources or the leverage, is all the more damaging.

The administrative process is made even more complex by the multiple, and often overlapping, jurisdictions of federal, state, and local governments in various aspects of commercial activity. Many procedures that fall under federal jurisdiction, such as customs, immigration (for foreign firms) and some taxation matters, are problematic and need urgently to be streamlined. This is a top-down agenda, where the federal government needs to show that it is serious and making a difference. However, it is often procedures at the local and state government level that constitute the biggest barriers, not only for small domestic companies, but also for foreign ones. Firms routinely cite examples of state and local officials imposing myriad arbitrary taxes, permit requirements, and licenses in an attempt to raise revenue from companies situated in their jurisdictions. Some companies report that state and local officials, occasionally accompanied by local military or police officers, routinely ask companies to pay new taxes and fees, clarify plans, and submit additional documents—or face being shut down.

These state and local barriers to doing business necessitate a bottom-up agenda. A more detailed analysis of the statutes, regulations, and mechanisms governing state and local power in relation to federal power would be helpful in assessing the extent to which these problems of deficiency in design of legal and regulatory framework or in its application by state and local officials. However, dealing with these problems will require a different mindset, and vastly more proactive, public and private sector institutions at the sub-national level.

In summary, from a legal, administrative, and corruption perspective on doing business in Nigeria, the following issues are key:

- The legal and judicial systems have been severely run down and in their current form do not offer a reliable basis for dispute resolution, protection of property rights, and enforcement of contracts.
- The tax system is complex, poorly administered and widely evaded.
- Business establishment procedures are complex and lengthy.
- Customs and import/export procedures are poorly administered and subject to widespread evasion.
- Governance and policy formulation are weak at the state and local level and create a complex web of overlapping taxes and regulations.
- Public and private institutions are weak and require significant strengthening to be able to bring about positive change the business climate.

Public and Private Sector Institutions

Nigeria realizes the importance of rebuilding the public and private sector institutions that have suffered from many years of neglect, distortion under military regimes, or international isolation from best practice. The private sector, meanwhile, has lost faith in the ability of public sector institutions to deliver support. Similarly, private sector institutions, and in particular business membership organizations, have lost much of their capacity for service provision and have suffered from relatively inactive memberships in an economy where companies have often survived through carefully nurtured contacts or opportunistic trading activities. Furthermore, there has been very little institutionalized interaction between businesses or private sector organizations, and the different levels of government.

In assessing the role of institutions in stimulating and supporting growth of the private sector in Nigeria, it is useful to identify five key groups of institutions or mechanisms. Below we shall look briefly at their current capacity to support private sector growth, and some priorities for each.

Federal Government Agencies / Institutions

Many of the institutional issues that need to be dealt with at the federal level are well known and are being undertaken with some seriousness. Privatization, trade and customs reform, some judicial reform and capacity building, intellectual property rights, the anti-corruption commission are a few examples. But probably the most important and difficult issue relates to efforts to reduce the size of the government-public sector and to deal with the issue of oil revenue distribution to lower levels of government.

State and Local Governments and Their Agencies

The performance of federal government agencies and the distribution of oil wealth are pressing areas for reform, but there is much critical work also required at the sub-national level. It is at this level that institutions have been weakest and where a vision for local economic development can be realized. A vision and successful agenda for local economic development can exist where the political economic unit is large enough to wield resources, yet small enough for the corporate and individual constituents to see the effect of policies and actions. This has been a key reason for the success of certain sub-national regions in the United States and Europe, as well as that of the coastal regions of China, Singapore, and Ireland. In some cases, this happens at the national level, but Nigeria is too big for that.

The Niger Delta Development Commission (NDDC), established in 2000 to promote non-oil sector development in the Niger Delta region, is a test case in many ways. It replaces the ill-reputed Oil Mineral Producing Area Development Commission (OMPADEC) that was widely viewed as a corrupt. Besides the credibility factor and the high expectations that have been placed on it (leading to high pressure to deliver), NDDC faces other big challenges such as the social instability that characterizes the Delta region. If the new organization fails, it could do more harm to the region's future prospects and reputation than if no new organization had been attempted. Yet NDDC has tremendous opportunities if it manages to capitalize on its oil resources to promote the entrepreneurial capacity that exists in the region. In this respect, NDDC has identified SME development as a core element of its mandate and is considering setting up a special SME unit. The importance of NDDC is recognized in its high level supervision through the President's Office. The World Bank and other international or bilateral organizations are keen to support it through technical assistance. A World Bank project is in preparation at the current time to support NDDC.

For reform and progress to be made, if the credibility of the public sector in the eyes of business is to be restored, the public sector will need to strive to commit itself to establish performance criteria against which relevant government agencies and functions can be assessed in terms of the regularity, transparency, and effectiveness.

Public–Private Dialogue Mechanisms

While there is much to be done to improve the effectiveness of public-private dialogue in Nigeria, the new administration has demonstrated its belief in partnership between the private sector and the public sector. It has not only consulted but also works closely with the leadership of the organized private sector (OPS). There are a number of committees and advisory bodies on ground. Meanwhile the private sector has intensified its advocacy. Most associations are in the process of strengthening their organizations and capacities to improve services to members and fortify their advocacy.

There is a legacy to be overcome if this new momentum is to realize some tangible results. Public–private interactions in the past have typically been of two kinds:

1. Groups of companies or organizations seeking particular tax advantages or protection for individual industries or sectors. Government officials interpreted this as the private sector being "too dependent on government," while for the private sector it has been a matter of survival or normal rent-seeking practice;
2. Individual companies meet with government officials to negotiate tax bills or various licenses, because one-on-one interaction is the only approach when corruption is effective or necessary and because business associations did not fulfill a policy advocacy role.

At the federal level, the Nigerian Economic Summit Group (NESG) has emerged in the last few years as the foremost forum for public–private interaction and debate on business and economic issues. For instance, NESG was instrumental in fostering the public-private dialogue that led to the formulation of Vision 2010, one of the first attempts to articulate a common agenda for Nigeria's socioeconomic development. This is a positive development, and there are many policy and administrative issues that do need to be dealt with at the highest levels.

There is also a huge potential benefit to be gained if increased public-private engagement could be replicated at lower levels of the administration, and at the sub-national level. The NESG has recently established an SME Working Group that seeks to deal with these and other issues. This dialogue is crucial and could be led by business associations in collaboration with sub-national governments.

Business Associations

Business membership organizations have a very important role to play in helping especially smaller enterprises address policy, business regulation, infrastructure, and other constraints. This is particularly true for SMEs, which are often "too big to hide, and too small to fight"—that is, they do not have the power to influence government on their own but cannot hide in the informal economy to fight off predatory officials. Consequently, they suffer disproportionately from bureaucratic burdens, red tape, high taxes, and poor government policies. These are constraints that well-organized business associations with strong membership bases can help them overcome.

Nigeria has a large number of business membership organizations. These include several horizontal groups, like the Chamber network (the Nigerian Association of Chambers of Commerce, Industry, Mines, and Agriculture, or NACCIMA, and its regional chapters), the Manufacturers Association of Nigeria (MAN), the Nigerian Economic Summit Group (NESG), the Nigeria Employers' Consultative Association (NECA), the National Association of Small and Medium Enterprises (NASME), and the National Association of Small Scale Industries (NASSI), as well as a number of sector-specific associations. These associations are at very different stages of development and have varying strengths and weaknesses. However, most of them, from the oldest association—the Lagos Chamber of Commerce and Industry (LCCI), founded in 1888—to the most recently established ones—Nigeria Business Women Forum (NBWF)—are in need of capacity building. They need to upgrade their organizational structures, membership services, and lobbying capacity and to develop a strategy to better finance core activities and achieve greater self-sustainability.

The pro-activity of business associations in Nigeria varies from region to region, as does collaboration among them. It is difficult to impose activities or structures, or to demand results from above, especially since umbrella groups are often relatively weaker than the best regional chapters. Rather, business associations are successful when they are embedded in a local economy, and work with local clusters for example. Even in some of the more proactive cases in Nigeria, there is as yet little regular dialogue between businesses, as represented by associations, and local or state governments. Thus, the capacity building needed by business associations is on both the public-private dialogue side (for instance, policy advocacy) and on the membership services side (that is, gathering more enterprises together and serving them better). In November 2001, a Roundtable for Business Membership Organizations was organized.[7] The objectives of the roundtable included fostering such cooperation and identifying the specific needs of selected business associations for downstream capacity building support.

Banks and Finance-Related Institutions

Finally, the financial infrastructure and capacity to support the growth of the non-oil private sector, especially SMEs and the informal sector, is inadequate. Most of the problems and some of the potential solutions and priorities have already been covered in the Access to Finance section above. It is clear that much needs to be done, but also that several positive developments are in progress.

- The SMIEIS is a significant new measure, although it has been surrounded by some skepticism. Great care will be needed in its implementation, but the need for something innovative and the potential positive effects have led to increasing support for the project.
- Commercial banks are gradually finding increased competition and a shrinking market for in their traditional lending segments. Lending to state governments has been curtailed as a result of new regulations. Also, larger, “safer” companies have become more adept at accessing local and foreign currency at better rates than the banks offer. Consequently, some banks are showing interest in learning about technologies and methodologies that can help them lend more profitably to SMEs. These views were highlighted at the Roundtable “Making Small Business Profitable in Nigeria,” held in Lagos in November 2001 and organized by the International Finance Corporation (IFC).
- Better systems for assessing SME risk and for helping SMEs to build up credit and financial records would help stimulate finance to that sector. Credit scoring systems and credit bureaus have been successfully deployed in other developing countries, and should be nurtured in Nigeria. Credit rating agencies do exist in Nigeria, but they focus on larger companies. The point is to make such institutions and practices common elements of SME lending and borrowing.

For many banks, SMEs are new business. Lending demand in the past has been good enough with governments and large companies. SMEs were seen as prohibitively risky, and there was enough profitable business without them. This situation is changing. Banks need to downscale their lending and need the support institutions and training to do this.

Notes

1. WTO 1998.
2. WTO 1998.
3. DFID, *Economic Strategy and Policy: The Way Forward* (London: DFID, July 2000).
4. Many companies also report that invoice details from NEPA are often extremely inconsistent with the amounts of electricity used, and vary widely from one billing period to the next.
5. Corruption Perceptions Indices, on the Transparency International website: www.transparency.de.
6. Results of the Nigeria Firm Survey, World Bank RPED, November 2001, pp. 97–99.
7. "Scaling Up Business Associations in Nigeria: Best Practice Programs and Tools", November 21–22, 2002. Organized by UNIDO and the World Bank Group SME Department.

Introduction

The development of the non-oil private sector is crucial to a country so dependent on a single commodity subject to world price fluctuations and to creating jobs and other income-earning opportunities for the vast majority of a population who gets no benefits from oil. The current difficult predicament is unfortunately coming during a period of fragile democratic consolidation. A more balanced distribution of private sector resources within the economy will mean strengthened linkages throughout different sectors and geographic regions, leading ultimately to greater poverty reduction. Above all, there is a need for proof, in some sectors or in some regions, that the non-oil private sector can achieve sustainable growth and be internationally competitive in the Nigerian context. The energy for this does exist within Nigeria's private sector—the intense trading and entrepreneurial activity on the streets of Nigeria's cities are evidence enough of that—but it needs to be redirected and have a conducive operating environment. A much lower tax rate on productive activity, possible if oil windfalls are well managed, is one option.[8]

As stressed in the introduction, Nigeria is not a poor country, but it has been a poorly managed country with a great source of wealth. That means that properly managed, it can look at solutions that are not open to other countries. For the **government in Nigeria**, this requires a change in mindset at the national and sub-national levels. Government must graduate from a controller/predator mindset to one of facilitation and serving the private sector that drives sustainable growth and employment. Where proactive leadership exists, along with a commitment to public service and equity, transparency, and public-private collaboration, it must be fully encouraged by federal government and outside stakeholders such as the World Bank.

The FGN needs above all to manage windfall revenues from oil better. It needs to distribute those revenues decisively and properly and so reduce dramatically the oil-proceeds "lobbying" efforts that sap or divert so much energy from sub-national regions. Also, it needs to reduce the proportion of GDP that is mediated through the public sector (currently around 50 percent). The privatization process and various government retrenchment initiatives at the center will both clearly help. In turn, a lower proportion of GDP being absorbed by the FGN will make more income available for redistribution and also show that the central government is making the effort to be more effective and efficient—leading by example.

Privatization of infrastructure will contribute to the improvement of vital services for business, which currently impose exceptionally high costs on the Nigerian economy. Almost all firms suffer from serious frequent interruptions of electricity, water, telephone and transport services. The recent telecommunications privatization was an important step forward, although its full impact will not be measurable for some time. The privatization of electricity generation and provision is perhaps the number one priority for the government, and depending on its level of success will have a tremendous impact on the operations of the private sector.

In spite of the obstacles described in this assessment, Nigeria has a strong and potentially vibrant **private sector**, which can respond quickly to an improvement in the business climate. The size and capacity in the Nigerian private sector distinguishes it from most other African countries. For example, the leading Nigerian **firms**, often conglomerates, have achieved a scale of operations not possible in other African countries outside of South Africa. Also, leading Nigerian businessmen and managers have often been educated overseas and have business experience in other countries and corporate environments as well as in Nigeria. Many of those now abroad keep a close eye on the business environment back home, and an increasing number are returning to Nigeria out of a combination of patriotism and a desire to do business there. Nigeria's leading firms and business people have often weathered the country's difficult political climate, and while certainly relying to varying degrees on political connections for survival, also would not have maintained their position solely on this basis.

There is also a critical mass of foreign firms present in Nigeria. While many are concentrated in the oil production and services sector, many are not. Indeed, the non-oil foreign direct investment (FDI) alone is on a scale far greater than that of most other African countries. Although many multinationals exited Nigeria during the years of military rule, those that stayed have developed means of coping with the challenges in the investment environment and are highly profitable. A number have begun to expand with the improvement in the political situation that came with the Obasanjo government, often while applying their international standards of corporate governance and corruption. Major international firms such as Blue Circle Cement, Heineken Breweries, Guinness, Michelin, Citibank, and others have all maintained or expanded their Nigerian operations.

Nigeria's **financial sector** also has a scope and depth lacking in other African countries. Of the 80 or so commercial banks, a small group is well managed, financially sound, highly profitable, and expanding at a rate of over 20 percent per year. They are providing important financial services and innovation to serve new markets and develop new financial products. At least one major international bank has developed its Nigerian business into its most important African operation outside of South Africa.

The size of the Nigerian economy also gives it a natural advantage over most African countries, enabling economies of scale in manufacturing that are not possible elsewhere on the continent. With a GDP of $42 billion and a population of 120 million, Nigeria has a potentially vibrant domestic market for many products. Even after discounting for the large portion of the population in poverty, there is still, by African standards, a relatively large middle class with purchasing power. This creates opportunities in agriculture as well as manufacturing and services. The attractiveness of the Nigerian market was well demonstrated by the interest from cellular telephone operators bidding on national GSM licenses in 2001.

Nigeria's market size is complemented by its energy resources and the economic assets clustered around Lagos. This area is already to some degree a major industrial and financial center but could be much more so if the many bottlenecks to business could be addressed. Lagos could, more readily than virtually any other African city, develop further into a major industrial and financial center that could be the engine for the country's growth. This does not mean that all economic activity must be concentrated here, and it need not contradict Nigeria's stated policy of spreading benefits around to all the states. However, the potential for Lagos, with its location, port facilities, cheap energy supplies, agglomeration of professional and business services, to become a true industrial center is still largely undeveloped. Nigeria should be competitive in energy-intensive industries, taking advantage of low cost natural gas in particular, which to date have been pre-empted by misdirected and mismanaged government owned mega-investments in key sectors such as steel and aluminum.

Several other potential drivers of growth should be mentioned:

- Beyond the assets of Lagos and Nigeria's industrial potential, there is a substantial agriculture/agribusiness sector that has languished in recent years. With an appropriate policy framework and consistent incentives, this sector could once again be a powerhouse of the economy.
- Nigeria also has huge pent-up demand for communications. As the government gradually permits it, private investment flows strongly into this sector. Here again, a stable regulatory

environment will be key to sustaining investment and ensuring it expands access and service as broadly as possible, rather than skewing benefits to favored firms.

- Nigeria's professions benefit from a talented and dedicated pool of human resources that provides the basis for activities that could expand rapidly in a positive environment.

Suggested Priorities and Actions

This report has provided an overview of key issues affecting the development of a vibrant non-oil private sector in Nigeria. It has tried to describe objectively the country's strengths and weaknesses and to bring out its vast potential. At the same time, it has suggested what actions and priorities are needed to release that potential. This final section highlights some specific opportunities arising out of the broader priorities and longer-term agendas discussed above and suggests some other activities that, although not mentioned before, are guided by the same principles and findings.

Sub-National Public Institutions: State and Local Governments

State and local governments have the advantages of smaller size and more flexibility relative to the federal government. In a country the size of Nigeria, activity at this level is a necessary complement to top-down efforts to foster the private sector. A selective program of support to progressive governors and mayors who are actively seeking assistance could bring changes in areas under state and local responsibility such as tax reform, regulatory reform, and privatization. Increasing private sector promotion efforts at the state and local level and providing support for competitive differentiation would be widely popular. Certain infrastructure initiatives could also be pursued, such as business parks if they can be guided by best practice experiences elsewhere where such public-private partnerships are founded on private sector leadership and commercial principles and practices.

Governments at the sub-national level should work more collaboratively with the private sector to facilitate business operations towards the common goal of local economic development. NDDC in the Delta region is an example of a new (or newly reconstructed) institution that has the opportunity to build such bridges. Local governments, business organizations, service providers, nongovernmental organizations (NGOs), international organizations, and others must collaborate to ensure that the mistakes of the past are not repeated.

Sub-national governments also need to pursue vigorously their components of the privatization program to end the drain of parastatals on sub-national resources. Taking the lead from Edo and Lagos, other states could also consider raising money in the future through domestic bond issues for infrastructure projects that could support private sector growth.

Private Sector Institutions and Public Private Dialogue

Business membership organizations have a very important role to play in helping especially smaller enterprises address policy, business regulation, infrastructure, and other constraints. These associations are at very different stages of development, have varying strengths and weaknesses, and have suffered many years of neglect and distorted priorities, but most are in need of capacity building to upgrade their organizational structure, membership services, and lobbying capacity and to develop a strategy to achieve self-sustainability. The World Bank Group and other donor organizations are working with some of the most proactive, both at the national and sub-national levels, to strengthen them through training and the introduction of best practices from abroad. These capacity-building efforts need to be supported by sub-national governments in particular, by recognizing their role in policy advocacy, and by engaging in substantive and regular public private dialogue with them.

Effective public-private dialogue is crucial if the public and private sectors are to work together toward common ends, rather than at odds. The government has taken significant steps to jump-start such a dialogue. At the federal level the NESG is an active forum. A public-private dialogue is most valuable at the grass-roots level where day-to-day issues affecting the health and sustainability of the private sector need to be handled. Sub-national governments and business associations must be proactive, and if this is difficult in the first instance, sub-national leadership in the form of active governors, for example, must be mobilized to catalyze it. Federal government and donor organizations should seek to engage with regions where collaborative energy is greatest. Actions taken at the federal level must be complemented by more activity at the local level. Donors can help in this regard as well.

In some areas of Nigeria, clusters have naturally formed in spite of the problems of doing business in Nigeria. Business associations and governments need to engage these groups of companies as pools of intense entrepreneurial energy that—with the right policy, administrative, and infrastructure support—could transform the Nigerian industrial landscape. For example, the U.N. Industrial Development Organization (UNIDO) and the World Bank Group are developing a program of assistance for the leather product cluster in Aba and the (automotive spare part) cluster in Nnewi, with the active support of respective state governors. The promotion of such clusters can be a vehicle or showcase to promote sustainable sectoral growth, build public-private interaction, and also identify and resolve the administrative barriers faced by companies at the sub-national level.

The Nigeria Investment Promotion Commission (NIPC) is a particularly useful institution for facilitating investment in the private sector. As part of its activities, it

- Coordinates and monitors all investment promotion activities
- Initiates and supports measures that enhance the investment climate in Nigeria
- Promotes investments in and outside Nigeria
- Collects, collates, analyzes, and disseminates information about investment opportunities and sources of investment capital and advises on the availability, choice, or sustainability of partners in joint venture projects
- Registers foreign enterprises
- Identifies specific projects and invites interested investors to participate in those projects
- Initiates, organizes, and participates in promotional activities such as exhibitions, conferences, and seminars and maintains liaison among investors, ministries, and government
- Gives up-to-date information on investment opportunities and incentives available in Nigeria to investors

Recently, the commission's chief executive officer stressed in a workshop jointly organized by NIPC and UNIDO that the new operational philosophy of NIPC is "to be the foremost investment agency and the largest single contributor to Nigeria's economic transformation." This is coupled with a mission "to proactively position and promote Nigeria as a preferred investment destination." In terms of focus, NIPC has as a core purpose "to be a facilitative rather than an approval agency that will advocate de-bureaucratizing and de-bottlenecking the process for investment in Nigeria."

According to the NIPC leader, the six features of the NIPC are: (1) opening of zonal offices, (2) image building, (3) investment generation, (4) investor servicing, (5) investment facilitating, and (6) investment climate improvement. He also highlighted the achievements of the NIPC, such as the hosting of the business and investment forum 2000 in New York; participating at the Nigerians in Diaspora forum in Atlanta and London in 2000; participating at a meeting for Nigerian investment in Hanover, Germany 2000; participating at recent investment forums in China and South Africa as well as being part of the investment component of President Obasanjo's state visits and as an investment facilitator for Nigerian businesspeople and their foreign counterparts.

Tax Reform and Simplification

Tax reform and simplification is one approach that Nigeria can use to encourage sustainable business growth and simultaneously lessen one of the major causes of corruption and insecurity. The taxation system in Nigeria is a major burden on businesses, especially SMEs in Nigeria, not because of the headline rate, but because of the predatory imposition and number of taxes at the sub-national level in particular. These changes, perhaps on a pilot basis to begin with, would be easier to implement than in other African countries because revenue needs are ultimately modest. The Government of Nigeria might consider how this could be ventured and request the necessary technical assistance in designing such a program.

Financial Sector Development

Nigeria needs to finish implementing its key reform efforts in the financial system, in particular the restructuring and merging of three development financial institutions (DFIs) in October 2001—the Nigerian Industrial Development Bank (NIDB), set up with World Bank support and focused on foreign industrial funding; the Nigeria Bank for Commerce and Industry (NBCI), targeted at financing SMEs; and NERFUND, a wholesale institution targeting mainly indigenous SMEs—to form the Bank of Industry (BoI). Although NIDB's performance was relatively good in the initial period, its portfolio started to deteriorate in recent years, just like that of NBCI and NERFUND. The mandate of the BoI, which started operating in early 2002, is the provision of long-term financing through equity or long-term loans, the expansion and diversification of existing projects, and the promotion of a new competitive industry. For the BoI to perform well, it will have to be vigilant in contending with the same structural and policy problems as its predecessors, such as non-commercial governance that compromises essential commercial rigor under the cover of pursuing priority developmental needs. However, the board is expected to have only one representative from the private sector. A new structure and revised standards of operation are necessary to avoid future waste of resources. Also, the process of auditing the community banks for financial soundness and ownership structure is important since this will allow the survival and expansion of the sound institutions among them.

Nigeria is also making efforts to reestablish interest in the capital markets. Currently only the largest firms utilize equity or bond financing as the listing requirements are prohibitive for smaller companies. Corporate governance and transparency standards need to be improved to stimulate broader interest in equities, in which the large corporations, including foreign firms whose affiliates are listed, can play a leadership role. The Corporate Bond market has been dormant for over two decades but could be revived. The Securities and Exchange Commission (SEC) is studying options for encouraging the re-establishment of the market. An initial focus on high-quality issues with credit enhancements from international institutions will probably be needed to establish the market.

Promoting SME Access to Finance

Downscaling lending for SMEs should be a priority for Nigeria. SMEs face continued extreme difficulty in finding term financing. There are innovations beginning in the market, including the Citibank Extended Target Market (ETM) program in conjunction with IFC. Under the SMIEIS, banks will set aside 10 percent of their profit before tax (PBT) for equity investments in SMEs. The scheme is taking shape with banks already beginning to set aside funds, although legislation is still pending in the National Assembly. Banks are also still working on the modalities of how they will implement the scheme and face a deadline of December 2002 for disbursement of the first tranche. The implementation guidelines and measures to prevent abuse of the system need to be clarified before the schemes become operational, and careful implementation and monitoring will be required for it to be successful.

There is a great need for training in loan and equity investment skills in Nigeria to support the SMIEIS and promote downscale bank lending. For SME lending, banks need to have loan officers trained in SME lending skills; SMEs need to be made aware of the importance of credit track records and financial management; and the necessary support mechanisms, such as credit scoring systems and credit bureaus, need to be introduced to the SME sector. One group of banks is also considering the establishment of a banking training school in Nigeria.

Microfinance, although underdeveloped in Nigeria, represents a key source of financial services to the urban and rural poor. These institutions can be encouraged by partnerships with established operators from other countries, donor-supported technical assistance, and an appropriate regulatory framework.

By the end of 2002, the financial landscape in Nigeria, as far as the private sector is concerned, will have changed substantially. Government and private sector support appears to be firm. Nevertheless, careful implementation of the new schemes and governance structures and handling of past non-performing loans are challenges for the next twelve months and will be important determinants of successful reform. One final point is that the success of these bold initiatives will, at the end of the day, depend upon parallel efforts to deal with broader issues in the financial system and the business environment, and on building human and institutional capacity in the financial and SME sectors.

Business Service Provision

Providers of business services to SMEs are in short supply. Those that exist, either as NGOs or private companies, need to build their capacity and reach a wider audience. Those that are normally too expensive for SMEs, but of high quality, could perhaps be engaged to a greater degree through matching grant or voucher schemes, for example. The possibilities for replicating innovative and effective pilots and models such as the Support and Training Entrepreneurship Program (STEP), FATE or the Grow Your Business Program should be considered. The IFC is also seeking to expand the operations of the multidonor-funded African Project Development Facility (APDF) and Africa Management Services Company (AMSCO) that it manages to increase the support they provide to local intermediaries—be they companies or other organizations—that provide various forms of business services to local companies (refer to Section 6 of the Technical Annex for further information on these various initiatives and projects).

Federal Government Priorities

Although many of the suggested priorities and actions above have focused on sub-national governments or the financial-private sector, the federal government clearly has a fundamental role to play. Above all, the federal government needs to concentrate on managing and deciding how to share oil revenues. Satisfying all claimants will not be an easy task, but Nigeria cannot squander the luxury and flexibility of windfall revenues that most African countries do not have.

Federal government must show its commitment to reducing public sector mediation of GDP (currently around 50 percent) through efforts to reduce the size and influence of central government, in particular through continued and concerted efforts on the privatization agenda.

Continued Pursuit of Privatization

The ongoing privatization process is discussed at length earlier in this overview and in the technical papers and has had its successes and failures so far. The privatization of public enterprises, especially in infrastructure sectors such as power and telecommunications, is of immediate importance to improving the operational environment for the non-oil private sector.

There has been some progress in strengthening the institutions behind the privatization yet there is also considerable room for improvement. Extremely difficult and critical cases remain on the priority list. The unbundling of the electric power transmission, generation and distribution units of NEPA and their proposed privatization during the next several years will be an enormous test. It is also of the utmost importance to the private sector in Nigeria, as witnessed by its being the number one constraint identified by respondents to the RPED and other surveys. Continued and concerted efforts on privatization are essential, not just in efforts to improve the environment for private business operations, but also to halt the enormous drain on Nigeria's financial resources that the parastatals represent.

Small-Scale Infrastructure

The provision of small-scale private infrastructure services will increase in importance as the privatization process continues, and there is ample potential for such providers to emerge. They would fill pressing social needs for small-scale provision and offer sustainable employment and business opportunities to a large pool of entrepreneurs. Small-scale providers in both rural and urban areas would be able to service sections of the population that would otherwise be unlikely to have access to utilities, for example, small-scale water systems, off-grid power networks, small-scale wireless telephony, and so on.

Some opportunities for small-scale infrastructure provision are curtailed by prohibitions or laws that reserve these activities for nationally or state-licensed utilities. Lifting these prohibitions would allow these activities to develop where the larger scale services, including new private ones, are absent. It is not a substitute for these large-scale, regulated operations, but it can complement larger formal sector operations. There is ample evidence of the responsiveness of these small-scale private operations from other countries, where service has been expanded rapidly, especially to the poor.

Trade Policy Reform

Regarding trade policy reform, the current positive trend toward an overall decrease in protection should be pursued. There is ample evidence of the benefits of open trade regimes. Also, to be consistent with the previous round of decreases and Nigeria's international commitments (WTO and the customs union) the targeted overall rate of nominal protection should be in the 10 to 15 percent range. Furthermore, Nigeria must meet its commitments to harmonize its tariff regime within the ECOWAS zone.

The excessive current tariffs, set at 100 percent for some goods previously banned from import or subject to import quotas, should be decreased to a more reasonable level in the range of 10 to 15 percent. Another key point is the dispersion of tariffs, which must be reduced. This could be attained either by relying on targeted tariffs that could vary within a limited range or by using a single uniform tariff.

In terms of political considerations, a flat tariff would reduce the incentive for manufacturers to spend resources lobbying the government for higher tariffs, because by doing so they would only be forcing themselves to bear a higher cost on imported inputs and a face a lower price of exports through a real exchange rate effect. A single tariff in the 10 to 15 percent range, applied both on raw materials and final goods would be an appropriate tool.

Finally, trade policy cannot be separated from the macroeconomic context of a country. Of particular importance are developments on the exchange rate front for Nigeria. A stable and competitive exchange rate is crucial for the success of the private sector.

Improving Operations at Lagos Port

A final suggestion relates to the benefits of improving operations at port of Lagos. Doing so would complement efforts in trade policy reform and be a very public example of showing that effective reform can be achieved in Nigeria. Publicly owned port facilities and equipment are especially inefficient and outdated at the Lagos port. Estimates by private shippers suggest that "associated port costs" at Lagos are roughly three times higher than any other West African port, at approximately US$200 per container.

There are many options as to how to achieve an improvement in port operations at Lagos, ranging from complete privatization and contracting out of customs services to a management contract and institutional reform efforts. Contracting out port management to a private firm or privatizing it outright could attract parallel private investment in facilities under an appropriate framework. The design of the reform could draw on some other successful experiences such as the port privatization in Mozambique and the contracting out of customs in Indonesia. Combined with radical changes in customs administration to attack corruption, pushing port operations in this direction could be very advantageous.

Improving the Lagos port could prove politically difficult, however, due to the extensive vested interests of, and political opposition from, customs, port authorities, other authorities (standards and so on), labor unions, and possibly local government. The benefits from successful reform would, however, be enormous, in terms of costs of importing and exporting, in terms of the increased potential of Lagos as a location for international business, and as a global advertisement that the operating environment really is improving in Nigeria.

Note

8. The Republic of Ireland is one example of a country (the size of a state in Nigeria) where a drastically cut corporate tax rate (to 10 percent) attracted much foreign investment (that was also encouraged by access to the large European market) that in turn helped transform the economy over a couple of decades.

Nigeria Private Sector Assessment

Technical Papers

Regional Program on Enterprise Development

Africa Region
The World Bank
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The **Nigeria Private Sector Assessment** is a product of collaboration of the Regional Program on Enterprise Development (Africa Private Sector Dept.), the International Finance Corporation, and the Small and Medium Enterprise Unit. James Emery wrote the chapter on the business environment in Nigeria. Carl Aaron wrote the chapter on finance for the private sector. Paul Ballard and Shenhua Wang contributed to the chapter on privatization of public enterprises, and Vijaya Ramachandran and Linda Cotton made substantial contributions to several chapters. The team also benefited from contributions from our partners; Ravi Aulakh (United States Agency for International Development) and colleagues contributed to the overview of the Nigerian economy, as did Jeffrey Fine.

Much of the statistical data used in this report was generated by the **Regional Program on Enterprise Development** during its firm survey exercise in Nigeria (March-April 2001). This survey was designed and implemented by a team led by Tyler Biggs. The RPED report describing the results of this exercise is available separately and is authored by Jean Michel Marchat, John Nasir, Vijaya Ramachandran, Manju Kedia Shah, Gerald Tyler, and Lan Zhao, under the overall leadership of Ibrahim Elbadawi and Demba Ba. Several organizations and researchers in Nigeria helped with the production of the RPED report; in particular the National Association of Chambers of Commerce, Industry, Mining and Agriculture; the Lagos, Abia, Nnewi, Kano, Kaduna and Port Harcourt Associations of Chambers of Commerce, the National Manufacturing Association of Nigeria and its regional branches, KPMG, and the Nigerian Economic Summit Group especially Mary Agboli. The PSA team would like to acknowledge all of these groups and individuals in Nigeria. Field research and analysis carried out for the PSA and RPED reports was generously funded by USAID and the Department for International Development (UK).

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Vijaya Ramachandran served as Task Manager for this exercise and produced the final document. All queries regarding this document should be directed to her via e-mail at vramachandran@worldbank.org, or to Gerry Meyerman, at gmeyerman@worldbank.org.

This chapter provides an overview of the results from the Regional Program on Enterprise Development Survey, in which Nigerian manufacturing firms participated in spring 2001. The major areas of investigation were: the determinants of productivity, the manufacturing labor market, access to finance, protection of the manufacturing sector, business problems and uncertainty, the cost of electricity and the implications of HIV/AIDS for manufacturing firms.

The Sample

The manufacturing firms interviewed are spread over nine sectors—chemicals/paints, food/beverage, metal, non-metal, paper-printing-publishing, pharmaceuticals, plastic, textile and wood. Firms in five different size classes were interviewed—micro (less than 50 employees), small (50 to 99 employees), medium (100 to 199 employees), large (200 to 499 employees) and very large (500 or greater) and an effort was made to include firms in the East Region, Lagos and the South Region and the North. (Tables 1.1 and 1.2.) Of the 232 firms in the survey, 61 were micro/very small, 47 were small, 51 were medium-sized, 42 were large and 31 were very large.

While making any inference about the broader results of the survey, it is important to keep in mind the major characteristics of the stratified random sample: the importance of firms with more than 500 workers and the prominence the “Lagos and South” region. Firms with more than 500 workers accounted for 65 percent of the sample employment. 53 percent of the enterprises were located in the “Lagos and South” region, which accounts for 57 percent of the employment in the sample.

Table 1.1. Structure of the Surveyed Sample by Sector and Size

Sector	Size	20–49	50–99	100–199	200–499	500 +	Total
Chemicals/paints	Number of firms	9	2	7	5	3	26
	Total employment	213	151	927	1,631	3,591	6,513
Food/Beverage	Number of firms	5	6	9	7	7	34
	Total employment	140	424	1 238	2,175	9,876	13,853
Metal	Number of firms	8	12	12	10	3	45
	Total employment	247	849	1 668	2,783	2,654	8,201
Non-Metal	Number of firms	2	1	2	na	na	5
	Total employment	71	98	342	na	na	511
Paper/Printing/Publishing	Number of firms	12	6	4	5	na	27
	Total employment	351	429	570	1,301	na	2,651
Pharmaceuticals	Number of firms	6	6	4	4	1	21
	Total employment	164	422	589	1,182	4,961	7,318
Plastics	Number of firms	11	6	7	4	2	30
	Total employment	328	393	1,020	1,236	1,352	4,329
Textile	Number of firms	na	8	6	5	15	34
	Total employment	na	539	823	1,517	24,160	27,039
Wood	Number of firms	8	na	na	2	na	10
	Total employment	215	na	na	465	na	680
Number of firms		61	47	51	42	31	232
Total employment		1,729	3,305	7,177	12,290	46,594	71,095

Source: World Bank, RPED Nigeria, 2001.

Table 1.2. Structure of the Surveyed Sample by Sector and Region

		East Region	Lagos and South Region	North Region	Total
Chemicals/paints	Number of firms	5	17	4	26
	Total employment	285	5,281	947	6,513
Food/Beverage	Number of firms	8	18	8	34
	Total employment	2,559	9,523	1,771	13,853
Metal	Number of firms	14	23	8	45
	Total employment	2,590	3,870	1,741	8,201
Non-Metal	Number of firms	na	4	1	5
	Total employment	na	413	98	511
Paper/Printing/Publishing	Number of firms	4	19	4	27
	Total employment	149	2,019	483	2,651
Pharmaceuticals	Number of firms	2	16	3	21
	Total employment	461	6,568	289	7,318
Plastics	Number of firms	6	10	14	30
	Total employment	938	2,177	1,214	4,329
Textile	Number of firms	6	13	15	34
	Total employment	3,546	10,523	12,970	27,039
Wood	Number of firms	2	5	3	10
	Total employment	60	560	60	680
Number of firms		47	125	60	232
Total employment		10,588	40,934	19,573	71,095

Source: World Bank, RPED Nigeria, 2001.

The Determinants of Productivity

Background information on value added per worker is presented first, followed by surveyed firm size and employment over time. Following this discussion is an analysis of various factors of productivity including capital, labor, ratio of skilled to unskilled workers, capacity utilization, age of firm, percentage of foreign equity, percentage of inputs imported, and age of equipment. Concluding the section is a more in-depth look at the role of ownership in productivity.

Value added per worker (measured in US dollars) as an approximate measure of productivity, reveals some interesting differences between various types of firms, (Table 1.3). Value added per worker is (not unpredictably) driven by firm size. The smallest firms have the lowest value added and the very large firms have a value added per worker that is significantly greater than other types of firms. Local firms have less than half the value added of firms with foreign equity and firms owned by Black African entrepreneurs have a lower value added than firms owned by entrepreneurs of Indian, European and Middle Eastern descent.

Value added for the sample as a whole is about $5,000 per worker. However, there is a quite a lot of variance by sector, as seen in Table 1.4. The food-processing sector has the highest value added—over $9,000 per worker. Value added in other sectors is considerably smaller. It is interesting to note that the mean age range of equipment is fairly high—the

Table 1.3. Value-Added Per Worker in USD

	Value-Added/Worker	N
Local	3,137.52 (3,777.80)	93
Foreign	8,790.12 (9,673.41)	78
African	4,460.05 (6,081.85)	106
Non-African	7,791.56 (9,433.69)	63
Micro	2,765.58 (5,663.97)	48
Small	3,859.39 (5,529.24)	42
Medium	5,020.36 (7,258.61)	46
Large	4,198.73 (4,401.79)	35
Very Large	11,094.26 (12,767.19)	28

Source: World Bank, RPED Nigeria, 2001.

Table 1.4. Value-Added Per Worker By Sector in USD

	Value-Added/Worker	N
All Sectors	4,941.55 (7,636.97)	
Chemical	6,122.60 (6,265.81)	25
Food	9,439.04 (13,368.35)	26
Metal	4,380.73 (7,022.35)	42
Non–metal	4,006.01 (3,268.24)	5
Paper	3,242.03 (4,737.46)	22
Pharmaceuticals	3,715.95 (5,102.91)	18
Plastics	5,173.85 (6,919.73)	24
Textiles	3,742.69 (6,506.00)	30
Wood	886.20 (590.51)	7

Source: World Bank, RPED Nigeria, 2001.

mean value is 3.5 on a scale of 1–5, which translates to 10–20 years; and capacity utilization hovers around 50 percent with a minimum value in the sample of 26 percent. Average value of sales per firm is around $10 million, which is substantially larger than average value of sales in most countries in Sub-Saharan Africa. The average number of employees in our sample at the time of the survey was 329, with a minimum of 5 and a maximum of almost 5000. The mean number of employees declined somewhat in the early to mid 1990s and then rose slightly at the end of the decade. Overall, there has been virtually no growth in employment in Nigeria.

Examining mobility from one firm size to another over the period 1990–2000, we see that firms have not been stagnating during this period. A majority of firms have moved up from their initial size class in all size categories, except for the large firms. About 37 percent of large firms remained large, but more than 50 percent of them downsized to the lower size classes. Only 11 percent moved up to the largest size class. All three of the smaller size categories *added* employees during this period. Most of the employment losses in manufacturing came from the largest size class. Insofar as the sector was protected and inefficient before liberalization, falling firm size may, in fact, indicate a move towards greater efficiency. Our sector data show that the average firm size in most sectors has declined slightly except for the wood sector where average employment has risen steadily since 1994.

In almost every size category, Nigerian firms suffered a loss of employment between 1990 and 2000. Average number of employees per firm fell by 12 percent between 1990 and 1994, 7 percent between 1994 and 1998, 5 percent between 1998 and 1999 and another 6.6 percent the following year. The percentage change in mean number of employees between 1990 and 2000 is almost 28 percent. In other words, firms are a third smaller now than they were a decade ago.

Our data show that capacity utilization averages around 52 percent for the entire sample, with very large firms utilizing significantly more capacity (66 percent) than other firms. Foreign and non-African owned firms also have greater capacity utilization than local and African-owned firms.

Tables 1.5 and 1.6 describe various factors driving productivity in the Nigerian private sector. The results are not surprising—inputs of labor and capital are highly significant in determining value added per worker. The ratio of skilled to unskilled workers is significant at the 10 percent level of confidence, as are capacity utilization and age of the firm. The percentage of foreign equity in the firm is a highly significant determinant of productivity and the percentage of inputs imported is significant at the 5 percent level. The age of equipment used is negatively and significantly correlated with value added.

When firms are disaggregated into four categories—purely locally-owned, firms with some foreign equity, firms that are Black African-owned, and firms that are owned by ethnic minorities (referred to in the table as Non-African firms), the results are far stronger for foreign-owned and ethnic minority-owned firms than for locally-owned and African firms. Presumably this is due to lack of variance in locally-owned and African firms. These firms tend to be smaller with lower value added per worker. Finally, it is interesting to note that worker training and the incidence of technical assistance contracts and foreign licenses were not significant determinants of productivity.

Table 1.5. The Determinants of Productivity in the Nigerian Private Sector

Intercept	6.92** (1.05)
Ln(capital)	0.25** (0.06)
Ln(labor)	0.99** (0.12)
Skill ratio	2.18+ (1.31)
Capacity	0.007+ (0.004)
Age of firm	0.01+ (0.009)
Percentage of foreign equity	0.007** (0.003)
Imports	0.0056* (0.0025)
Age of equipment	–0.552** (0.211)
N	134
R-squared	0.73
F-statistic	42.92

Source: World Bank, RPED Nigeria, 2001

Comparative Productivity and the Cost of Labor: Nigeria, Sub-Saharan Africa, and the Rest of the Developing World

The productivity of Nigerian labor is crucial to its competitiveness, both in the short and long term. In particular, it is useful to compare Nigeria to other countries in Asia and sub-Saharan Africa. An examination of the Nigerian wage to value added ratio gives some cause for concern when compared with this ratio in other countries.

One of the key issues in the private sector is the competitiveness of African labor. While some researchers believe that Africa can be competitive in international markets, there is compelling evidence to suggest that there are factors unique to Africa that

Table 1.6. Firm Productivity by Ownership

	Locally owned firms	Firms with foreign equity	African firms	Non-African firms
Intercept	8.29**	7.24**	6.897**	7.09**
	(1.54)	(1.54)	(1.39)	(1.76)
Ln(capital)	0.21*	0.26**	0.23*	0.26**
	(0.09)	(0.08)	(0.09)	(0.09)
Ln(labor)	0.98**	0.91**	1.25**	0.81**
	(0.19)	(0.14)	(0.18)	(0.16)
Skill ratio	0.33	4.62**	0.36	5.69**
	(1.95)	(1.74)	(1.76)	(2.11)
Capacity	0.002	0.01*	0.004	0.009
	(0.007)	(0.005)	(0.006)	(0.006)
Age of firm	0.003	0.018+	–0.0003	0.031**
	(0.015)	(0.011)	(0.0133)	(0.012)
Imports	0.005	0.007*	0.007*	0.008*
	(0.004)	(0.003)	(0.003)	(0.004)
Age of equipment	–0.458	–0.695**	–0.51	–0.551+
	(0.333)	(0.263)	(0.29)	(0.320)
N	71	62	81	51
R-squared	0.57	0.75	0.67	0.72
F-statistic	12.19	24.19	21.59	16.33

Source: World Bank, RPED Nigeria, 2001

have driven the cost of labor higher there than in other countries. A calculation of unit labor cost in Africa compared to other parts of the world is revealing, as shown by Lindauer and Velenchik.[1] Unit labor cost measures the total cost per unit of output in a common currency, which enables international comparisons of competitiveness of labor. This measure is driven by the ratio of wages to productivity and is defined as:

$$ULC = (w.L/Q).(1/e)$$

where w is the manufacturing wage
L is the amount of labor employed
Q is a physical measure of output
e is the exchange rate defined as domestic currency per dollar.

Unit labor costs are therefore high in countries that have high wages and low labor productivity. Apart from overvalued exchange rates that have hampered Africa's competitiveness, the data on unit labor costs show that Africa has higher ratios of wage to labor productivity relative to Asia at roughly equivalent stages of development. When data from Africa for the 1980s are compared with Asian data from the 1960s and 1970s, it is clear that earnings in Africa are about two-thirds higher than was the case historically in Asia, and African productivity is about one-fourth lower.

Two explanations for the phenomenon of high wages are plausible—one is the effect of unionization and labor regulations that have resulted in high wages in the formal sector, and the other is the low man to land ratio in Africa. There is some evidence to back up the theory that non-market forces have resulted in higher wages in Africa, whereas wage increases in Asia have been tempered by abundant supplies of cheap labor. The difference is that the marginal product of labor in agriculture continues to be high in Sub-Saharan Africa. Thus, the relatively high opportunity cost of labor in African manufacturing raises unit labor costs and reduces manufacturing competitiveness. Lindauer and Velenchik also pose a very interesting hypothesis regarding the supply of female labor, which is crucial to the success of countries that have relied on manufactured exports. They argue that in sharp contrast to Asia, African women are productively employed in the agricultural sector. Consequently, unlike Asia, a large pool of relatively cheap female labor is not available for employment in the manufacturing sector in Africa.

Unfortunately, data limitations make it difficult for us to do a unit labor cost comparison for Nigeria. However, we have a cruder estimate to do some comparisons—the wage to value added ratio (or the ratio of wages to productivity). Data on both wages and productivity are available from surveys of manufacturing in many countries. This ratio is useful to consider because we do not have to have an exchange rate conversion to a common currency or physical measures of productivity (which are required for unit labor costs, and are very hard to come by).

A comparison of the current situation in sub-Saharan Africa (and Nigeria in particular) with the historical experiences of already-industrialized Asian economies is revealing. The idea here is to consider Asian countries at points in time when their economic circumstances, particularly with respect to per capita income, were roughly similar to Africa today. Since we may be interested in the ability of African countries to follow the industrialization patterns of East and Southeast Asia, it is useful to compare the current situation in Africa with the historical situation in Asia. A smaller ratio indicates a more competitive labor force and manufacturing sector.

Table 1.7 describes the ratio of wages to productivity (value added) for several countries in Asia and sub-Saharan Africa, including Nigeria in 2001. The ratio for Nigeria in 2001 (0.26) is clearly comparable with that of Asian countries in the 1960s and 70s. It is higher than Taiwan (0.16) but similar to Indonesia (0.21), South Korea (0.26), Malaysia (0.27) and Thailand (0.24). Table 3.9 also shows that the ratio of wages to productivity for Nigeria in 2001 is

Table 1.7. Ratio of Wages to Value Added

Country	Year	Ratio of Wages to Productivity
Africa		
Botswana	1990	0.39
Cameroon	1978	0.39
Cote d'Ivoire	1982	0.31
Ghana	1983	0.23
Kenya	1988	0.41
Madagascar	1984	0.36
Malawi	1983	0.59
Mauritius	1987	0.50
Nigeria	2001	0.26 (0.20 in 1983)
Senegal	1984	0.43
Sierra Leone	1986	0.31
Tanzania	1985	0.35
Zimbabwe	1987	0.37
Asia		
Indonesia	1981	0.21
South Korea	1963	0.26
Malaysia	1970	0.27
Singapore	1963	0.35
Taiwan	1961	0.16
Thailand	1970	0.24

considerably lower than the values for other African countries in the 1980s. However, wage to productivity has risen for Nigeria itself; in 1983, Nigeria was more competitive than it is now, with a ratio of 0.20. This change in ratio is presumably because wages have risen more than productivity in the past two decades.

The Manufacturing Labor Market

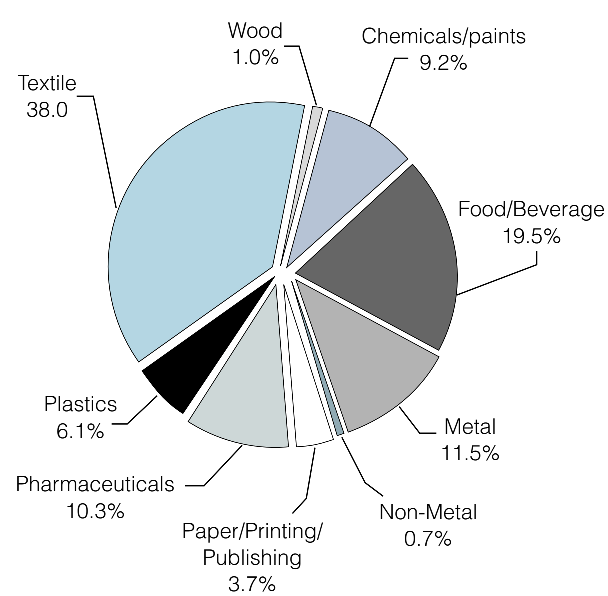
Nigeria is a densely populated country, which had roughly 49 million persons in its labor force in 1999 (World Bank 2001), i.e. about 35–37 percent of the total population. The population and the labor force are on the rise while labor demand is at best stable or even declining. There is a high rate of unemployment. 1998 estimates from the Federal Government indicate that the unemployment rate in the formal labor market reached as high as 17.2 percent in Lagos State (Dabalen, Oni and Adekola 2001). The bulk of unemployed workers feed a growing informal sector. Usually, this informal sector provides a low level of income and sometimes finds itself competing with the formal sector. Overall, the manufacturing labor market is a tiny fraction of the Nigerian labor market. According to the last estimate available, it accounted for about 7 percent of employment in 1990 (World Bank 2001). It is, however, plausible that this proportion has decreased since then, as population grew quickly in the 1990s, and the manufacturing sector was in crisis during most of this period.

A large section of the RPED survey in Nigeria was devoted to the collection of labor data. The 232 surveyed enterprises provided information on a wide variety of issues ranging from technology, finance, the structure and compensation of the labor force, basic accounting data, regulation and infrastructure. Worker interviews, a sample was taken of up to 10 employees in each firm, provided information on their starting and current wages, occupation, union status, education, tenure, apprenticeship history, layoff experience and some demographic data. This section draws on both the general and worker sections of the questionnaire. In the first part, the salient features of employment in Nigerian manufacturing are described. The second part provides information on the characteristics of the workforce. Finally, issues of labor earnings and of wage determination in Nigerian manufacturing are examined.

Structure of the Manufacturing Labor Market. Macroeconomic data suggest that employment in manufacturing has been declining over the years and that the distribution of employment remains quite uneven across regions and sectors. Using our detailed firm level survey data, we examine the patterns of employment within manufacturing, and the changes in employment across sectors during the structural adjustment period (1990–2000).

Within the sample, employment in manufacturing tends to concentrate in the “textile” and “food and beverage” industries, two labor-intensive activities. They respectively account for 38 percent and 19.5 percent of the employment in 2000 (Figure 1.1).[2]

Figure 1.1. Sector Structure of Employment in 2000



Source: World Bank, RPED Nigeria, 2001.

The importance of the southern part of the country is obvious in terms of employment. While about 53 percent of the firms are located in the Lagos area and the southern part of the country, they accounted for about 58 percent of the employment in 2000.

The share of non-production workers in each firm's workforce is of special interest. It is often argued that one possible explanation of the comparatively high cost of labor in Africa is attributable to an excess of non-production workers, the so-called white collars (Mazaheri and Mazumdar, 1998). Previous RPED surveys have found that in other African countries[3] non-production workers[4] comprise between 20 to 30 percent of the workforce. In the Nigeria sample we find about 37 percent of the workforce is composed of non-production workers, a figure higher than in many other African countries, (Table 1.8).

Next, we examine changes in manufacturing employment during the structural adjustment period. Employment data for the period 1990–2000 is available only for firms that existed during the entire period, therefore excluding entering and exiting firms. We see that overall, in our sample, total manufacturing employment over the structural adjustment period declined from 57,114 employees to 52,131 employees, for firms that existed over the entire period. All three of the smaller size categories *added* employees during this period. Thus, most of the employment losses in manufacturing came from the largest size class. This in itself does not reflect

Table 1.8. Percentage of Non Production Workers by Sector and Size Class

		Very Small	Small	Medium	Large	Very Large	Total
Chemicals/paints	Average percentage	63.9	55.3	33.2	41.3	19.5	44.8
	Standard Deviation	*(12.46)*	*(0.39)*	*(14.82)*	*(25.04)*	*(11.09)*	*(21.64)*
Food/Beverage	Average percentage	54.6	37.1	45.3	37.6	38.9	42.5
	Standard Deviation	*(22.33)*	*(13.07)*	*(15.20)*	*(5.88)*	*(9.94)*	*(14.29)*
Metal	Average percentage	47.2	34.8	35.6	32.9	15.2	35.2
	Standard Deviation	*(16.13)*	*(8.81)*	*(16.12)*	*(16.26)*	*(8.97)*	*(15.30)*
Non-Metal	Average percentage	50.0	72.7	35.1	na	na	48.6
	Standard Deviation	*(0.00)*	*na*	*(6.69)*	*na*	*na*	*(15.76)*
Paper/Printing/Publishing	Average percentage	38.7	31.8	37.8	30.1	na	35.5
	Standard Deviation	*(22.46)*	*(6.61)*	*(16.52)*	*(12.28)*	*na*	*(17.05)*
Pharmaceuticals	Average percentage	52.2	45.7	51.0	43.9	na	48.6
	Standard Deviation	*(17.69)*	*(19.25)*	*(14.01)*	*(20.24)*	*na*	*(16.74)*
Plastics	Average percentage	46.6	30.3	30.2	19.8	16.9	34.0
	Standard Deviation	*(20.77)*	*(5.73)*	*(16.66)*	*(15.00)*	*(0.45)*	*(18.39)*
Textile	Average percentage	na	33.2	23.5	25.9	20.1	24.8
	Standard Deviation	*na*	*(12.29)*	*(7.85)*	*(12.85)*	*(11.68)*	*(12.11)*
Wood	Average percentage	40.4	na	na	12.1	na	34.7
	Standard Deviation	*(23.66)*	*na*	*na*	*(1.94)*	*na*	*(24.05)*
	Average percentage	**48.0**	**36.9**	**36.2**	**32.3**	**23.9**	**37.1**
	Standard Deviation	***20.28***	***13.19***	***15.73***	***16.13***	***13.29***	***17.92***

Source: World Bank, RPED Nigeria, 2001.

the process of de-industrialization or stagnation of the manufacturing sector. Insofar as the sector was protected and inefficient before liberalization, decreasing firm size may in fact indicate a move towards greater efficiency.

Apart from the distribution of firms and workers, two other elements may affect the structure of the manufacturing labor market: the type of labor contract in use and the role of labor unions. Most of the workforce in Nigeria—about 89 percent of the workers in the sample—hold full-time permanent contracts in manufacturing firms. The reliance on casual or part time labor contracts is limited, indicating the rigidity of the labor market. The importance of full-time permanent employees may also provide a possible explanation for the fact that manufacturing firms hire only a small number of extra workers[5] when they are in a peak period.

The trade union movement, once a powerful force in Nigeria, was weakened during the 1990s by poor leadership and political repression from the various military governments (EIU 2001). Since the advent of democracy in 1999, labor unions have regained strength and staged several major protests against the administration. They succeeded in raising the minimum wage in 2000. On average, almost 43 percent of the workers belong to a union. This number is higher than all other seven Sub-Saharan African countries examined by RPED.

Characteristics of Workers. Workers employed in Nigerian manufacturing tend to be middle-aged, on average 36 years old. Women are usually younger than their male colleagues. The dominant age group of workers in manufacturing is male employees in their thirties.

The distribution of education level among workers is uneven. While on average workers seem to be quite educated, 12.7 per cent of them did not attend school beyond the modern school. Most of workers went to secondary school (42.3 percent) or followed technical/vocational training (about 25 percent of them). About 18 percent went to universities. Interestingly, no major difference appears between the level of training of men and women. This dominance of the secondary education in the workforce is very similar to what is found in many West African countries but the proportion of employees with higher education is a slightly larger in Nigeria.

The level of education of workers is likely to vary widely according to sector, the size of firms and other stratification variables, (Table 1.9). Not surprisingly, the largest proportion of workers with “high” education is found in sectors with significant technological requirements and relatively high capital intensity, sectors like “pharmaceuticals,” “food/beverage,” and “chemicals/paints.” Interestingly, there is not a clear-cut relationship between the size of the firms and the level of education of the employees, contrary to what is found in some other African countries, Côte d’Ivoire for example.

The educational distribution of workers varies significantly across regions, a fact to be related to the geographical distribution of the sectors. The largest proportion of workers with “high” education is found in the East Region while comparatively the North Region employs more workers with “no or primary” education. Comparatively, firms located in the Lagos and South area tend to use more workers with “middle/secondary” or “technical/vocational” training. Finally, it appears that foreign firms tend to have workers who are more educated than enterprises with local ownership. Usually, these firms tend to operate in more technical sectors where the skill requirements are higher and often provide higher wages, which attract people with better education. The fact that the average level of education of the workforce is higher than other Sub-Saharan African countries may help explain why, according to our discussions with workers, relatively little training is provided.

A factor which may contribute to a segmented labor market in Nigeria is the possible restricted geographical mobility of workers. The distribution of workers by ethnic origin is also very uneven. This

Table 1.9. Education of Workers (R.Pct)

	None or Primary	Middle or Secondary	Technical and Vocational	Higher
By Sector				
Chemicals/paints	8.1	47.2	21.3	23.4
Food/Beverage	8.5	38.8	26.0	26.7
Metal	11.8	37.4	30.7	20.1
Non-Metal	12.2	26.8	46.3	14.6
Paper/Printing/Publishing	6.9	60.4	21.2	11.5
Pharmaceuticals	6.8	42.2	22.4	28.6
Plastics	13.3	41.8	26.0	18.9
Textile	11.1	50.6	21.4	17.0
Wood	20.3	48.1	20.3	11.4
By Size Class				
Very small	12.2	48.4	25.1	14.2
Small	13.9	43.6	26.2	16.3
Medium	9.0	41.2	23.5	26.4
Large	6.1	46.3	22.5	25.1
Very Large	9.2	42.7	29.7	18.4
By Location				
East Region	9.3	43.8	21.6	25.2
Lagos and South Region	8.0	45.6	28.5	17.9
North Region	16.6	43.0	20.2	20.2
By type of Ownership				
Firms with Foreign Equity	9.9	41.7	25.7	22.6
Pure Local ownership	10.8	46.7	24.4	18.2

Source: World Bank, RPED Nigeria, 2001.

suggests that the geographical segmentation of the labor market along ethnic lines remains important. Hence, for Nigerian employees, most workers tend to belong to the dominant ethnic group inside a region. In the East region, home of the Igbo group, almost 70 percent of the workers are from this ethnic group. Yoruba account for 59 percent of the employment in the Lagos and South region while Hausa represent about 27 percent of the employment in the North. Employees of non-African origin tend to locate in the "Lagos and South" region and in the "East" region.

The division of the labor market along ethnic lines is not restricted to geographic location alone. It seems that some groups dominate in manufacturing employment and that some positions are predominantly filled by members of specific ethnicities. The Igbo and Yoruba workers are the dominant ethnic groups in Nigerian manufacturing. They respectively account for about 27 and 39 percent of the workforce. The Igbo and Yoruba groups also provide the bulk of employed managers. They respectively account for about 30 and 39 percent of the managers. Interestingly, most of the production workers also come from these two groups, about 41 percent are of Yoruba origin and 27 percent Igbo. On the other hand, the Hausa group accounts for only 11 percent of the managerial positions and about 9 percent of the production workers. Workers of non-African origin tend to be concentrated in Management or Engineer positions.

Labor Market Earnings. It is often argued that wages are high in West Africa by the standards of low-income countries. In such a situation, understanding the mechanism behind the formation of wages in manufacturing becomes crucial. It seems that the high share of white-collar workers in the total workforce may account for a part of the problem. However, this is just a descriptive element, which tells nothing about the underlying determinants of wages. Preliminary econometric results suggest that wages in Nigeria mainly depend on human capital variables, some specific firm characteristics and a set of variables which account both for a mix of rent-sharing and hold-up mechanisms. In this type of framework, firms must share or give up a part of their profit in response to various pressures, either internal to the firm or sectoral. The fact that most of the labor contracts are permanent and unions are relatively strong can explain to some extent the existence of pressures inside the firms.

In general, the labor market in Nigeria is far from integrated. Moreover, any attempt at containing wage growth in the manufacturing sector should focus first on the role of unions and the bargaining power of workers. In the Nigerian context, infrastructure issues make it such that every single worker has a possibility of stopping production at will. They are thus a factor in any intra-firm wage negotiation. The erstwhile result of this is that improving the infrastructure of the country, might provide, quite unexpectedly, a way to moderate the growth of wages in the medium term, which would help regain or maintain competitiveness.

Access to Finance

According to our survey data, lack of finance is a key problem in the Nigerian manufacturing sector, (Table 1.10). While almost all firms have relations with banks and are able to access at least some external finance, it is very costly and for most firms, insufficient. Inadequate access to finance appears among firms' three biggest business problems more often than any other problem except uncertainty and poor infrastructure. The high cost and limited availability of credit is a major factor that raises the cost of doing business and lowers competitiveness in Nigeria.

Firm Level Access. The bulk of available credit comes from domestic banks and almost all loans are

Table 1.10. Percentage of Firms Reporting Being Credit Constrained

Group	Percentage
Full Sample	38.5
Micro	48.2
Small	38.6
Medium	36.7
Large	36.1
Very Large	25.0
Foreign Owned	33.3
Indigenous	42.5

in Naira. Although banking facilities are widespread throughout the country, only 23 percent of the sample reported having bank loans (this does not include overdrafts) and 20 percent of the sample said that they had been rejected for a loan sometime in the past. More than half the firms stated that they had never applied for a loan. Almost half of these firms said they would like a loan, but that interest rates and collateral requirements were too high or that they did not think they would be approved for a loan. Not surprisingly, the larger a firm is, the more likely it is to have access to external sources of credit.

Table 1.11. Interest Rate on Overdrafts

Group	Percentage
Full Sample	23.5
Micro	25.1
Small	25.2
Medium	23.2
Large	23.2
Very Large	20.8
Foreign Owned	21.8
Indigenous	25.4

Banks. Banks in Nigeria are highly liquid and report that they would like to make more industrial loans. However, it is a common belief that lending to the manufacturing sector is not justified in terms of balancing risk and cost. The perceived high risk comes from a number of sources. It is difficult obtain information on a firm's true financial condition and performance. The judicial system is reportedly inefficient, making contract enforcement difficult. The business environment in general is very risky and uncertain so it is feared that firms may not be able to service debt. Consequently, banks charge high interest rates, demand high levels of collateral and make few loans of more than a year in term.

Most bank debt is provided in the form of overdrafts and almost 70 percent of the sample had access to such facilities. Since overdrafts are commonly rolled over, unless the borrower's financial situation changes, firms often rely on them to finance long-term investments. Overdrafts have to be fully collateralized and their average interest rates are 23.5 percent, similar to short-term bank loans. The difference in the average interest rate on overdrafts between the very largest firms and the micro firms is over 5 percent, (Table 1.11). This suggests that the interest rate differential reflects a risk premium and not just higher costs of administering smaller loans. Foreign-owned firms also report lower interest rates. Companies report that overdraft limits are determined by companies' ability to provide collateral and not by their business plan or future potential.

The interest rates on short-term loans are similar to those on overdrafts. Because short-term loans are usually rolled over every year, there is effectively little difference between them and overdrafts and firms often confuse the two. The average level of collateral, for those firms in the sample who reported, was 151 percent of the value of the loan. This can tie up substantial capital and raises the cost of loans. In addition, there are various fees associated with requesting and processing loans.

Long-term finance is very rare and only the most creditworthy receive it. Less than 16 percent of the sample reported having loans with a term of more than one year. Medium and large firms were more likely to have long-term loans. Very large firms tend to have enough internal sources of funds and the smaller firms are often viewed as less creditworthy. Foreign-owned firms were almost twice as likely to have long-term loans than indigenous firms, reflecting that fact that they are usually part of a group or are subsidiaries of larger firms who are able to supply them with guarantees.

Trade Credit. After commercial banks, the other major source of external finance is trade credit. This refers to the short-term credit extended to companies by their suppliers, and by companies to their customers. Trade credit is common in Nigeria but not as common as it could be. Between 75 and 80 percent of our sample reported giving or receiving trade credit. The typical arrangement in some developed countries is to give customers 30 days to pay with a 2 percent discount for cash. It appears that Nigerian firms are operating along similar lines. Few customers though, are actually given trade credit. The legal and judicial system is such that few firms are willing to rely on courts to enforce contracts. Consequently, firms only extend trade credit to their most valued and trusted customers.

Investment. Evidence from the RPED survey suggests that investment by Nigeria's manufacturing sector is high compared to many other Sub-Saharan African countries. While only a few firms in the sample made large investments, the majority of firms made at least some equipment investment in the last three years. However, nearly half the firms in the sample did not even invest enough in 1999 to cover their reported depreciation.

Investment in most developing countries is lumpy and Nigeria is no exception. In many years firms did not invest at all while during other years they made major investments. Investment is indivisible and it takes firms time to build up enough capital to make the investment and to assimilate the new technology. Part of the reason that investment is not smooth may be due to imperfect credit markets, which forces firms to build up internal funds before making investments. Part of the reason behind uneven investment over time may also be the uncertain business environment.

The average investment level in Nigeria is higher than many other African countries. Table 1.12 gives the mean and median of the average ratio of equipment investment to the market value of capital stock for firms. The median for Nigeria is 0.03 (the best measure of central tendency because of the high standard deviation), higher than similar figures in Cameroon, Ghana and Kenya.

Table 1.12. Investment to Capital Ratios

	Mean I/K	Median I/K
Nigeria 2000	.09	.03
Cameroon	.11	0
Ghana 1993	.13	.003
Kenya 1994	.11	0
Zimbabwe 1994	.12	.03

As usual in African countries, size appears to be an important determinant of investment. The median of level of investment to capital ratio for the three-year period increases directly with size, as shown in Table 1.13. The largest firms have a median ratio more than 10 times higher than the micro-firms.

The data for investment by size categories show that the investment rate for firms with more than 500 workers was almost three imes that of the next highest group.[6] At the other extreme, investment by firms with less than 50 workers was very low and more than half the firms made no investment in any year. For the size categories of 50 to 500 workers, the rates of investment are similar; they are much greater than the firms with less than 50 workers and much less than the super-sized firms. The rates of investment mirror

Table 1.13. Median Investment to Capital Ratios

Size Category	Median I/K
Micro	.008
Small	.024
Medium	.027
Large	.042
Very Large	.09

access to credit. The very large firms in our sample have much better access to formal credit, use bank credit to finance much of their investment, and have much higher rates of investment. The smallest firms have less access to formal credit and use commercial banks for only a small portion of their investment.

Protection of the Manufacturing Sector

Trade policy in Nigeria has mainly consisted of translating a strategy of import substitution into tariffs. Even if the broad aim of reducing overall protection has been reached to some extent, tariffs in Nigeria remain well above world averages.

A pre-set tariff schedule, introduced in 1995 and valid until 2001, was intended to further decrease existing tariffs and reduce uncertainty for firms. Import liberalization has been pursued in order to significantly reduce the reliance on quantitative restrictions. Only *ad valorem* tariffs were used in the new pre-set schedule. Import duties consisted of a basic rate of customs duty modified by an annually set rebate, plus a 7 percent surcharge (WTO 1998).

The 1995–2001 tariff structure was designed to stimulate competition and efficiency by reducing tariffs on consumer items relative to tariffs on raw materials and intermediate and capital goods. The reduction of tariffs on final consumer goods was expected to expose domestic manufacturers to import competition while the relatively higher tariffs on raw materials were supposed to attract investment into raw material and intermediate goods production (WTO 1998). In the course of the reform program, all excise duties levied on domestically produced goods were removed in January 1998. Finally, as of 2000, most bans on imports were abolished.

An analysis of the current level of nominal protection in manufacturing raises three broad sets of issues. First of all, it is necessary to assess whether or not the 1995–2001 reform was implemented as expected and if it reduced tariff uncertainty for firms. Then, the current overall level of nominal protection can be estimated and compared with other countries. As a final step, it is thus necessary to compute firm-level indexes in order to take into account the fact that firms have multiple outputs and inputs, often subject to different tariffs. Each of these problem is addressed in turn.

The application of the 1999–2001 tariff reform. While the 1995–2001 reform pursued a planned decrease in the overall rate of tariff, it seems to have failed at reducing various distortions. The impact of the 1995–2001 round of tariff changes can be assessed by computing nominal protection coefficients (NPC). The NPC is usually defined as the ratio of the appropriately adjusted domestic price and a comparable world price.[7] Comparison of NPCs allows for an analysis of the pattern and level of protection. The tariff data used for the exercise come from the latest available official publication (Nigeria Federal Government, 2001) at the time of writing and have been adjusted by taking into account the changes made public every fiscal year between 1995 and 2000. When a protection regime is entirely based on tariffs and there are no quantitative restrictions to trade, NPCs equal one plus the tariff rate. Due to both data limitations and the official removal of most QRs in Nigeria, this definition is retained for the rest of the section.

Two types of NPCs are used. First, ex-ante NPCs, based on the officially pre-set schedule of tariffs, are computed. Secondly, ex-post NPCs, taking into account the various yearly changes, which occurred, are estimated. If ex-ante and ex-post NPCs are similar it can be stated that the reform was implemented as expected, otherwise, it was not.

The analysis of ex-ante and ex-post NPCs suggest that while for many products, yearly changes in tariffs have a minimal impact, there are a few significant exceptions. At the two-digit level of the tariff classification, products from categories “22—Beverage, Spirits,…”, “57—Carpets and Other Textile Floor Coverings”, “58—Special Woven Fabrics” and “10—Cereals” had their average ex-post NPCs increase from 3 to 7 percent. The range of existing tariff rates also remains wide, the minimum ex-post NPC being equal to one (zero tariff) while the largest ones reach two (or a 100 percent tariff). The yearly changes also impacted on the dispersion of tariffs inside each two-digit product category. For many goods, the ex-post dispersion (measured by the standard deviation of the ex-post NPC) increased. In some cases, the impact was extreme. Products from categories “57—Carpets and Other Textile Floor Coverings”, “15—Animal or Vegetable Fat and Oils” and “22—Beverage, Spirits,…” have an ex-post dispersion ranging from almost 9 to 29 percent, well above the ex-ante values.

Table 1.14 reports some statistics on the products with the largest ex-post dispersion at the two-digit level; “Tobacco Products” (position 24), Cereals (position 10), Beverages and the like (position 22) are the three products with the largest internal distortion. Moreover, many products reported in this table are primary inputs for manufacturing. Tariff fluctuations on inputs are difficult to cope with in the current business environment in Nigeria. This provides a strong incentive for some firms to try to reduce import taxes by falsifying the denomination of goods to benefit from lower rates while keeping them within the same two-digit classification.

In effect, for many product categories the dispersion in NPCs is still high and actually was increased by the various yearly changes.

Based on what has been presented here, it is difficult to believe that the pre-set tariff schedule of 1995–2001 was implemented in a consistent manner. Even though about 38 percent of the categories at the two-digit level of classification remained unchanged as of 2000 compared to what was planned for 2000 in 1995, still 23 percent of the tariff categories had increases and almost 39 percent had decreases. Moreover, the average decrease in the latter was smaller than the average increase in the former. While the dispersion in rates was small for those categories with tariff decreases, the situation was the opposite for the products whose nominal protection increased, where the dispersion remained large.

The FGN also increased nominal protection for more than a fifth of the tariff categories. Moreover, the nominal protection from which firms benefit is usually higher than what is predicted by computations on the basis of the customs book, due to the fact that they often produce a wide range of products subject to varying tariffs. As before, raw materials tend to be less protected than final products. All of this translates into a very uneven structure of effective protection.

Overall level of protection and global comparison. The frequent adjustments in rates imply a non negligible deviation of the tariff structure in 2000 at the two-digit level compared to the initial schedule devised in 1995. However, at a global level, there is virtually no change between the ex-ante and ex-post average NPCs computed on the entire tariff schedule. As of 2000, their respective values were 1.2543 and 1.2524. Hence, deviations from the planned schedule did not really affect the overall level of protection targeted for 2000.

On the positive side, it must be noted that the global level of nominal protection has indeed decreased since the 1995 reforms. WTO data indicate that in 1994, just before the new round of reforms, the average unweighted tariff was around 30 percent and has reached about 25 percent in 2000. Yet, was this decrease large enough to bring Nigeria in line with the current protection trends worldwide? It seems the answer is no. Since 1982, Nigerian tariffs have been constantly above the average tariffs applied by industrialized and least developed economies. While data reported in Figure 1.2 do not go beyond 1998, it is unlikely that the trend of reduction of average tariffs

Table 1.14. Characteristics of the most distorted NPCs by product category in 2000

Classification	Consolidated NPC Applied by 2000			
	Average NPC *	Standard Deviation	Max. NPC	Min. NPC
24 Tobacco and Manufactured Tobacco Substitutes	1.561	0.358	1.800	1.150
10 Cereals	1.445	0.335	2.000	1.150
22 Beverage, Spirits and Vinegar	1.744	0.287	2.000	1.225
88 Aircraft, Spacecraft and Parts Thereof	1.190	0.204	1.550	1.050
49 Printed Books, Newspapers	1.180	0.198	1.450	1.000
36 Explosives, pyrotechnic products	1.292	0.183	1.600	1.150
05 Products of Animal origin not specified elsewhere	1.386	0.180	1.600	1.100
33 Essential oils and resinoids	1.374	0.171	1.600	1.150
19 Preparation of Cereals	1.410	0.161	1.640	1.200
04 Dairy Produces	1.289	0.157	1.550	1.090
15 Animal or Vegetable Fat and Oils	1.288	0.148	1.650	1.050
69 Ceramic Products	1.355	0.147	1.500	1.067
06 Lives Trees and Others Plants	1.525	0.144	1.650	1.400
58 Special Woven Fabrics	1.365	0.144	1.650	1.250
96 Miscellaneous Manufactured Service	1.285	0.142	1.550	1.050
42 Articles of Leather	1.283	0.140	1.500	1.150
34 Soap, organic surface-active agents	1.286	0.135	1.450	1.150
32 Tannings or dyeing extracts	1.219	0.124	1.450	1.033
55 Man Made Staple Fibres	1.328	0.123	1.500	1.100
51 Wool, Fine or Coarse Animal Hair	1.277	0.120	1.450	1.150
50 Silk	1.257	0.113	1.450	1.150
17 Sugar and Sugar Confectionnery	1.245	0.108	1.400	1.150
52 Cotton	1.439	0.108	1.560	1.300
11 Products of the milling industry	1.418	0.103	1.600	1.200
67 Prepared Feather and Down	1.350	0.100	1.400	1.200

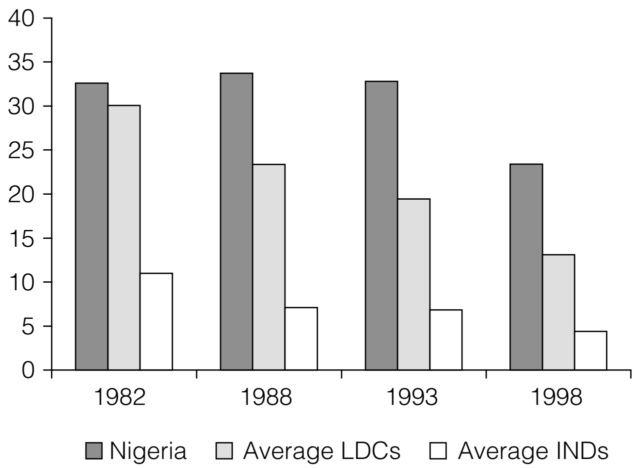
* Non-Weighted

Source: Computations on the basis of FGN (2001).

in LDCs and industrialized countries was reversed. Hence, in 2000, the protection in Nigeria was still well above the level of other countries.

Nominal protection at the firm level. The majority of firms in Nigeria are not single product firms, but produce a variety of goods and use diverse raw materials, which do not necessarily always fit into a single tariff category. Hence, in order to assess the "true" level of nominal protection granted to a firm, it is necessary to compute a weighted average ex-post NPC at the firm level, with the weight being the share of each product/raw material in the total sales/ purchases of a company. In other words, NPCs have not only an impact on the value of firm's output but also on the cost of their inputs, thus affecting the

Figure 1.2. Nigeria and Worldwide Trends in Production (unweighted tariffs in percentage)



Source: WTO database.

value-added generated by enterprises. This effect is usually captured by the Effective Rate of Protection (ERP).[8] Effective protection in 2000 was sometimes higher than in 1993, varies widely across sectors, ownership and regions.

Conclusions. The picture of the current level of protection in Nigeria is thus mixed. On the one hand, the overall level of nominal protection decreased (to about 25 percent in 2000 from about 30 percent in 1994). On the other hand, severe distortions persist as indicated by the high value of many standard deviations and the wide range of the Effective Rates of Protection (ERPs). It is likely that the issue to be addressed first is the dispersion of the tariffs and their year-to-year instability. These undermine the credibility of the trade policy. The tariff level is still an issue, but less critical (with the exception of a few specific products with exorbitant tariffs which should be reduced to a more reasonable level). A major consequence of the present tariff structure is to add uncertainty on the level of protection to the already high uncertainty faced by firms. This provides fertile ground for fraud.

The previous findings suggest a few guidelines for the coming reform of trade policy in Nigeria.

- The current positive trend toward an overall decrease in protection should be pursued. There is ample evidence of the benefits of open trade regimes. For example, Sachs and Warner (1995) have estimated that open economies have grown on average about one percent faster every year than closed economies. In order to be consistent with the previous decrease and Nigeria's international commitments (WTO and the customs union), the targeted overall nominal protection should be between 10 and 15 percent.
- The excessive current tariffs, set at 100 percent for some goods previously banned from import or subject to import quotas, should be decreased to a more reasonable level in the range of 10–15 percent.
- A critical point is the dispersion in tariffs, which must be reduced. This could be attained either by relying on targeted tariffs which could vary within a limited range or by using a single uniform tariff. The usual set of arguments in favor of multiple tariffs is of little relevance for Nigeria and these are not an optimal instrument of taxation. In consequence, imposing a uniform tariff is probably an option to investigate further for Nigeria. The arguments in favor of a uniform/flat tariff usually fall into three categories (Tarr 1998): political considerations, administrative convenience and possible reductions in smuggling.
- In terms of political considerations, a flat tariff would reduce the incentive for manufacturers to spend resources lobbying the government for higher tariffs, because by doing so they would only be forcing themselves to bear a higher cost on imported inputs and a face a lower price of exports through a real exchange rate effect. A uniform tariff would thus allow for a reduction in the diversion of resources and contribute to reduced

corruption. This would be especially helpful for Nigeria. A uniform tariff is also easy to administer. It allows for custom officials to focus more on the value of imported goods (to avoid under-invoicing fraud) and less on the classification of goods (a single tariff makes useless any attempts to misclassify imported goods in order to obtain better tariff rates). Finally, it may help to reduce smuggling. A varied tariff structure provides an incentive to illegally import goods subject to high tariffs. If a reasonably low and uniform tariff is applied, there is little rationale for smuggling.

- For the reasons above, it is thus suggested that a single tariff in the 10–15 percent range, applied both on raw materials and final goods would be an appropriate tool. This would allow for: i) eliminating the dispersion in tariffs and thus reducing the uncertainty faced by firms; ii) harmonizing the ERPs by eliminating tariff escalation and thus allowing for an allocation of resources between sectors based on unbiased (or less biased) relative profitability; iii) easier administration by custom officials and reducing the incentives for corruption and smuggling.
- Finally, trade policy cannot be separated from the macroeconomic context of a country. Of particular importance are developments on the exchange rate front for Nigeria. If any trade policy reform is to have an impact in this country, the prerequisite is to unify the exchange rate market so incentives become more clear and the only rational way to bring in goods is to do it officially.

Business Problems and Uncertainty

One of the most remarkable findings of the RPED survey is the high level of uncertainty and lack of confidence expressed by managers in interviews. Firms in most countries are generally willing to make predictions about future sales and investment plans and are usually optimistic about long run sales. It is reasonable for them to be optimistic, otherwise they would be considering leaving the industry in search of more profitable opportunities. However, in Nigeria managers appeared to be much more hesitant to venture forecasts of future economic conditions or to make predictions of high growth.

In our sample, about 79 percent of firms estimated that sales would increase in the next year and about 10 percent expected them to decline. When asked about the long run, managers' willingness to estimate sales growth declined significantly and almost 20 percent of firms were unable or unwilling to predict whether, over the next three years, sales would grow, fall or remain unchanged. In these cases, most managers said that the business environment was too unstable for them to hazard a guess on future sales.

There is a significant difference in expected sales between sectors. The strong confidence expressed by the food and beverage and paper sectors reflects their belief that consumer demand will continue to rise with the growing population. The low expected sales growth of textiles probably reflects the competitive pressure from growing low cost imports.

Firms that are optimistic about future sales generally outnumber those actually planning to make additional investments in their companies. Just over 70 percent of firms in the full sample reported planning to make significant investments in the upcoming year while 56 percent said they planned to

Table 1.15. Percentage of Firms Reporting Expected Sales Changes

	In One Year	In Three Years
Lower than today or closing	10.1	4.9
No change	5.7	2.6
Higher than today	78.9	72.3
No Prediction	4.4	19.4

Table 1.16. Firms' Expected Sales and Investments

	% Expecting Sales Increase in Next 3 Years	Median % Increase Expected in 3 Years	% Planning to Invest in Next Year	% Planning to Invest in Next 3 Years
Chemical + Paints	73.1	50	73.1	53.9
Food	84.9	60	78.9	72.7
Metal	72.8	50	68.2	61.4
Paper	76.0	82.5	68	52
Pharmaceuticals	66.7	50	76.2	52.4
Plastic	79.3	65	69	62.1
Textile	55.9	47.5	70.6	41.2
Wood	60	15	60	50
Non-Metal	80.0	30	40	20
Full Sample	72.3	50	70.5	56

make significant investments in the next three years (Table 1.16).

Again, as we move the time horizon out, fewer managers feel able to make predictions. While only nine firms could not say whether they plan to invest in the next year, more than 21 percent were unable to answer about the next three years, saying it depended on government policies and market conditions. The textile and wood sectors show the least propensity to invest, which corresponds with their low expected sales growth. The food and beverage sector has the highest sales expectations and the largest proportion of firms planning to invest. When firms were asked whether it is a good time to invest in Nigeria, the patterns were very similar. More than half of the firms that said it was a bad time to invest specifically referred to uncertainty and the inability to plan. At the same time, very few of the pessimistic firms mentioned low demand or market forces. This suggests that managers generally believe that they can prosper if the business environment is improved.

Foreign-owned firms were much more negative about the investment climate than indigenous firms. Foreign-owned firms were also more likely to cite uncertainty and not market conditions as the reason not to invest. On the bright side, over 60 percent of the sample said it was a good time to invest. Most of these firms argued that the market opportunities and the current government's commitment to reform make them optimistic, despite poor infrastructure and past political upheavals.

When firms were asked their three biggest problems, "uncertainty and inability to plan because of fluctuations in government policies" ranked third, behind "lack of infrastructure" and "access to finance." Uncertainty was twice as important as the next major problem, "inadequate demand." The unstable macro environment, especially the exchange rate volatility is a major reason that firms in Nigeria are unable to plan and unwilling to make large investments.

Though it remains a highly unstable business environment, the new Nigerian government has made great progress in eliminating many regulations that were burdensome in the past. Very few firms complained about labor laws, receiving business permits, obtaining foreign exchange, bringing in capital or repatriating profits. Not that these areas are without problems. It seems every action with government officials requires payment and, depending on one's relations with the officials, obtaining any official permission can be painfully slow. It is still a time-consuming and bureaucratic process to obtain an expatriate quota and the way in which the minimum wage was recently increased came in for bitter criticism. In some locales it is still a difficult process to get clear title to land. However, generally the labor laws, business licensing and capital flows were not viewed by a significant number of firms in any region as a major problem.

Despite the recent improvements, the regulatory environment remains problematic and is an important cause of the uncertain business environment. Among the most frequently mentioned regulations was the recent requirement to obtain NEPA permission to import generators. Since generators are a necessity to operate in Nigeria it affected almost every firm. Most firms saw it as nothing more than a blatant way for NEPA officials to seek bribes. The Standards Organization of Nigeria (SON) and the National Agency for Food and Drug Administration and Control (NAFDAC) were frequently mentioned as sources of burdensome regulations. Managers repeatedly stated that neither organization appears to have the capabilities needed to adequately perform their regulatory roles. It is beyond the scope of this survey to assess the abilities of these regulatory agencies and this portrayal may not be accurate. However, it is a common perception among many of the firms interviewed that these agencies are not competent and function more as a source of graft than proper regulatory bodies.

The state and federal environmental agencies were also major source of complaint. All managers recognize the need for environmental regulations, though some are more willing to bear the cost than others. However, the environmental protection agencies are viewed as not capable of adequately protecting the environment while still being a significant burden on the manufacturing sector.

Most of the actual laws and policies in Nigeria are reasonable and their value is generally understood by the manufacturing sector. However, the value of many regulations is lost when they are implemented in an arbitrary and capricious manner. This leads to relatively ineffective regulations that still add considerably to risk and uncertainty in the business environment. The only reason these regulations did not come in for more extensive criticism is that most can be avoided through negotiation, bribery and political connections. In addition, managers are focused on the more pressing problems of infrastructure and access to capital.

Crime and security are significant issues facing every person and enterprise in Nigeria. The lack of security is particularly discouraging for foreign investors. Foreign-owned firms, and those with expatriate managers, were far more likely to cite crime and security as a major issue than were indigenous firms. In addition, security appears to be a bigger concern in Lagos, the first place new foreign investors usually visit.

Few firms reported having trouble with their labor unions. For the 12 percent of firms that did report having trouble, the mean number of days lost to strikes was only 2.3. More than half of the sample reported losing no days to strikes.

The risk and uncertainty in the Nigerian business environment is heightened by the tax regime. Though taxes rank well below questions of infrastructure and finance they are still an important constraint on doing business and are mentioned among the top three business problems by more than 11 percent of the sample. While some tax policies and laws are poorly designed, a much more severe problem is the arbitrary and capricious manner in which they are administered. The overall tax burden reported by firms in the sample is relatively low. The mean is below 10 percent for both public and private limited firms.

But the transaction costs firms incur trying to comply with and avoid the complicated tax system are substantial. Several managers candidly remarked that they could avoid paying a high amount in tax and that the real burden came from the time and aggravation spent dealing with tax matters and not being able to plan for what their tax burden would be.

The constant refrain heard throughout all regions and among all types of firms is that the multiplicity of taxes is among the most frustrating challenges facing firms in Nigeria. The majority of this problem stems from the wide variety of constantly changing taxes and levies imposed by the state and local governments.

Most levies are not large by themselves, but they all require extended negotiations with tax collectors, are not predictable and their cumulative value can be substantial. It is so difficult for firms to know which levies are valid and which are just tax officials seeking to raise revenue, that the Chamber of Commerce in one state was forced to create a list of valid state taxes and to distribute to its members. Eventually, it became impossible for the Chamber of Commerce to even keep the list current.

The inefficient tax administration forces manufacturing enterprises to devote considerable management resources to dealing with the tax regime. Also the poor design of the different taxes (VAT, WHT and PAYE) reduces the amount of funds firms have for investment and day-to-day operations. The tax regime may also discourage foreign investment. In a very complicated system where the tax code is not understood or closely followed, there is much room for negotiation. In such a system, new firms and foreign firms are at a disadvantage because they are not as politically connected or knowledgeable on how to navigate the bureaucracy.

In recent years there has been some movement to improve tax administration. It appears that the practice of using police or soldiers to shut down firms during tax disputes has ceased. Only 26 firms in our sample reported ever being closed over a tax dispute and almost all of these occurred during the military regime. Firms report that recently the states have quit using independent tax consultants but managers are still subjected to frequent visits by tax officials seeking payments of various kinds. However, they are no longer worried about visits by tax consultants seeking to audit returns and payroll taxes from several years back or about the sudden arrival of police to shut the factory over a tax dispute.

The Nigerian government offers a wide variety of investment incentives for the manufacturing sector. When asked if the tax system affects their investment decisions, only six firms said that tax incentives influenced them to increase investment or exports and even these companies said that the incentives were not a major factor. When they are implemented, they are usually too late to be any value. Consequently, some managers did not even bother to learn what incentives were available. Managers view tax incentives as a bonus, but not something reliable enough on which to base plans.

The Cost of Electricity

Nigerian firms complain about increasing competition from imported goods and commonly place much of the blame on the high cost of manufacturing. They report that their most serious business problem is the state of infrastructure, and the biggest infrastructure problem is electricity.

In considering the cost of electricity, one has to bear in mind that in the case of both publicly- and privately-provided power, the prices are distorted by government subsidies. In the case of publicly-provided power, it is reported that the Nigerian Electric Power Authority (NEPA) produces electricity at a relatively high cost of 11 USCents/KwH compared to an international average of about 5–6 cents/KwH. The company is allowed to charge only 3.5 cents/KwH, and is supposed to receive the rest as a government subsidy. Yet NEPA's accounts receivable run into billions of naira. Private and public consumers sometimes fail to pay due to frustrations with the poor service and frequently inaccurate billing."[9] In the case of privately-provided electricity, the government subsidizes the cost of fuel (which represents 75 percent of the cost of electricity).

Virtually all the firms have the facility to generate their own power, as shown in Table 1.17. In fact, infrastructure problems are rated as nearly two-and-a-half times worse than the next biggest problem, "access to finance."

Deficient supply of electricity is by far the biggest infrastructure problem faced by firms. Overall, some 94 percent of firms reported this is the case as shown in Table 1.18.

Kyu Sik Lee *et al,* 1999, identified "essentially four ways in which firms might respond to infrastructural deficiencies. These are: relocation; factor substitution; private provision; and, output reduction." In our study, we found that there exists an additional response mechanism, i.e., product substitution. These response mechanisms are discussed below.

- *Relocation*. There was no evidence of firms relocating to other areas in order to obtain an improved electricity supply. Electricity problems are wide-spread.

Table 1.17. Percentage of Firms with Private Generators

	Location			
Employment size	**East**	**North**	**South**	**All**
20–49	93.3	91.7	94.1	93.4
50–99	100.0	100.0	94.2	97.4
100–199	100.0	100.0	100.0	100.0
200–499	100.0	100.0	100.0	100.0
500–999	100.0	100.0	100.0	100.0
1000 and over	66.7[a]	100.0	100.0	94.1
All	95.7	98.2	97.7	97.4

[a] *One of the four firms in this category did not have a generator for production, but for other purposes.*

Table 1.18. Percentage of Firms which Reported Electricity as their Biggest Infrastructure Problem

	Location			
Employment size	**East**	**North**	**South**	**All**
20–49	100.0	91.7	90.1	93.3
50–99	88.9	100.0	94.1	94.9
100–199	90.0	91.2	92.9	92.0
200–499	87.5	91.0	100.0	96.0
500–999	100.0	100.0	100.0	100.0
1000 and over	66.7	80.0	100.0	88.2
All	91.5	92.9	95.3	93.9

- *Factor substitution*. There was much evidence of factor substitution, e.g., adjusting the mode of production in favor of less electricity-intensive inputs, usually with sub-optimal technology.
- *Private provision.* As noted earlier, nearly all Nigerian firms have private sources of electricity generation and supply to substitute for public provision. It is not uncommon for firms to operate their generators even when the public supply is available, (e.g. sometimes a continuous manufacturing process is required and the switch-over process from one power source to another would damage the material being processed). It is becoming more difficult for firms to provide their own power because they now have to get permission from NEPA to import generators.
- *Output reduction.* Firms commonly reported output reductions due to deficiencies in the public provision of electricity. A loss of up to 30 percent is not uncommon.
- *Product substitution.* Several firms noted that the mix of products they produced was influenced at least in part by the power deficiencies, (e.g. a pharmaceutical company switched to products for which the demands of refrigerated storage are less critical.)

Firms are spending a considerable amount of capital on the private provision of electricity. As shown in Table 1.19, on average some 22 percent of the total value of equipment and machinery is represented by generators and accessories, such as cabling. Firms also bear extra on-going capital costs for the maintenance of their equipment and machinery due to power fluctuations and cessations. On average, damage to equipment and machinery accounts for 3.3 percent of total value of equipment and machinery.

Table 1.20 indicates that on average, all firms are privately providing electricity 67 percent of the time. There is an insignificant variation between the East and South regions (at around 70 percent) while in the North region electricity is privately provided 56 percent of the time. In general, there is little variation by size of firm—firms over 1000 employees use private provision the least (at 63 percent of the time), while firms with 100–199 employees use it the most (at 69.5 percent of the time).

There is a substantial difference between the cost of publicly- and privately-provided electricity. On average, the cost of privately-provided electricity is 2.42 times more than that provided by NEPA—N19.05 per KwH compared with N7.86 per KwH. Both costs can vary considerably. The variation of the cost

Table 1.19. Value of Generators and Accessories as a Percentage of Total Value of Equipment and Machinery

	Location			
Employment size	**East**	**North**	**South**	**All**
20–49	16.6	21.7	23.3	20.9
50–99	55.3	12.7	17.9	27.2
100–199	31.8	14.0	16.1	18.9
200–499	7.0	8.9	18.8	14.9
500–999	61.2	21.1	19.6	29.2
1000 and over	11.2	35.8	44.1	37.5
All	30.3	16.7	20.6	21.9

Table 1.20. Percentage of Privately Provided Electricity out of Total Firm Demand

	Location			
Employment size	**East**	**North**	**South**	**All**
20–49	68.9	49.0	68.9	65.5
50–99	77.8	54.3	71.2	67.2
100–199	67.6	66.7	71.2	69.5
200–499	74.5	58.6	68.6	67.3
500–999	77.5	38.3	69.3	64.2
1000 and over	53.3	53.2	72.5	62.9
All	70.7	55.9	70.0	66.8

per KwH of publicly-provided electricity is due to the "demand charge" which can vary from 5 to 461 percent of the consumption charge. The highest cost of electricity per KwH is 3.89 times the lowest cost, while the highest cost of privately-provided electricity is 4.4 times the lowest cost. Variation in the cost of privately-provided electricity depends mostly on the variation in the cost of fuel and the efficiency of the generators—which is heavily dependent on the age of the generator and the quality of the servicing and operation.

While most of the import competition firms reportedly face comes from manufacturers in Southern and South-East Asia, they are most worried about competition from Ghana, particularly within the context of ECOWAS. It is interesting to compare the views on the electricity supply of Nigerian firms with those of Ghana, which were obtained by the World Bank in late-2000.[10] Ghanaian firms were interviewed about electricity supply and the utility provider. In Ghana, a multi-national reported that its electricity cost was USD0.07 per KwH, the same as the average price of publicly provided electricity in Nigeria. However, whereas in Nigeria firms relied on self-generated power 67 percent of the time on average, in Ghana, firms reported using self-generated power for up to 10 percent of the time. Furthermore, there are striking differences in the attitude of the power generators and the firms to each other. In Nigeria, one firm reported that it rarely received NEPA bills, but regularly received disconnection notices. The only way it could get a disconnection threat withdrawn was to take an old bill to NEPA, pay it for the second time and get a receipt for the second time. The firm noted that it had never been able to even discuss billing questions—it was told to pay first, and when the bill was paid, NEPA still refused to answer the query. In another case, a firm was so worried about being disconnected without notice after not receiving a bill, that it was in credit to NEPA by the equivalent on one year's supply of electricity. In Ghana, some firms do report problems with the electricity supply, noting that up to 10 percent of power is privately provided and that it adds some 5 percent to the production costs. However, the attitude of the provider seems to be different with firms reporting that "if one complains about water or electricity, the authorities do something about it," and that the authority informs it of potential outages.

The Implications of HIV/AIDS for Manufacturing Firms

The AIDS module of the RPED survey was authored by researchers at the Center for International Health, School of Public Health, Boston University and was designed to answer three main research questions:

- What is the risk of HIV/AIDS in the workforces of Nigerian manufacturing companies?
- What are the types and magnitudes of costs that HIV/AIDS imposes on the companies?
- What actions are companies taking to manage the impact of HIV/AIDS among employees and what has led some firms to act while others have not?

The survey data allows for some tentative conclusions about the implications of HIV/AIDS for Nigerian manufacturing firms and for recommendations of some next steps for businesses, the Nigerian government, and international agencies such as the World Bank. The data collected by the survey are not detailed or comprehensive enough to quantify costs and benefits or make definitive statements about the impact of the epidemic on the manufacturing sector.

Conclusions

We know almost nothing about the epidemiology of HIV among adult males in the formal sector in Nigeria. However, the results of the 1999 HIV sentinel seroprevalence survey showed a nationwide median HIV prevalence among women attending public antenatal clinics of 5.4 percent. This widely-cited median prevalence estimate was a worrisome, though not catastrophic, increase from the prevalence of 4.5 percent measured by the last sentinel survey in 1995. Antenatal clinic (ANC) data indicate that some of the companies in the survey are drawing their workforces from populations whose HIV prevalence exceeds 10 percent, and the firms' self-reported experience with HIV is correlated to the prevalence in the local ANC population (Table 1.21).

But the population-level risk factors for formally employed males with access to private health care are sufficiently different than those for pregnant women using public antenatal clinics to make a direct extrapolation meaningless. The best we can say from the RPED survey results and the ANC data is that there are HIV-positive employees in most companies' workforces and that AIDS is causing some morbidity and mortality. Better data on prevalence is perhaps the single highest priority for future research.

It is also nearly impossible to project what will happen to the epidemic in the future. The Federal Ministry of Health believes that a take-off is inevitable without a massive intervention program. The

Table 1.21. RPED Survey Locations in each of the HIV Risk Regions

Low risk region (<5% HIV prevalence)	**Medium risk region (5–10% HIV prevalence)**	**High risk region (>10% HIV prevalence)**
Abia *(15 firms)*	Anambra *(14)*	Benue *(5)*
Enugu *(3)*	Lagos *(98)*	Kaduna *(17)*
Jigawa *(3)*	Plateau *(4)*	*(22 firms /10% of total)*
Kano *(32)*	*(116 firms /50% of total)*	
Kwara *(4)*		
Ogun *(10)*		
Oyo *(17)*		
River *(10)*		
(94 firms /40% of total)		

existence of high prevalence "hot spots" in some states points in that direction, as do a number of population risk factors (high incidence of STDs, high unemployment, etc.). The antenatal clinic survey now underway will greatly improve our ability to project future prevalence. Results are not expected until well into 2002, however.

HIV/AIDS is so far having little impact on Nigerian manufacturing firms. While the direct costs per AIDS case might be quite high, the number of cases to date seems to be very small. Although AIDS accounts for a substantial share of all medical retirements and deaths in service, it caused less than 2 percent of all workforce turnover least year. Absenteeism is low and stable. Since the firms invest relatively little in training their employees, the human capital investment they lose when a worker is lost to AIDS is small. It is clear that some companies are forestalling the potential impact of AIDS by screening job applicants and dismissing HIV-positive workers. If HIV/AIDS-related illness becomes more prevalent in the applicant pool, this strategy could worsen the skills shortage that already exists.

Managers of Nigerian manufacturing firms, in turn, are generally not concerned about HIV/AIDS at this point in the epidemic. The survey provides several explanations for this attitude. First, the firms have very little first-hand experience with the disease—only 14 percent of them reported knowing of an AIDS death or an HIV-positive individual in the workforce (or both). Second, as noted above, the cost "indicators" of AIDS becoming a problem in the workplace—higher absenteeism and turnover, sharp increases in medical and benefits costs, management and supervisory time diverted to deal with employee morbidity and mortality—are not yet raising a red flag for Nigerian businesses. And third, Nigerian firms face very high costs for basic inputs, such as electricity and water, and for a range of transactions with the government and with private institutions like banks. It is likely that these other problems are keeping HIV/AIDS off the "top 10" list of concerns of Nigerian managers—and may continue to do so for some time to come. For this reason, expectations that business will take a leading role in fighting the epidemic in Nigeria may be unrealistic.

On a case-by-case basis, AIDS has the potential to impose substantial costs on the RPED survey firms. Most of the companies provide generous benefits to employees who die in service or are medically retired and generous allowances for paid leave (Table 1.22).

Research conducted in southern Africa by the Center for International Health at Boston University shows that the cost to an employer per HIV infection can be several times the infected employee's annual salary. If AIDS-related morbidity and mortality rise sharply, the epidemic is likely to cause a measurable increase in labor costs. Given the Nigerian firms' struggle to compete with lower-cost producers in other countries, higher labor costs are a source of concern. The results of the 2001 antenatal clinic survey should help determine whether, and when, a spike in AIDS cases and costs can be expected.

Less than one third of Nigerian firms are taking action to prevent HIV in the workforce or address its potential impacts. If AIDS-related morbidity and mortality increase, the companies are likely to be caught off guard, without programs, policies, or strategies in place. There seem to be two main reasons for their apparent complacency. First, as noted above, most firms have not experienced an AIDS death or incurred high costs that they attribute to AIDS. Second, most firms do not have ready access to information about HIV/AIDS or how to manage it. While the lack of business action on HIV/AIDS is disappointing, both of the reasons cited above point to feasible and affordable interventions by the government or other organizations.

Practices that might violate the rights of employees (and possibly Nigerian law) appear to be common. These include covert pre-employment HIV testing, dismissal of HIV-positive employees on no

Table 1.22. Benefits Provided by Companies in the Survey

Type of benefit	Percentage of firms that provide this benefit	Source of funding: Self-financed	Source of funding: Outside provider	Source of funding: Both
Retirement, death, and disability benefits				
Pension fund—annual payments until death	19%	47%	14%	40%
Pension fund—single payment upon termination	61%	89%	4%	7%
Disability benefit	68%	72%	16%	12%
Severance or service gratuity	81%	98%	0%	2%
Reimbursement for funeral costs	61%	98%	1%	1%
Death benefit	66%	79%	9%	12%
Life insurance	31%	49%	29%	22%
Other	7%	58%	33%	8%
Medical benefits				
Health insurance	17%	68%	16%	16%
Medical care at company clinic	58%	81%	7%	12%
Other[a]	44%	74%	12%	14%

(a) Typically a retainer arrangement with a nearby hospital or an allowance to employees to pay for medical care.

grounds other than their infection status, and exclusion of HIV/AIDS from medical coverage. Further research is needed to determine how widespread and harmful these practices are and gauge the willingness of Nigerian firms to adopt workplace policies on HIV/AIDS.

Recommendations

- Carry out voluntary, anonymous, unlinked seroprevalence surveys at selected companies in various parts of the country. A good deal of preparation is needed before such surveys are possible, but the experience of other African countries (South Africa, Zambia, Botswana) demonstrates that workforce surveillance can be done successfully and is of tremendous value in understanding how HIV/AIDS will affect businesses.
- Undertake more detailed research on the potential impact of AIDS in Nigeria at a small number of firms that have reliable information systems in place. Ideally these would be the same firms that have agreed to carry our seroprevalence surveys, as described above. Detailed case studies will help fill in the gaps from the RPED survey and provide the empirical basis for interventions.
- Develop and disseminate an HIV/AIDS information kit for Nigerian business managers. The kit could include basic information about the disease, descriptions of "best practices" from businesses in other countries, models of workplace policies on AIDS, a reminder of relevant Nigerian laws protecting HIV-positive individuals, posters and handouts for employees, and so on.
- Create opportunities for business leaders who have experience with AIDS in the workforce to

speak to those who do not. This might include sponsoring speakers at existing business fora or creating local business councils or committees whose purpose is to inform participants about HIV/AIDS.

- Analyze the willingness and ability of Nigerian businesses to bear the burden of HIV/AIDS among employees, rather than following the trend among some firms in South Africa and elsewhere to shift that burden onto the public sector and households. The policy and resource allocation decisions made by the Nigerian government and international agencies should reflect a realistic assessment of the contribution that businesses can make while remaining domestically and internationally competitive.

Notes

1. D. Lindauer and A. Velenchik, "Can African Labor Compete?" in *Asia and Africa: Legacies and Opportunities in Development,* ed. David Lindauer and Michael Roemer (San Francisco, CA: ICS Press, 1994).
2. As mentioned in the section on sampling, the structure of the sample probably overestimates the size of the "textile" sector and underestimates the size of the "food and beverage" industry. However, this does not change the fact that these two sectors are the main providers of wage employment in Nigerian manufacturing.
3. Other African countries surveyed by the RPED program include: Cameroon, Côte d'Ivoire, Kenya, Ghana, Mozambique, Tanzania, Zambia and Zimbabwe.
4. Non Production workers or "white collars" are defined as any worker which, inside a firm, *does not* belong to the following job positions related to the productive process: technician, foremen and supervisors, other production workers, machine, maintenance and repair workers.
5. Firms hire between 8 and 12 workers in peak period, or about 2.5 to 4 percent of their average employment.
6. The following tables present only the equipment investment rate. The pattern for total investment was the same as would be expected since the vast majority of investment is in equipment.
7. The "Nominal Protection Coefficient" (NPC) equals $[P^D_{jk}/P^w_{jk}]$ for a firm k producing a good j, with P^D_{jk} being the domestic price and P^w_{jk} the relevant world price. When quantitative restrictions (QRs) or other non-tariff barriers (NTBs) to trade are in use, the domestic price results from various other factors (supply/demand balance generated by regulatory policy, the degree of competition in domestic industry, the institutional framework, etc.). In this case, a tariff-based NPC does not capture fully the extent of distortions. The NPC is then better proxied by computing the ratio of ex-factory price to the CIF import price (Ettori, 1992). In the current situation in Nigeria, a good approximation is to assume that the dominant distortion is induced by tariffs as most QRs/NTBs have been removed. Then, the domestic price equals $P^w_{jk} = (1+t_j).\ P^w_{jk}$ which simplifies the NPC to $(1+t_j)$.
8. The ERP is defined as: $ERP_k = [(VA^D_k - VA^W_k)/VA^W_k]$ for a firm k where: VA^D_k is the value-added at domestic prices or the tariff distorted value added; VA^W_k is the value-added expressed at world prices or simulated for the same sector in the absence of trade restrictions. Thus the ERP indicates to which extent the value added changes as a consequence of the entire tariff structure under the assumption there is none or little NTBs, which may cause further distortions. Other things being equal, the ERP is higher the higher the nominal tariffs on output and lower the higher the tariffs on inputs. When computing ERPs, a key question is to properly define the value added. In what follows, the value added is

assumed to cover labor costs, the profit and the depreciation of capital.

9. *Economic Strategy and Policy: The Way Forward*, July 2000, DFID.

10. Observations which were obtained in the preparation of *GHANA: International Competitiveness—Opportunities and Challenges Facing Non-Traditional Exports*, 2001.

An assessment of the business environment of this type normally focuses on the legal, policy, and institutional factors affecting business operations, beyond the general macroeconomic factors discussed above. The scope of analysis usually covers investment policies and incentives, business taxation, trade promotion policies, business registration and regulation, commercial law, and the capacity of various institutions to implement those policies and programs. These factors are covered here as well. However, were we to examine just these elements in Nigeria we would be missing most of the picture. For the defining feature of the Nigerian business environment is the pervasive legacy of widespread corruption and the breakdown of the normal institutions of civil society which act to ensure a supportive business environment. These are pervasive yet intangible factors which are especially important in the Nigerian setting. While not uncommon in other developing and industrial countries, their impact has been much greater and more destructive to a dynamic economy in Nigeria than in most other countries. And while these factors are in some sense intangible in the business climate, their impact is real and tangible in terms of its effect on private sector behavior and consequently on the growth of the economy. Therefore, to set the stage, we begin with an assessment of the impact of corruption and mistrust in business, and then from that starting point examine the main points of a more conventional analysis. This chapter draws on a diagnostic study conducted by FIAS of the overall environment for foreign direct investment.[11]

Corruption

In the past decade, and perhaps for even longer, Nigeria has consistently been rated by various indicators as one of the most corrupt nations. In recent years, it has consistently placed at the bottom or next to last as the most corrupt country in a ranking of perceptions of corruption by Transparency International.[12] The most egregious abuses of political power for private gain have come from the mismanagement of public resources, the scale of which has been made possible by oil revenues flowing to the federal government. This large scale corruption from diversion of public resources has a direct effect on the private sector, in that it makes participation in those activities the most lucrative form of business. Therefore, a great deal of private initiative has gone into ultimately unproductive pursuits such as brokering contracts, providing middleman services in the diversion of funds, and developing uncompetitive firms in construction and other services which rely on patronage in winning contracts rather than their capacity to perform, cost-effectiveness and efficiency. The large scale corruption of public procurement has skewed the incentives to the private sector away from productive activities.

However, corruption has a broad impact beyond those firms directly participating in the diversion of public funds. The main areas in which corruption affects the business community on a broad basis are in the enforcement of regulations, taxes, and provision of key services. This impact is negative, and hence tends to raise the cost of business for otherwise legitimate firms, increase uncertainty, and hence further exacerbate the skewed incentive system away from long term productive investments by the private sector.

The current government has made fighting corruption a priority, and has taken major steps towards curtailing the most egregious sources of diversion of public funds. These have included passing the Corrupt Practices Act, and establishing the Independent Corrupt Practices and Other Related Offences Commission called for in that legislation. In so doing, it has also begun to change the perception of the acceptability of corrupt practices, which most Nigerians have viewed simply as a fact of life. This has no doubt had some impact on the scale of corrupt practices, particularly that undertaken on a grand scale. However, despite the commitment of the President actual progress has been slow, for example it took over a year until the Commission came into operation in late 2001. From the private sector's perspective, the new thrust of the government does not appear to have changed the reality on the ground for most businesses, where corruption in the enforcement of regulations, administration of taxes, etc. remains a fact of life.[13] This in part reflects the difficulty in combating a system of corruption which is so deeply ingrained into most Nigerian institutions and practices.

In an informal survey undertaken for this Assessment, corruption was the third most frequently cited problem for firms (after infrastructure and inability to secure VAT refunds). In addition, other obstacles highly correlated with corruption were also highly ranked: these included Customs, obtaining investment incentives, administration of taxes, the legal and judicial system, obtaining duty exemptions, and government regulation. All were listed in the top 10 of constraints in the business environment by the firms surveyed. Firms' complaints about corruption depended upon the degree to which their activities were subject to extensive sectoral regulation, such as in telecommunications, or depended upon frequent interfaces with government services, such as Customs. While more optimistic that the new government was serious about combating corruption, most firms found no improvement over the past year in this regard.

These informal results were mirrored as well in the RPED survey of manufacturing firms. Here the largest problem associated with taxes, for example, was that the system of administration encouraged simple harassment of formal sector firms because they were visible targets for tax inspectors, consultants, and others looking for a bribe. The uncertainty and multiplicity of "visits" by tax authorities was much more of a negative factor than the ultimate tax burden. Furthermore firms reported that they disregarded most tax incentive programs as it was possible to negotiate one's own "tax incentives."[14] The firms surveyed reported similar problems related to corruption in other matters—ability to get service from parastatal utilities, dealing with customs and other authorities, etc.

Other elements of the business environment discussed in this report—the complex regulatory environment, policy instability, the predominance of state owned enterprises, and layers of business regulation at the state and local level—all contribute to and enable corruption. While these other issues have their distinct effects on the business climate, they also act to facilitate corruption by providing multiple opportunities for graft, patronage, and general intervention in private business affairs.

The major impacts of official corruption are well known, and are present in Nigeria. These are the increase in costs associated with paying bribes to conduct business, the uncertainty associated with uneven application of laws governing business, and the diversion of business activity into areas where rents could be captured. Thus, there is a highly uneven playing field that rewards those with access to public officials and increases the normal risks of business activity. Pervasive corruption in Nigeria has, over the longer term, also has led to a number of more subtle but equally important impacts on the private sector. These include the following.

- **Infrastructure.** The poor state of infrastructure in Nigeria can be largely attributed to mismanagement by parastatal monopolies, in which corruption figured prominently.
- **Undermining public institutions.** Widespread corruption has created a lack of credibility of public sector institutions, as they are perceived by business to be simply motivated by rent-seeking.
- **Undermining of legitimate public sector functions: taxation.** The ability to circumvent

payment of taxes through payment of bribes, compounded by the lack of institutional capacity in the public sector, has led to widespread and recognized evasion. During interviews conducted for the survey, the level of tax rates was identified by only a small number of firms as a constraint. Most admitted non-payment of corporate profits taxes, with the exception of banks and listed companies. Many companies expressed a moral outrage at payment of taxes: "government officials will just steal the money anyway . . . we get nothing back from government; why should we pay taxes? . . ."

- **Undermining of legitimate public sector functions: trade policy.** As pointed out above, levels of protection in Nigeria are relatively high, and for some sectors, extremely high. Yet, whatever the wisdom of a protectionist trade policy, it is undermined by widespread smuggling and duty evasion. In textiles, for example, the industry complains of the barrage of legal and illegal imports that pay no duties, against which domestic firms can't compete. In petroleum products, subsidized prices have meant large profits for those who can ship products across the border in to neighboring countries to sell them at world prices, so that Nigerian consumers get no benefits while the government directly supports the profits of the smugglers. While porous borders are a common phenomenon in West Africa, the degree of smuggling and evasion of duties appear to be more elevated, in particular due to the high tariff levels and the persistence of subsidies, as in petroleum products. In an attempt to reduce duty evasion, the government recently instituted a 100 percent inspection requirement at the Port of Lagos. This has simply raised the stakes in the game, and in the process significantly increased congestion and delays associated with clearing imports through the Port.
- **Undermining of legitimate public sector functions: business regulation.** Beyond taxes and customs, many business regulations also suffer from uneven enforcement due to corruption of agents. Thus, for example, environmental regulations are poorly enforced, even though there has been a great deal of effort placed in developing those regulations. In other areas such as labor regulation, a similar situation prevails where there is little enforcement, and attempts at such can be routinely evaded by paying bribes.
- **Discrimination against SMEs.** Corruption in Nigeria has meant that smaller firms are routinely disadvantaged vs. larger competitors. This is a direct factor in procurement, especially at the state level where SMEs are competing, and where they can be effectively shut out by larger competitors with better connections and more experience in arranging government contracts.
- **Barrier to entry for potential foreign investors.** Corruption constitutes a significant barrier to entry for new foreign investors, who may not have political connections, or cannot be sure that those they establish will be sufficient to navigate the complicated maze of doing business in the country. In this case perceptions are as important as the reality of the situation, and serve to raise the threshold required to get foreign investors interested in the country.

Business Ethics Breaking Down: The "419" Syndrome

Corruption is compounded in Nigeria by poor business practices, fraud, and a lack of ethics in the private sector itself. There is little basic trust among business partners, between management and employees, and in relations with suppliers and customers. The impact on business is indirect yet pervasive and acts as well to increase costs, risks and uncertainties as businesses develop special mechanisms to cope.

Nigeria has become famous for "advance fee fraud," more commonly known as "419" from the section of the Nigerian Penal Code which governs these types of deceptive business practices.[15] Indeed, prominently featured in the investment promotion literature given to foreign investors is a full page notice from the Central Bank to be wary of Nigerian businessmen in these types of scams. The final exhortation in the notice—"You have been warned!"—may serve the needs of the Central Bank in making this warning to potential investors, but more importantly just draws attention of potential investors to the problem, and the seeming inability of government to contain this type of fraud.

The basic lack of trust in business transactions typified by the 419 syndrome have a number of repercussions in business practice in Nigeria, all of which tend to increase costs and hamper private sector development.

Reliance on cash transactions. Routine credit among business is scarce, and even checks are frequently fraudulent and not trusted. Credit card use is limited because of frequent fraud problems. Supplier credit often works in the reverse of normal relations where large firms can press suppliers into granting them favorable credit, but firms rarely do so outside of this relatively small circle of large firms.

Controls. Most businesses face increased costs associated with stringent internal controls required over cash and inventories. Employee pilferage is widespread, and factories and other business establishments have extensive controls. Controls over cash and banking transactions are equally important to protect company assets. Foreign firms interviewed in the survey reported they had to maintain higher numbers of expatriates in key financial and management positions in order to maintain stringent controls.

Strained Management-Employee Relations. The lack of trust between management and employees translates into poor relations in general, and a difficulty in adapting to new management techniques, realizing productivity improvements, etc. Employees, including those in management, may view the company as many do the government—as an opportunity for siphoning off funds or goods for their personal gain. In this environment it is difficult to instill productive management techniques and labor relations.

International Isolation. Nigerian firms face an immediate disadvantage in making routine business inquiries abroad. They are perceived warily, and report that potential business partners or other organizations are often reluctant to share information, or even respond to inquiries for information. Many Nigerian firms establish affiliates in London or other business centers in order to have an overseas base for routine contacts which otherwise prove difficult from Nigeria.

Vertical Integration. In an atmosphere characterized by mistrust, and a difficult business environment in general, many firms have responded by increasing vertical integration, or other means of internalizing risks. They cannot rely on outside suppliers, where even if they are honest, may face interruptions in power supply, logistical problems, and other difficulties which will interrupt their production. Large firms in particular have found the only way to guarantee their ability to maintain production is to do it all themselves, in one integrated operation.

Limited SME linkages. A direct implication of the above is the lack of sourcing opportunities for SMEs stemming from large firms. SMEs firms face immediate obstacles in establishing their credibility with potential purchasers, exacerbated by the general environment of mistrust.

Barriers to foreign firms. The perception of poor business ethics and fraudulent practices in Nigeria acts as an additional deterrent to foreign firms, who are unsure of how difficult it will be to operate in the Nigerian environment.

A related factor is the lack of physical security and high crime rates in Nigeria, and the impact on business operations. Crime and security were ranked as a major constraint (in the top three) by 15 percent of the firms in the RPED survey, however this was much higher in Lagos than in other regions. The lack of security generally in society has several impacts on business operations. These include an obvious costs of security guards, investments in secure facilities, etc. but also have indirect costs. These indirect costs are exemplified in the inability to travel easily at nighttime, higher costs in attracting and housing expatriates, including short term consultants and technical assistance, high risks to keeping cash on hand (in an economy which functions largely on cash), and difficulties extending distribution areas due to the threat of robbery. Concerns over the problems associated with security and crime were greater with foreign firms in the RPED survey.

These two factors, the pervasive impact of corruption and the breakdown in business ethics, are distinctive characteristics of the Nigerian business environment. Their pervasiveness tends to color many of the more typical factors affecting the business environment, which are discussed below.

Legal and Judicial Environment

The commercial legal framework—especially the ability to enforce property rights, contracts, and have an accessible and impartial venue for dispute resolution are key elements of the enabling environment for private sector development. The legal and judicial system is important both in terms of resolving disputes among private parties, but also in those between private sector and government. Given the scale of government in Nigeria, and the legacy of poor governance, the latter is especially important.

In Nigeria, the courts have been ineffective as the primary venue for enforcement of rights and dispute resolution. A general concern relates to the legacy of rules, regulations and legal practices from years of military rule. During the latest period, which ended with the change in government in 1999, Nigerian lawyers and judges confronted extra-constitutional attempts by the government to limit the judiciary's jurisdiction. Although democracy and human rights received the greatest international exposure, commercial laws were also affected. Government contracts and concessions were routinely awarded through non-transparent means and without regard to merit. Laws were passed that forbade the importation of certain commodities in order to create lucrative monopolies. Some of these laws have been repealed; others have not. Successive military governments explicitly targeted the courts as an obstacle to the arbitrary mode of governance which prevailed, and their authority was purposely undermined. These efforts included the appointment of judges who were poorly qualified but politically loyal, as well as the chronic under-funding of the judiciary.

There are conflicting, confusing or obsolete regulations. One example is overlapping jurisdiction in the approval of expatriate work quotas and permits by the Nigerian Investment Promotion Commission (NIPC) and the Ministry of Internal Affairs. The requirement under the federal land law that all land transactions and mortgage applications be approved by state governors or attorney generals on their behalf, goes back to a time when a governor's seal was the only fully reliable proof of ownership. Companies report that they must rely on lawyers to complete routine interactions with government, including company registration and licenses that elsewhere could be handled directly.

A primary concern for investors is Nigeria's poor track record in the enforcement of contracts between private companies, as well as between firms and government, in part attributable to poor business practices. The principal reason is slow, inefficient, and corruptible courts. Foreign investors also charge that local magistrates are likely to side with a Nigerian against a foreigner, regardless of the legal merits of their case. Most common disputes are settled out of court. Some firms stated that even the most frivolous claims against a company sometimes result in the firm making a "negotiated payment" because of a lack of faith in the efficacy of the official legal system.

This inability to get a fair and speedy redress to contractual disputes creates distortions of business practices. For example, many firms are simply unwilling to extend credit to customers. Conversely, some customers simply use supplier credits as a form of cash flow until enforcement actions are logged. Such behavior compromises business confidence. The courts have a great backlog of cases. On average it takes three years for a claim to be heard at the court of first instance and five years is not unknown. Only the larger firms may have the knowledge and resources to solve their problems extra-judicially. The main problem appears to be simple lack of capacity. Judges have few or no staff, courts have no reporters and are not computerized. Therefore Judges often have to record evidence presented by hand themselves, and there are long delays in getting opinions typed and published. Judges also are forced to take on many preliminary tasks normally allocated to staff, such as the screening and preparation of cases.

As a result the backlog of cases is large, their treatment is slow, and reaching a decision in the courts typically takes years. A land case brought up through various levels and settled only in 2000 in the Supreme Court has taken 35 years. The fact that Courts are tied up and slow to process cases also makes lawsuits an attractive tactic for delay; there are reportedly many frivolous suits filed simply for tactical purposes. Courts do not have Administrators to weed out such frivolous cases, so resources are then tied up in responding to them.

In the case of intellectual property rights (IPRs) and trademark laws, legislation exists but enforcement is weak. Enforcement is currently left to the trademark or IPR owners and some business groups working with informants and law enforcement agents. An increasing number of IPR violation cases have been successfully prosecuted in Nigerian courts. By some accounts, this has encouraged companies like Microsoft to establish operations in Nigeria despite almost entirely pirated copies of its software having been distributed in the past. For small domestic or foreign companies, however, protracted prosecutions are not practical. In order for Nigeria to attract investment and foster growth (such as the local music industry), far stricter implementation and enforcement of legislation is crucial.

At higher levels of the judicial system, Nigeria has an accomplished bar, and the main courts are capable and subject to the panel system. However, at lower and intermediate levels, judges are commonly viewed as corrupt and unskilled.

The business community has shown a tendency toward the appointment of a skilled mediator and arbitration panels in the event of a contractual dispute, although the system is still underdeveloped. The governing legislation, the Nigeria Arbitration Act, was passed in the 1980s to address the mass of contracts involving the shipment of cement. Domestic alternative dispute resolution (ADR) is often conducted under the auspices of the Lagos Chamber of Commerce or the Nigerian Arbitration Institute. For international contracts, arbitration under the London Court or the International Chamber of Commerce (ICC) is formally an option. In practice, it is available only to the largest and most sophisticated companies. Even if used, business people doubt whether a judgment would be honored. ECOWAS is investigating the creation of a regional court, and perhaps an ADR requirement.

Many businesspeople complain that public officials exercise wide discretion in interpreting regulations as a way of exerting undue influence over commercial activity. In addition, investors report that officials within a given agency will interpret the same statute in different ways. For example, company representatives of import/export related businesses suggest that a complicated clearance system and willfully variable interpretation of customs regulations creates a confusing and highly corrupt process. Some public officials suggested that agency staff rarely receive sufficient training to interpret regulations appropriately.

Investors (foreign and local) are confused and hampered by the overlapping jurisdictions of federal, state and local governments in various aspects of commercial activity. Foreign firms routinely cite examples of state and local officials imposing a myriad of arbitrary taxes, permit requirements, and licenses in an attempt to raise revenue from companies situated in their jurisdictions. Some companies report that state and local officials, occasionally accompanied by local military or police officers, routinely ask companies to pay new taxes and fees, clarify plans, and submit additional documents—or face being shut down. A more detailed analysis of the statutes and mechanisms governing state and local power in relation to federal power is necessary to assess whether these problems are exacerbated by deficiencies in the law or in its application by state and local officials.

Procedural and Administrative Barriers to Investment

Indigenous entrepreneurs and foreign investors must deal with a gauntlet of administrative procedures to establish and operate a business in Nigeria. Executives of both foreign and local firms singled out the very poor quality of government services. Mid-level and front line civil servants tend to be unresponsive, poorly trained, unwilling to take responsibility or make decisions, slow to process routine applications, and often looking for rent-seeking opportunities. Investors report that Nigerian government agencies regularly and arbitrarily intrude upon normal decision making processes and often seek excessive clarification to issue routine approvals. Companies are forced to wait a long time for decisions, and projects often fall behind schedule and run over budget. Reportedly, personal influence and monetary inducements play a very important role in determining the speed and outcome of a bureaucratic approval. The inadequate telephone system, poor service in government agencies, and the tendency for some public servants to maintain unusual hours, makes the arrangement of appointments difficult and time-consuming.

Some government officials attribute shortcomings to inadequate financing of the civil service, the absence of computers at many agencies, poor power supply, and limited access to training and management expertise. Personal and political influence has also been significant in public sector hiring practices. Some public managers concede that productivity is low. Some intermediaries, including accountants and lawyers, point to a persistent attitude within government that business cannot be trusted.

Many of the shortcomings in government services were experienced directly in unsuccessful attempts to contact by phone the Ministry of Internal Affairs, Department of Immigration, and Ministry of Industry. When inquiring about procedures for an expatriate work permit, a license for manufacturing, and registering for taxes, federal government employees gave different answers. This inconsistency extends to states. Many civil servants do not respond to requests for information.

In a new publication, the NIPC has sought to outline in four stages the steps that foreign investors must follow to operate in Nigeria. This presentation, summarized in Table 2.1, is mostly focused on the Commission's own role (and on increasing it), and does not inform an investor about such issues as how

Table 2.1. The Investment Process as Outlined in the NIPC's *Investors Guide to Nigeria*

Stage A

1) Establish partner/shareholder stake in company.
2) Establish name, initial authorized share capital, and main functions of company.
3) Prepare joint venture agreement and/or internal management/Board structure and function.
4) Prepare Memorandum and Articles of Association.
5) Grant power of attorney to local agent or lawyer in Nigeria while awaiting Business Permit.
6) Conduct names search and reserve name with the CAC.
7) Pay stamp duties and CAC fees to conclude local registration.

Stage B

8) Obtain Tax Clearance Certificate.
9) Prepare deed of lease or sublet of business premises.

Stage C

10) Apply to NIPC for Business Permit, Expatriate Quota, and Pioneer Status incentives.
11) Prepare the various documents needed to apply for the permissions noted above.

Stage D

12) Arrange for the import of foreign equity (Note: The NIPC may withhold issuing the Expatriate Quota and Pioneer Status approvals until the investor can prove that he or she has imported capital).
13) Present to NIPC the Certificate of Capital Importation from a local bank.
14) After Expatriate Quota is granted, recruit expatriate staff and get work and residency permits for foreign workers and their family members.

to acquire land, what licenses are required, and what local level permissions are needed. Further, as discussed below, the NIPCs emphasis is clearly on screening investors through its own rather cumbersome approval process. A more detailed, accurate picture, as revealed by our own inquiry, is set out in the following sections in terms of:

- **Employing,** which typically includes investor entry, obtaining expatriate work and residence permits, and local hiring and firing procedures;
- **Locating,** including such issues as acquiring title to land, developing a site, obtaining utility connections, and complying with environmental legislation;
- **Reporting,** including such issues as incorporating a business, registering and paying taxes, obtaining sector and operating licenses, and acquiring incentives; and
- **Operating,** which includes issues related to importing and exporting, acquiring foreign exchange, and repatriating profits.

a) Employing

Visas

With the exception of ECOWAS nationals, all visitors to Nigeria must obtain a valid visa before entry. Many visa types require the submission of a letter of invitation. In practice acquiring a visa can be fraught with bureaucratic delay. Documentation and processing procedures differ by visa. Some foreign investors reported that a multiple entry visa is particularly difficult to obtain. The invitation letter requirement seems to serve little purpose, and is inconsistent with Nigeria's stated objective of opening up to foreign investment.

Employment Permits

Nigerian authorities issue three different employment permits:

- *Expatriate Quota Employment Permits* to the employees of a company operating in Nigeria. This permit is valid for two years in most cases and can be renewed.
- *A Resident Permit* to non-Nigerians who seek to establish permanent residency in the country. This permit is valid for two years in most cases and can be renewed.
- *A "Permanent Until Reviewed" permit*, which, according to the NIPC, is to be granted only to a company's managing director and only for firms that are majority foreign-owned enterprises with authorized capital of N5 million (US $50,000) or above.

The number of expatriate workers allowed to work in Nigeria is related to the company's paid-in capital. An investment of N10 million (US $100,000) will currently earn a firm one expatriate employee.

Both NIPC and the Ministry of Internal Affairs claim the right to issue expatriate quotas. NIPC has taken on this task as part of its efforts to establish a "One Stop Shop." The Ministry of Internal Affairs meanwhile has issued a decree, circulated to all embassies, stating that quota grants by NIPC will not be honored, and that all applicants must conform to statutory procedures set forth in the Immigration Act No. 6 (1963, as amended). Both NIPC and MoIA agree that the Ministry has the right of final refusal to "formalize" an employment permit.

Following submission of an application with extensive documentation on the firm and individual, the NIPC will send an inspector to an applicant's workplace to confirm that the investor is running a legitimate enterprise. After considering the inspector's report and other data, NIPC staff renders a judgment about approval of the request. Following NIPC permission, the investor must obtain Department of Immigration approval for stamped confirmation in the passport. The cost for the most common expatriate work permit is US $2,000. According to investors and government officials, the time required varies but a delay of two or three months is not uncommon. The quotas are renewable subject to the same procedure of filing an application and hosting an inspection.

Investors complain that the procedure lacks transparency and makes even short-term planning difficult. They do not always know what criteria are being applied and what documents are required. In many cases approvals seem to be issued arbitrarily, with one firm receiving an approval for an executive and another firm being denied a permit for the same position.

Local Labor

Nigeria has extensive labor legislation. Dispute resolution, minimum wage, compulsory benefit rules, and termination guidelines are of particular interest to foreign investors. They disagree about the degree to which local labor laws and dispute resolution procedures constrain the hiring and firing of local workers. Some suggested that the severance packages accorded to local workers make firing unnecessarily burdensome; others stated that due to Nigeria's high unemployment rate employers have an advantage in negotiating with workers. Nigeria has a high rate of unionization (43 percent of the labor force in manufacturing firms surveyed by RPED) even though unions were systematically weakened under previous military regimes. Unionization also increases with firm size. Unions have proved effective in bargaining for higher wages, with unionized firms and sectors enjoying generally higher wage levels. The minimum wage increase passed in 2000 appears to pose an active constraint on employers, with many small firms in the RPED survey sample reporting having paid lower wages.

Most investors noted the shortage of qualified managers and engineers. The expatriate employee quota system constrains foreign investment and the potential of foreign firms to help develop the supply of such individuals. Absenteeism, petty theft, and incompetence were also identified as constraints.

b.) Locating

Land Acquisition and Registration

Securing tenure is a major barrier to investment. Perhaps 90 per cent of Nigerian land is publicly held, and although leases of up to 99 years are available in theory, investors must navigate their way through the uncharted waters of state government.

Under the Federal Land Use Act (1978), the vast majority of Nigerian land transfers fall under state jurisdiction. The power to approve land transfers is vested in state governors for urban land, and with local governments for non-urban land (although other approvals are also required). A customary land allocation system works in parallel to the state system in many areas, and any investor often ends up having to negotiate with two or three occupiers or "owners." Some states also have their own rules governing land acquisition, especially as part of the rudimentary industrial estate system. Interviews indicated that state governors can take from six months to ten years to approve land transfers, and permission to lease land and use land as security must be approved separately.

The limited land on the private market is available at perhaps four to five times the price of state land, but the acquisition of land with secure tenure invariably still requires the state governor's approval. Investors report that identifying available land is a problem in Nigeria because of poor record-keeping, variation in procedures from state to state, and a backlog of unresolved title disputes. The problem of accessing accurate information is further exacerbated by the lack of computerization in most individual states' land registries, much less a national digital databank of survey and title records.

The cost and time required for other routine business transactions involving land titling, such as registering collateral on loans by financial institutions, is also problematic. Real property is valuable as collateral, and lienholders rights can be enforced without going to court. However, registering collateral can be expensive and time consuming. Typical time requirements are 6 months to 2 years. In many cases the act of using land as collateral is what forces individuals or companies to complete the titling process, which in itself is cumbersome and expensive. In Lagos, for example, legitimate fees can be as high as 15 percent of the value of the land. The cost and delays associated with registering real property are such that a standard practice is to hold all land in a corporation, even that owned by individuals. In short, it is easier to establish a corporation to hold residential land than to face re-registration at the time the property is sold—then the company can be sold without changing the underlying real property registration and paying fees once again.

Construction Permits

State and local authorities govern construction procedures in Nigeria, and procedures apparently vary considerably across jurisdictions. Typically, projects must be approved at the planning stage (and before investment approval from NIPC) by a state or local zoning authority. Commercial developments are usually allowed only in pre-designated areas. It is normally easier for an export-oriented business to obtain permission though the Nigerian Export Processing Zones authority to build on an industrial site.

In most cases an investor must submit the following documentation in order to obtain a building permit, namely:

- Architectural drawings
- Structural engineering drawings

- Survey plan of the land
- Tax payment certificates
- Receipt of payment of ground rent
- Police report certifying that the planned construction does not create a traffic hazard
- Report from the local fire safety officer attesting that the plans conform with fire codes

The approval process can take four to six months if no complications arise. The various inspection procedures are considered extremely problematic, with officials tending to be incompetent and/or corrupt.

After the local planning commission grants approval, the applicant must then take this approval, accompanied by the building plan and policy and fire reports, to the Federal Ministry of Commerce for its approval. Once construction is completed, local authorities will conduct an inspection and issue an Occupancy Permit.

Environmental Compliance

The Federal Environmental Protection Agency (FEPA) requires an Environmental Impact Assessment (EIA) for a wide range of business activities. The EIA should cover: the project's expected short and long-term environmental impact; a description of planned efforts to mitigate any damage; and an assessment of the physical extent of the potential impact. States also have their own environmental protection agencies and regulations. The state and federal environmental agencies were a major source of complaint in the firms surveyed by RPED. All managers recognize the need to environmental regulations, though some are more willing to bear the cost than others. However, the environmental protection agencies are viewed as not capable of adequately protecting the environment and are a significant burden on the manufacturing sector. The regulatory agencies are seen to come down and levy fines and fees and demand firms clean up their operations. However, they appear unable to offer technical assistance to help firms meet environmental requirements. Complying with many of environmental regulations is beyond the means of many manufacturing firms, especially the small one and consequently they are avoided by paying bribes. In addition to meeting standards the reports required by the environmental protection agencies are very expensive and require hiring technical experts, yet firms see no value in them.

c) Reporting

Company Registration

Foreign companies operating in Nigeria must register with the Corporate Affairs Commission (CAC) in accordance with the Companies and Allied Matters Act (CAMA, 1990), and with the Nigerian Investment Promotion Commission (NIPC). The CAMA recognizes three general forms of business: companies limited by shares; companies limited by guarantee; and unlimited companies. These three types can include: private or public limited liability companies; unlimited liability companies; companies limited by guarantee; foreign branches/subsidiaries; partnerships or private firms; sole proprietorships; incorporate trusteeships; and representative offices. The minimum authorized share capital is N10,000 (US $100) for a private Nigerian company, and N500,000 (US $5,000) for a public company.

Private companies must have at least two directors, and public companies must have a minimum of seven directors and seven shareholders. If the public company is listed on the Nigerian stock exchange, the firm must have at least 50 shareholders. A foreign firm can only purchase shares in a local company if it is incorporated as a joint venture.

Nigerian law states that only accredited individuals, including local lawyers, accountants, and chartered secretaries, can register a company in

Nigeria, and most foreign enterprises hire a lawyer to complete this process. A names search is also conducted as part of the registration process. Stamp duties and filing fees are payable.

When registering, a foreign firm must submit:

- Memorandum of Association/Company Charter
- Articles of Association/Company By-laws
- Statement of proposed authorized share capital
- Background information on the top company officers
- Proof that 25 percent of the company's authorized share capital has been deposited in a Nigerian bank

After completing the company incorporation process, which reportedly takes an average of one to three months, foreign firms must apply to the NIPC for a Business Permit, which will allow the firm to begin operations. Registering with NIPC, which is compulsory for foreign companies in Nigeria, also allows a foreign firm to be considered for "Pioneer Status" incentives. According to the NIPC's *Investor's Guide to Nigeria,* although not in practice, an investor must submit:

1) Completed NIPC application form
2) Receipt for the purchase of the NIPC form
3) Certificate of Incorporation
4) Tax Clearance Certificate
5) Memorandum of Association
6) Articles of Association
7) Receipt of payment of stamp duties on the authorized share capital
8) Joint venture agreement (if company is not 100 percent foreign owned)
9) Feasibility study and project implementation report (Note: The NIPC recommends that applicants include letters or intent and quotations for the purchase of any required machinery with these documents)
10) Deeds and/or subletting agreements
11) Training program for local personnel, including a promotion schedule for Nigerian employees
12) Name, address, and nationality of directors
14) Job titles and academic and professional experience required for expatriates
14) Brochure related to the foreign shareholder

During the application phase, the NIPC will physically visit the site of a foreign enterprise to ensure that the firm is being established according to the business plan. NIPC officials stated that their inspectors are sent out within one week of an application being filed with inspectors preparing a report on their findings within a week of their visit. The NIPC employs 20 inspectors who monitor business activity.

According to NIPC officials, the NIPC Certificate, which costs N10,000 (US$100) and is renewable annually, is usually issued within two weeks. Several private sector representatives suggest the process can easily take two months or longer.

After registering with the NIPC, a business must also register in the state where it will operate.

Tax Registration and Payment

Taxes: The basic corporate profits tax rate in Nigeria is 30 per cent. However, many types of business are eligible for tax incentives, namely those operating in the manufacturing, solid minerals or tourism sectors; those in export processing zones (EPZ's) and other exporters; those located away from utility services; SME's earning less than N500,000 (US$5,000) per annum; non-agricultural companies with 25 per cent or less foreign equity that are still unprofitable after four years; and others listed earlier in our section on trade.

Nigeria's tax code includes a capital gains tax of 10 percent, and a tax of 10 percent on dividends and rent withheld at source. Capital gains tax is assessed on the disposal of financial and material assets, including options, debts, property, and foreign currency. Rental income, including for the lease of transportation and machinery, is taxed at 10 percent. Nigeria imposes a royalty withholding tax of 15 percent. An education tax of 2 percent is levied on company profits in Nigeria, and several business transactions are subject to the payment of stamp duties, which vary in the amount and formula for calculation. Nigeria also has a value added tax (VAT) of five per cent applied to all services and goods, except food, medicine, books, and personal rent. Excise taxes of 40 percent apply to tobacco and alcohol products.

Filing: Taxes are assessed on an annual basis, and a company must file its returns within six months of the end of the previous financial year. New companies must file taxes within six months of the end of their first fiscal year or within 18 months, whichever is sooner. Companies are required to pay a provisional tax payment, equal or greater than the previous year's tax assessment, within three months of the end of each fiscal year (although few companies apparently comply and others are not pursued by the authorities). Commercially based interest rates are charged on all late payments. The various reduced tax rates and other fiscal incentives available to companies operating in Nigeria are assessed at the time of filing by the Federal Inland Revenue Service (FIRS).

Registering to pay taxes is considered an easy and simple process, and federal tax authorities have offices in each state, although companies must register to pay corporate taxes separately from VAT. Companies that earn more than N1 million (US $10,000) a year must complete a self-assessment tax return, and in return their tax rate is lowered by 1 percent. Nigerian companies are assessed taxes based on their worldwide income, and foreign firms pay taxes based on income generated in Nigeria. Investment income generated abroad by Nigerian firms is not taxable as long as the funds are imported into Nigeria through licensed financial institutions. Taxes are to be paid in the currency in which the income is earned. The government issues a "tax clearance certificate" to firms that have paid their taxes in full.

Personal Taxes: Nigerians pay personal taxes at rates varying from 0.5 per cent on the portion of annual income below N20,000 (US$200) to 25 per cent on the portion above N120,000 (US$1,200). There is a wide consensus that due to the government's inability to collect accurate financial data on companies, and the degree to which the informal sector provides income, many Nigerians either underpay personal taxes or avoid paying altogether. This reporting failure is reflected in the government's practice of calculating the personal income tax on foreign workers based on an estimate of "deemed income." Foreigners are considered residents for tax purposes if they live in Nigeria for 183 days over a 12-month period.

State Taxes: States collect a variety of taxes including capital gains tax; stamp duties; personal income tax; and business registration levy. Personal income tax on employees is collected through a Pay-As-You-Earn (PAYE) system whereby employers deduct the tax from an employee's paycheck at regular intervals. States also collect self-assessed personal income tax and a withholding tax on personal income.

Annual business registration and renewal levies are also collected by the states. Each state can define what qualifies as an urban and rural area, and the tax varies based on where a business is located. In urban areas, the annual business registration fee will be a maximum of N10,000 (US $100) for the initial registration and N5,000 (US $50) for each renewal thereafter. In rural areas, the fee is N2,000 (US $20) for the first registration and N1,000 (US $10) thereafter.

Local Taxes: Local governments, including villages, have the right to collect at least 18 different types of taxes and fees including shop and kiosk registration; right of occupancy permit; signboard and advertising permits; and so on.

At lower levels of government, several taxes seem to be arbitrarily levied, with investors often warned of their imposition in advance so that unofficial arrangements or payments can be negotiated to forestall their imposition. Few firms have successfully had taxes repealed through recourse to the court system. Such arbitrary taxation clearly creates an unstable business environment and considerable suspicion among would-be foreign investors.

Overall Nigeria has a complicated tax system with federal, state and local authorities all having tax raising powers. These numerous taxes create an undue administrative burden for firms and government tax officers alike. Businessmen report that the rules governing tax payment are unclear, subject to excessive interpretation, and change frequently. It is often unclear which taxes apply and to what, particularly with regard to withholding, state and local taxes. As a consequence, tax collection is often arbitrary, with widespread evasion fueled by the ability to bribe inspectors. The PAYE and withholding tax were particularly cited by manufacturing firms in the RPED survey as problematic, poorly designed, and arbitrarily enforced.

Some investors report intimidation in the collection of taxes. Although this practice has declined since 1999, some businesses still find local authorities relying on police, military, and private “tax collection consultants” to assist in collecting. Several major foreign investors also reported that the government shut down their facilities during tax disputes.

d) Operating

Customs Procedures

Customs procedures and their enforcement are one of the most contentious and inefficient aspects of government regulation in Nigeria. In the estimation of many shipping and logistic firms it is perhaps the most uncertain customs environments in the world, as observed in other sections of this report.

The labyrinth of customs regulations, import documents and government agencies involved in export and import procedures hurts Nigeria’s competitiveness. False invoicing, counterfeit documentation, extortion, fraud, unclear security arrangements and other hazards increase the costs of imports by an estimated 45 per cent. As a result of these inefficiencies, much of Nigeria’s trade is diverted through Togo and Benin, and conducted on an informal basis.

Some of Nigeria’s high tariffs have been reduced in recent years, but many products continue to attract high rates. Tariffs are assessed on an *ad valorem* or commodity specific basis depending on the type of good being imported, and are payable in Naira upon entry. Apart from tariffs, additional duties on imports include VAT at 5 percent, an import duty surcharge of 7 percent of the normal duties assessed, a 2 percent “landing charge” on motor vehicles, and a 5 percent sugar levy on sugar imports.

Nigeria does not have fully elaborated anti-dumping legislation, but a special duty may be levied on imports if the government suspects that a particular product is being unfairly subsidized or dumped on the local market.

Officially, seven government agencies are allowed to operate in Nigeria’s sea and airports. These are the Nigerian Ports Authority, the Federal Aviation Authority of Nigeria (FAAN) (for airports), Nigerian Customs Service, the Port Police, the Nigerian Immigration Service, the Standards Organization of Nigeria (SON) and the National Agency for Food and Drug Administration and Control (NAFDAC). Each has the right to inspect imports and exports, for example, in order to ensure compliance with Nigeria’s product, health, safety, and environmental standards. Only the Customs Service is empowered to assess and collect duties, which can be paid to an authorized accountant or bank.

Nigeria has made efforts to improve its poorly reputed customs procedures in recent years. For example, the authorities have begun to implement the internationally recognized Automated System for Customs Data Entry and Control (ASYCUDA) and Nigeria has joined the World Trade Organization. In another effort to reform the system in 1996 a pre-shipment inspection (PSI) regime was introduced. Although this reform boosted customs revenues, each shipment required an import duty permit, and in many ways impeded the clearance of goods. A subsequent attempt to introduce a destination inspection system in 1999 failed. Under Nigeria's prevailing PSI regime, as stated in the official *Guidelines for Imports into Nigeria*, all imports must be accompanied by a clean report of findings (CRF) and an Import Duty Report (IDR) issued by a designated PSI company. Two companies, Bureau Veritas and Cotecna, are authorized to conduct these inspections.

To clear goods, an importer has to complete several forms depending on the nature of a given shipment. Form "M" is the main form for imports. This form can be obtained from the PSI companies, Nigerian embassies and consulates abroad, and local banks and their overseas branches. Three copies should be sent to the designated PSI company and one copy each to the importer's bank, the Nigerian Customs Service, and the National Maritime Authority. Once the PSI documents and forms are reviewed and duties are paid into the government's import duty account, Nigerian Customs is supposed to release goods within two days.

Duties paid on goods that are re-exported, damaged, or destroyed can be reclaimed from customs provided a claim is filed and substantiated prior to the goods leaving the control of customs. A certificate must be obtained from customs in order to get the refund. If an importer is transshipping goods through Nigeria, he or she must present a certificate proving that the goods are to be shipped to a third country before duties will be refunded. In cases where duties are overpaid, a refund can be collected if a claim is filed within a year of the transaction.

Nigeria ceased requiring importers to apply for a license as of 1986, but they are still required to secure an irrevocable letter of credit. Also, all imports valued at more than N10,000 (US $1,000) must be accompanied by a letter of credit confirmed by an international bank. A local insurance company must insure all imports. Commercial samples can be imported to Nigeria duty free if a bond is arranged.

Exports from Nigeria are subject to a PSI to ensure that the correct amount of currency is re-imported into the country. Six copies of a Nigeria Export Proceeds form must be completed to document an export transaction ten days prior to the planned shipping date. Exports incur a 1 percent processing fee and a 0.15 percent *ad valorem* tax on the FOB value of non-oil based goods. Nigeria does not require exporters to obtain licenses except when shipping petroleum products overseas, but the export of a few goods is prohibited (e.g. hides and skins, most types of processed and unprocessed timber and raw rubber).

The Standards Organization of Nigeria (SON) inspectors require from importers, a CRF, bill of lading, packing list, invoice, and other documents in some cases. SON is supposed to complete its review and clear goods within two working days. NAFDAC regulates the import, export, and distribution of food, drugs, chemicals, medical equipment, cosmetics, and bottled water. NAFDAC requires that firms exporting or importing such items must register with it.

Nigeria's customs clearance system is widely criticized for its complexity and unpredictability, as well as widespread corruption. Clearance procedures seem to be open to interpretation by customs officials and other Nigerian government agents, and disagreements about the classification of goods and their tariff rate are frequent.

As for corruption amongst businesses and customs officials, some businesspeople blame high tariffs, others the system's complexity, poor training of officials and low wages. On the business side, some shipping agents routinely undervalue or undercount their cargoes, thereby sparking disputes with customs officials. On the side of customs officials, PSI valuations are generally disregarded. Regardless of the reasons, clearing goods is universally considered to be the most consistently corrupt of procedures faced by investors in Nigeria.

Nigeria does not have a random inspections regime in place, and customs officials therefore inspect virtually all containers entering the port. This practice not only prolongs clearance times to a great degree, but also increases the chance of goods being damaged or stolen during inspections. In the past year, formal 100 percent inspection has been required as an attempt to reduce duty evasion. However, this has resulted in even greater delays, with questionable impact on revenue raising.

The import of commercial samples is allowed duty-free in theory, but investors claim that individual customs officials exercise wide discretion in approving or rejecting requests for duty remittances. The criteria applied to determining what is a sample item seem to be unclear.

Importers are also becoming increasingly frustrated with the arbitrary interpretation and application of Nigeria's health, safety, and environmental standards by inspection agencies. Some importers and government officials insist that SON and NAFDAC staff need additional training and better testing facilities in order to do their job effectively.

Publicly owned port facilities and equipment in Nigeria seem to be inefficient and outdated, especially at Lagos. The infrastructure at other ports varies in quality, but all of Nigeria's publicly owned facilities need upgrading. One private shipper estimates that cranes in Lagos port are out of service four out of every five days.

The combination of corruption, inefficiency and slow processing, poor infrastructure, and other factors have made Lagos port amongst the most expensive in the world. The imbalance between imports and exports also raises the cost of shipping, with most ships that arrive full departing only 25 percent full. Estimates by private shippers suggest that "associated port costs" at Lagos are roughly three times higher than any other West African port, at approximately US $200 per container. Import clearance, meanwhile, takes ten to 25 days on average. Reportedly exports are cleared at the quicker, yet still inadequate, speed of seven to ten days.

Foreign Exchange

As mentioned earlier in the sections on macroeconomic policy and trade, the foreign exchange market has been substantially liberalized in recent years. Businesses no longer need to seek special approval to trade currencies. Foreign exchange can now be purchased and sold on freely from private dealers authorized by the Central Bank of Nigeria, such as banks and hotels. Transactions through private currency traders are limited to N250,000 (US $2,500) per transaction, and the average currency broker will charge a 2 percent profit margin on these transactions. Individual transactions exceeding N1,000,000 (US $10,000) must be reported to the Central Bank.

Applications to acquire foreign exchange must be submitted to the Central Bank via selected intermediary banks. An application form must state the total amount of foreign exchange requested, applicant's name, name of the local bank, a Central Bank "intervention sales number," and the date of the transaction request. Once the application is approved the investor will be issued with a certificate of capital importation. The Central Bank is committed to releasing foreign exchange within three working days from the date that the request has been processed, although some company executives suggest that the release of foreign currency can take up to three weeks. Local banks cannot charge any rate spread on the Central Bank's currency sales rate for these transactions, but the intermediary banks will levy normal transaction charges and commissions. Private banks must report their buying and selling rates for foreign exchange to the Central Bank's Director of Foreign Operations on a daily basis.

Non-oil export proceeds must be deposited in "domiciliary accounts" maintained with authorized banks in Nigeria. In Nigeria a foreign investor can establish either a "non-oil export account" or an "ordinary" account. These account holders are apparently allowed to withdraw funds at the autonomous exchange rate, with 3 percent interest paid on the account, but can receive funds in convertible currencies only if planning to transfer funds overseas.

Clearly some vestiges of foreign exchange control remain. For example, NIPC still has the inappropriate requirement that investors provide proof of having imported investment capital. Certain restrictions also exist on the determination of interest rates, and foreign banking is restricted.

Investment and Export Incentives

Nigeria has a number of investment and export incentive schemes designed with the intent of easing the tax burden on specific types of investment or business operations.

"Pioneer status" tax holidays

These are granted by NIPC and administered by the Federal Inland Revenue Service (FIRS). Our interviews suggested that an NIPC declaration is not sufficient to obtain pioneer status. We were variously informed that that NIPC awards incentives; that an "Incentives Commission" in the Ministry of Finance awards them; that they are granted by the Ministry of Industry; and that they are given by the Joint Tax Board located in FIRS.

To affect investment decisions, incentives have to be awarded before an investor makes a commitment. However, it appears they are awarded only after a major commitment, for example acquisition of land and importation of capital goods, has been made.

The criteria are non-transparent and discretionary. The NIPC's *Nigeria* guide, for example, states that the five-year tax holiday is available to industries that produce products declared as "pioneer products" (for which there is a long list) under the Industrial Development (Income Tax Relief) Act No. 22 of 1971 as amended in 1988, or such other deserving enterprises as may be approved by the Council of the NIPC.

Other formal tax incentives

A variety of other tax exemptions and other incentives are listed in the NIPC's *Nigeria* guide and are contained in the Companies and Allied Matters Act, the Tax Code and other legislation. Federal ones are to be administered by FIRS since all companies file returns whether they have corporate income tax holidays or not. However, only some are included in the tax guide to which FIRS officials refer when assessing tax liability. It is unclear how entitlement to others is judged.

Investors are able to negotiate incentive packages on a case-by-case basis with both federal and state authorities. This confusing and ill-defined array of incentives is compounded by other factors:

- The criteria for awarding incentives are often unclear or inappropriate. For example, incentives for labor-intensive mode of production seem to reward *size* rather than labor *intensity*. The award is based on the number of employees and not a measure of labor intensity such as the capital/labor ratio.
- Incentives seem to overlap. Are tax incentives cumulative for a firm that is labor intensive, adds local value, uses local raw materials, and has pioneer status?
- The meaning of individual incentives is also unclear in some cases. For example, a two per cent tax concession for five years is offered "on

the cost of facilities provided for training." However, it is unclear whether this means a reduction in the corporate tax rate, an investment tax credit, or something else. More generally, it is not clear whether a 15 percent tax concession means that taxes are reduced by 15 percent, or whether the tax rate is reduced by 15 percentage points, although there appears some consensus that the latter was intended.

- Timing is also problematic. Ex post application for incentives generates greater uncertainty. Pioneer status can only be requested after an investor has made a substantial commitment.
- Responsibility for the administration of incentives is unclear and overly complicated. Although most seem to be administered by either FIRS or the Ministry of Finance, more bodies seem to be involved in awarding them. There may be little coordination between federal and state-level granting bodies.

Nigeria's incentive regime will inevitably confuse and frustrate investors, its targeted clientele. Criticism of the system is not louder, possibly because most investors do not bother applying for them or pursue a "negotiated" incentive route instead. The findings of the FIAS team corroborate the results of the RPED survey where very few firms actually benefited from incentives, and expressed the opinion that it was not worth spending the time applying for them.

Exporter grants and duty drawback schemes

All countries actively promoting exports have some form of export promotion schemes which extend free-trade status to exporters, or reduce the import tax burden on export production. The efficient functioning of such schemes is important for exporters to be competitive. These schemes exist in Nigeria, but as with other incentive schemes are not highly utilized. The Export Expansion Grant and Duty Drawback System have recently been brought together under the Manufacturing In Bond (MIB) scheme. Investors apply for these either through the Nigeria Export Promotion Council or the Ministry of Finance, although the latter administers them.

Companies wishing to benefit from the duty drawback scheme are first assessed by the Standards Organization of Nigeria, the Nigerian Customs Service and the Central Bank of Nigeria to determine eligibility and the duty drawback rate. The scheme is limited to raw materials that must be fully utilized for export, and foreign earnings must be repatriated. The Ministry of Finance has moved to a negotiable certificate form of refund rather than cash payments. The FIAS team did not investigate the approval process.

The Export Expansion Grant is unlikely to be allowed under World Trade Organization (WTO) rules after 2003, when the developing countries fall under the general rules on export subsidies. It is therefore inappropriate to offer them to newly investing firms.

Export Processing Zones

Export processing zones and industrial estates can help overcome, on a local basis, major barriers to investment, particularly red tape, the lack of security and poor infrastructure. Furthermore, they can be places for experimenting with new policies and simplified procedures; they can help build clusters of similar industries; they can offer superior infrastructure and utilities; and they can serve as a regional base for export.

The Calabar EPZ has been in existence for almost ten years. Of the four plants in operation, two are little more than saw mills that cut up primarily teak from nearby state-owned plantations. Although more processing is planned, operations are currently extremely simple and investments are small. Another small-scale plant produces cheese puff snacks for the West African market. A fourth plant had a small number of sewing machines for making garments, but had been unable to secure markets abroad. We were told of a weaving facility that was not operating and a steel-rolling mill under construction. Although other, mostly Chinese investors have announced their intention to build, their projects had not yet materialized.

Facilities appear rather run down. Stand-by generators are in place to deal with frequent power outages, but are idle since so few investors are actually in place and the generators are designed for much heavier loads.

Business managers had no complaints about the zone. Its management appears competent and espouses a positive attitude. It claims to offer one-stop approval, by dealing on the investor's behalf with NIPC and the Corporate Affairs Commission (CAC) for company registration, and other procedures. It also claimed that it could award tax holidays during the construction period.

The lack of success of the Calabar zone is a function of a number of factors, not the least of which is the lack of competitiveness of firms operating in Nigeria. It is not surprising that even a more favorable operating environment within the zone cannot make up for the more fundamental factors limiting exports from Nigeria.

A second free zone in Port Harcourt is currently under construction to host oil service industries focused on the offshore sector. This zone may have more inherent potential for success, provided it can effectively intermediate the government bureaucracy on behalf of the tenant firms.

State and Local Governments

The above has focused mainly on national laws and policies affecting the business environment. However, in Nigeria's federal structure state and local governments also have significant roles. In particular, the states are major actors and have direct control over the following areas relevant to business establishment and operation:

- **Access to government land.** As noted above, the states control public lands and have opaque and arcane procedures for leasing to private parties for commercial use.
- **Land titling and registration.** For private lands, states are responsible for land registration and titling. Most have outdated systems which are inefficient and involve high fees. The difficulties in transferring land titles, or even verifying and registering a lien, present a huge transaction cost and source of delay in routine business deals.
- **State taxes.** There are a number of taxes administered at the state level. State revenue agencies had come under the harshest criticism for use of tax "consultants" as collection agents, who had broad ranging powers and routinely abused them. Although discontinued, the practice created a climate of mistrust in a system characterized by corruption and evasion.
- **Business registration.** States typically have some form of business registration requirement also geared toward generating license fee income, but which becomes an irritant and source of corruption.
- **Provision of services,** primarily water, public education, roads, health. State governments are responsible for direct provision of services in these critical areas, either through government enterprises or state ministries or departments.
- **Direct ownership of commercial enterprises.** Finally, many states are direct owners of commercial enterprises. These include hotels, agricultural plantations, agribusiness, transport, and other firms. Most are troubled and are candidates for privatization in the more progressive states. Other states are continuing to invest directly in productive activities as a proactive development strategy.

In most of these areas, poor governance also characterizes the interventions of state governments. Corruption is widespread, service provision is poor, and the legitimate objectives of policies are undermined. The states have substantial resources, with approximately one-third of revenues flowing to the federation account earmarked for state and local governments. The oil producing states will have significantly more revenues, earning a constitutionally mandated 13 percent of oil revenues generated in their states, which in the past year actually began to be paid, if not fully.

The overlapping roles of all three tiers of government, federal, state and municipal, have led to a complex, regressive regulatory and taxation environment. This burden of multiple licenses, permits, and fees, administered inconsistently by state and local governments, falls disproportionately on SME's. In addition to registering with the Federal Corporate Affairs Commission (CAC), firms must pay state governments levies for business premises and registration as well as "right of occupancy" fees to state and local governments. Also imposed are shop and market fees. State governments impose direct taxes on individuals as well as a road tax.

Especially burdensome is the complex array of regulations, taxes, fees, licenses, and fines at the discretion of often-corrupt local officials. These appear to reflect the need for generating petty bribe income for officials rather than supplemental revenues for the municipalities. Firms object to them because of the harassment factor. One manufacturer noted that firms do not post signs identifying their factory, as it is simply an invitation to officials to stop in and demand license fees and petty tax payments, as a means of soliciting bribes. An informal canvassing of one city government identified the following fees and levies:

- Environmental fees
- Sign permits
- Hackney permit
- Haulage and loading permit (for anything carried in any size truck)
- Landing permit
- Inter-local governmental permit (for any activity spanning two jurisdictions, required from both)
- Tribal land use permit
- Township permit
- Mobile advert permits (required to place a sign on a vehicle)
- Operational permit
- Support levy
- Urban city carriage permit
- Enumeration levy
- Codification levy
- Educational/Occupational permits
- Commercial development permits
- Radio registration license (required for car radio, e.g.)
- Agricultural development permit

While some of the above represent legitimate licensing of certain types of activities, many are routinely ignored, except when inspectors call on firms finding them in non-compliance.

A number of states have taken aggressive efforts to promote themselves to private investors, have launched privatization programs, and are attempting reforms to improve what they can of the business climate. Indeed, competition among states can be an important positive force for improving the business environment in Nigeria, as states have already distinguished themselves on these grounds. If they prove successful in stimulating greater economic growth, leading to job creation, this differentiation can be an important force leading to broader based improvements in the business environment. Some states have been frustrated in their attempts to improve their business climates, and have taken on projects or initiatives to counter lapses at the federal level. Most frequent have been various schemes for state-owned or private power generation.

Institutional Capacity

Public Institutions

In this environment, both public and private sector institutions are weak and lack the capacity for effective service provision. Public sector institutions with important roles in private sector development have lost capacity, been isolated internationally, and have suffered from poor governance. This includes Ministries responsible for policy formulation and execution, organizations providing services in areas such as export and investment promotion, SME development, and financing. Many have lost standing in the eyes of the private sector, who appear to generally discount their services or their ability to help private sector development.

Public sector institutions in particular have been increasingly isolated from international contacts during the years of military government, especially under the Abacha regime. This includes contacts and technical assistance from donors or financed by donors, commercial contacts, and effective contacts with peers in other countries. As a result, they and have slipped behind in terms of current economic developments. A number of civil servants expressed frustration at their lack of knowledge of new thinking in areas related to economic development and private sector development. This isolation is compounded by low levels of internet use. While in other countries access to knowledge bases, including those of the World Bank Group, has been expanded greatly with wider internet access, this remains sadly restricted in Nigeria due primarily to problems in basic telephone connections.

Policy making in ministries has suffered as well under prior governments. As noted elsewhere, there have been frequent reversals of policies which have dramatically affected firms' operations. The manufacturing firms in the RPED survey overwhelmingly cited policy uncertainty as a major factor affecting their businesses, and expected new decisions or reversals to have consequences for their operations in the next year. The policy instability has been further exacerbated by capacity problems in Ministries, where serious policy development efforts were often not supported by decision-making under military regimes. This has led one observer of Nigerian corporate strategy to maintain that the ability to keep a close watch on a constantly changing policy environment is a key ingredient in business success in Nigeria—". . . firms with higher capacity for scanning the environment tend to quickly extract value from short term opportunity and contain the damage of policy choices outside their domain. . ."[16] Thus, adaptation to this instability has reinforced a short-term opportunistic strategy which can move quickly to take advantage of temporary situations.

Governance of public institutions has suffered as well. While the impact of corruption was discussed above in terms of undermining legitimate policy functions, there are also other more subtle ways in which service providers, in particular, have been frustrated. For example, many public sector organizations have not performed routine functions such as publication of data, etc. since 1995. Some have poor records of operations and ceased to provide certain functions for which they are responsible. Others have not held governing board meetings since 1995. And many have not received funding, other than that required to pay salaries, often despite budget allocations. Even those which have been funded adequately, such as NIPC, have still largely been ineffective for the other reasons noted below.

In many areas the government is attempting to revitalize certain organizations, including service providers. These include NIPC, the NEPC, the creation of SMIDA for SMEs, and the reconstitution of SME and micro finance agencies. Yet in doing so, in many cases the focus is to re-establish old programs, many of which involved government-driven assistance and financing programs. In the interim, most other countries have moved to private-sector driven programs with assistance and financing provided by private institutions, at times with implicit subsidies, or the creation of mixed public-private institutions or partnerships, or other types of support from government. This shift away from direct government involvement will be critically important to achieve in Nigeria as well, if these initiatives are to gain any credibility with the private sector, and avoid the governance and other pitfalls of past programs. This type of strategic reorientation of public programs related to private sector development will thus need to be the first step in any efforts to revitalize these organizations and their functions.

The Nigerian Investment Promotion Commission (NIPC)

Some of the problems facing Nigerian public institutions are illustrated by examining the Nigerian Investment Promotion Commission. The one not illustrated is a lack of resources, as the institution has been generously funded as the vanguard in attracting new foreign investment to the country. NIPC was created as a successor to the Industrial Development Coordination Committee (IDCC) to encourage foreign investment in Nigeria. The problems that discourage investment in Nigeria are severe; not all can be solved by the NIPC, no matter how well it is staffed and run. The tasks assigned to NIPC ought to reflect priorities for attracting foreign investment, and these tasks should be feasible.

The Commission is currently charged with becoming a "one-stop shop," where prospective foreign investors can complete all the procedures, including permits and licenses, necessary to undertake an investment in Nigeria. This goal is not feasible. Experience elsewhere indicates that those agencies previously controlling licenses, and permits refuse, in practice, to surrender their authority to the investment promotion agency. An alternative approach, wherein representatives of the responsible offices are assigned to the investment promotion agency, has also proven unsuccessful. The "home" offices quickly realize that the assignment of sufficiently influential persons to this task is wasteful of their resources, and they withdraw their personnel

The NIPC can assist investors in obtaining the permits, licenses, and conditions that they need. If its professionals understand the requirements for business in Nigeria, have close personal relations with the offices that control the permits and incentives, and establish early contact with potential investors, they can guide investors through the process. They should have a thorough knowledge of precedents and mediate between investors and officials. Currently, NIPC officials do not have these skills and relationships.

NIPC should have two interrelated goals, namely to become an effective investor-service organization and to champion improvements in the investment climate. By servicing the investor, the agency will obtain in-depth knowledge of constraints and their impact, and become better equipped to push for their removal.

Currently, NIPC assists investors already registered with the Corporate Affairs Commission (CAC) in Nigeria. It does not provide important pre-investment services that may significantly increase foreign investment. These include meeting prospective investors at the airport; arranging appointments with other business people and relevant government officials; providing transportation and guides; and showing facilities that might be attractive to expatriates.[17] Meetings should also be arranged with enthusiastic high-level officials. The agency should provide basic data and answer questions.

NIPC must also strengthen or reactivate relationships with existing foreign investors since they can be a country's best ambassadors or worst detractors. It should gather information on desirable improvements in the investment environment.

The NIPC issues its own business permit which is a precondition for investment. Since the NIPC should be engaged in promoting rather than screening foreign investment, this requirement should be dropped. Likewise, since its primary focus should be investor services in country, overseas offices are not needed. Information can be provided to investors via the NIPC website, or in printed form from Nigerian embassies.

State governments that are more proactive in eliciting foreign investment might benefit from outreach activities, including a small local office, of the NIPC.

The 200 plus establishment in the NIPC's Abuja office far exceeds what is needed to carry out its activities. Typically an effective investment promotion agency only requires ten to fifteen professionals to service investors and advocate key improvements in the enabling environment. Hence, establishment of regional offices should not require a net increase in staff.

NIPC has been engaged in a reorganization and reorientation exercise. In so doing, it will be addressing many of the shortcomings noted here. However, it will take a radical transformation to create a truly service-oriented promotion institution from the control-oriented bureaucratic entity which it started as. Moreover, as with other public institutions, NIPC has a real credibility problem with the private sector which can only be overcome through a radical transformation.

Private Sector Institutions

In the private sector, support institutions have also declined in their programs, services, and impact. Chambers of Commerce, their umbrella organizations, sectoral interest groupings, professional associations, and research institutions all play an important role in supporting the private sector. Yet here too some key institutions have also suspended or cut back operations during the Abacha years, lost international contacts, and are now seeking to rebuild their capacity. Others have grown in scope, and responded to the vacuum, such as the Nigerian Economic Summit Group.

Business associations largely operate at the federal and state level. The national associations with the greatest influence are be the Nigerian Association of Chambers of Commerce, Industry, Mines and Agriculture (NACCIMA), the Manufacturers Association of Nigeria (MAN) and the Nigerian Employers Consultative Association. These bodies typically have counterpart state chapters. In addition there are national professional associations of accountants/auditors, lawyers and engineers. Finally, sectoral and industry organizations such as the Road Transporters Association cater to specific interest groups.

At the national level, the Economic Summit Group is emerging as the business community's voice on the direction and pace of economic reform in Nigeria. The Economic Summit has, for example, been representing the Nigerian business community in the Joint Economic Planning Committee between the US and Nigeria, and has the support of the Office of the President and his chief economic advisor. Another step forward is the establishment of a presidential advisory council on investment, although the measure of its success will be how well its advice translates into institutional coordination and policy reform within the Nigerian government structure.

In other areas, some institutions have lost their capacity for service provision, in particular. Chambers of Commerce, outside of Lagos, appear to be minimally funded and lacking in capacity. Thus, they have been unable to perform functions related to training, dispersion of knowledge, provision of contacts, maintenance of information databases, and access to external sources of information. While national organizations have been more effective in developing these types of services, they are generally available only to larger firms which are members, or those based in Lagos. Local Chambers remain the main potential source of many of these services for SMEs, and their delivery capacity will need to be further developed.

Public-Private Sector Dialogue

In this environment, it is not surprising that the nature of public-private dialogue is often unproductive. It has recently been characterized by a focus on seeking particular tax advantages or protection for individual industries or sectors. Most expectations of the results of this dialogue go no further than that. As a result, a common perception of the public sector is that the private sector is “too dependent on government.” This was voiced repeatedly in the interviews conducted across agencies. Thus there was a certain cynicism regarding what may have otherwise been legitimate representation efforts by the private sector, and a general discounting of their claims, as they are perceived as being narrowly self-interested with little concern for broader policy or strategic concerns.

From the private sector’s side, here they too have focused on advocacy efforts in a narrow sense as a matter of survival. In the high cost, inefficient, and unstable environment which has characterized Nigeria access to protection or favorable treatment from the government has been critical to their continued operation. And given the policy instability which has characterized the recent past, this type of advocacy needs to be vigilant in order to be effective, with the ever present threat of reversals.

There is little in the way of productive dialogue on economic strategy and policy; again an exception has been the NESG, which has elevated the discussions in its annual summit meetings to a productive level, and provided a serious venue for discussions of economic policy and strategy. However, NESG has also been criticized as representing only the large Nigerian and foreign corporate interests, and not broadly the private sector, especially SMEs. The Vision 2010 Committee was also a productive example of how leading Nigerian businessmen could work together with government to define a comprehensive long range strategic document, and indeed spawned the NESG. Other recent initiatives, such as the Committee on the Trade Policy Framework, offer a broad based participatory approach to policy development which can be effective models.

The summit process has also emerged at the state level. In May of this year the First Lagos State Economic Summit held a two-day conference with the sponsorship of the Governor. Its objective was to address the economic transformation of Nigeria’s most populous and economically active region. Although there has been ample support for these processes emanating from political leadership in Nigeria, it is often observed that the reform effort breaks down at the implementation level where mid- and lower level bureaucrats have greater sway, and can thwart reform. The main function which has been preserved by private sector associations has been advocacy of their members’ interests with government. Here most have maintained and expanded their capacity to articulate their interests with respect to pending policy decisions by the federal and state governments. This is a direct function of the importance of securing and maintaining both general and specific treatment in terms of policy initiatives, and of the need for a constant effort at this given the steadily changing policy environment.

However, in the future there will be a clear need for more sustained and more productive dialogue in order to improve policy formulation, and generate a higher degree of consensus on economic policy. In the current environment, it is more akin to a lobbying effort revolving around what each interest group can get for itself, which in the end undermines serious efforts at dialogue, and compromises governance. It is likely that a new forum for public-private dialogue will be needed. Such a forum would need to be broadly representative of the private sector, receive appropriate high-level attention from the government, and serve as a counterweight to the influence of groups whose self interest leads them to block reforms, and as well as a balance against the more narrowly conceived lobbying efforts of sectoral and other groups. Without an effective forum for reaching a broad consensus on strategic objectives, initiatives such as opening the economy, privatization, and public expenditure reform are likely to be stalled as hostages of narrow interest groups. An effective forum can provide a mechanism for both sides to articulate and gain consensus on economic initiatives which can lay the basis for diversification and broad-based growth.

Conclusion

The above analysis is limited in depth and comprehensiveness. To fully document and assess the factors affecting the business environment will take a series of more focused analyses. Some of these are underway, such as the FIAS work on Administrative Barriers to Investment. However, there are several main conclusions which can guide efforts to address the deficiencies in the business climate.

- The impact of widespread corruption and notoriously poor governance under the succession of military regimes has created deep-seated anomalies in the business environment and undermined the effectiveness of traditional policy instruments.
- There has been a breakdown in private business ethics as well, which further complicates standard business operations in the country.
- The legal and judicial systems have been severely run down, and do not in their current form offer a reliable basis for dispute resolution, protection of property rights and enforcement of contracts.
- The tax system is complex, poorly administered and widely evaded.
- Business establishment procedures are complex and lengthy.
- Customs and import/export procedures are poorly administered and subject to widespread evasion.
- Governance and policy formulation is weak at the state and local level, and creates a complex web of overlapping taxes and regulations.
- Public and private institutions are weak, and require significant strengthening to be able to bring about positive change the business climate.

The result is a business environment where barriers to entry are high, where large firms are favored, where political connections are important for business success, and where uncertainty constrains firms willingness to invest. This assessment has focused on identifying constraints and problems, and it must be noted that in spite of the obstacles Nigeria has a large and relatively dynamic private sector. Foreign firms which have been present in Nigeria for some time have been able to operate to international standards of corporate governance, although most will say that it hasn't been easy to do so.

Fixing this set of problems will not be easy and will take consistent action over a period of time. While individual policy recommendations are beyond this analysis, there are some overriding principles and priorities which are likely to yield better results if used to orient reform programs.

- First, the complex regulatory and tax systems enable corruption and poor governance. Therefore, simplifying them and eliminating discretion as much as possible will bring gains on the governance side as well as removing policy distortions.
- Second, anti-corruption efforts will need to focus, at some point, on areas of importance to the

private sector. Improving tax and customs administration, for example, would yield immediate improvements in the business environment, and should be politically more palatable than other reforms as the beneficiaries.

- Third, restoring the effectiveness of government institutions, and of traditional policy instruments such as incentive programs, etc. will require dramatic improvements in governance. Otherwise, any new initiatives will simply be viewed by the private sector as further efforts to intervene or will be dismissed. The private sector does look for change, and will respond positively. For example, the investment response to some of the privatization efforts which have been implemented in a transparent manner have been quite promising.

Notes:

11. Foreign Investment Advisory Service, Nigeria: Joining the Race for non-Oil Foreign Investment, December 2000. A more detailed analysis of Administrative Barriers to Investment is currently under preparation by FIAS.
12. Transparency International, 2000 and 2001 Corruption Perceptions Indices, at www.transparency.de.
13. The World Bank and USAID are undertaking a comprehensive survey of the extent and impact of corruption, including among private businesses, which will yield more detailed data.
14. Results of the Nigeria Firm Survey, World Bank RPED, November 2001, pp. 97–99.
15. In this type of scam, unwilling persons are lured into revealing bank account and other information necessary for the collaborators to access those sources of funds directly.
16. Pat Utomi, *Managing Uncertainty: Competition and Strategy in Emerging Economies,* Spectrum Books, 1998, pp. 331–2.
17. Some of these steps are described in Debora Spar, *Attracting High Technology Investment: Intel's Costa Rica Plant* (Washington: Foreign Investment Advisory Service, 1998).

Nigeria has a chronic shortage of long-term debt capital, as well as equity funds and access to capital markets. Other financial instruments that could support private sector development, such as leasing, are underdeveloped. In a continent where finance is a major constraint on development everywhere, the private sector in Nigeria, above all small and medium enterprises (SMEs) suffer from high interest rates, terms of rarely more than one year, an absence of equity capital, and collateral requirements that are heavy and exacerbated by land-titling problems. Nigeria's desperate situation stands out even in Africa.

Sustained and equitable economic growth is key to alleviating the chronic poverty in which 70 million Nigerians presently live. Moreover, there is abundant evidence of the link between a strong, efficient and diversified financial system, and economic growth. Nigeria's declared strategy of private-sector led growth can only succeed if the financial sector is able to provide effective support for the real sector.

Most large-scale enterprises in Nigeria have reduced their borrowings from banks due to high interest rates and the short term nature of available loans. At the same time, banks are unwilling to lend to the SME sector with its high perceived risks, and few SMEs can make viable long-term productive investments with the cost and brevity of available loans. Consequently, banks are not actively lending to the real sector, and loanable funds are currently used to finance consumer imports, and to speculate in forex markets.

Nigeria's financial sector is, however, in the midst of substantial reform and restructuring, and the medium term outlook for more lending to the private sector (especially SMEs) by banks, and greater access to equity amongst larger companies, and perhaps SMEs, seems relatively bright. That said, it will be some time before the success of the current wave of reform, restructuring and new initiatives can be properly judged.

Introduction

The aim of this chapter is bring together a variety of information on the financial sector, and access to finance, in Nigeria from the perspective of the private sector. The World Bank's Financial Sector Review compiled in May 2000 (drawing upon data for 1998 and 1999) is a key reference document. Also, the RPED Survey work provides a valuable grass-roots input on the problems of accessing finance in Nigeria, while World Bank's SME Map of Nigeria focuses on financing issues from an SME perspective. Various other sources were used to update information on the financial sector in Nigeria.

In early 2002 a joint World Bank/IMF team will complete an in-depth review of Nigeria's financial system. It will look in particular at the impact of the financial system on the real sector, and the extent of distress in the commercial banking system. No details of the findings of this investigation are currently available, or included in this chapter.

After this introductory section, this chapter first provides an overview of the findings of the RPED survey and the SME Map relating to the private sector's access to finance in Nigeria. It is useful to have the private sector's voiced concerns in mind when seeking to understand the challenges facing the financial system that must supply it with capital. The central section of the chapter looks in depth at the financial system, in particular commercial bank loan financing, the development finance institutions (DFIs), and microfinance and community banking on the debt side, as well as sources of equity financing, and the underdeveloped leasing market. The final section looks at the financing needs of the private sector, and at the various reform efforts and new initiatives underway.

The availability of medium to long-term financing is very important in a developing country like Nigeria for the following reasons:

- Access to term finance encourages innovation and risk-taking by entrepreneurs. Most investment projects with high returns have long gestation periods which require long-term finance. If entrepreneurs finance such long-term investments with short-term debt, project risk increases sharply and failure rates are likely to increase substantially.
- With access to long-term finance, firms are able to engage in strategic, long-term planning since they have to worry less about the liquidity risks associated with failing to renew short-term credit, especially when (short-end) interest rates are high.
- Further, firms cannot easily undertake modernization of plant/equipment, adoption of more productive technologies, and expansion of productive capacity without long-term finance.
- From the government's perspective, long-term finance allows the financing of vital social and physical infrastructure such as roads, schools, and both commercial and residential buildings.
- Finally, long-term finance provides avenues for pension funds and life insurance companies to invest in long-term assets to enhance matching with their long-term liabilities.

Reasons why the financial system has been unable to provide long-term finance are discussed in sections below, but are partly systemic problems of the banking/financial system, partly problems internal to the banks and other financial institutions, and partly due to demand-side weaknesses. Also, the systemic problems are not only those internal to the banking system, but also functions of the larger picture—uncertainty (e.g. inability to enforce contracts) and infrastructure weaknesses (no point in expanding or buying expensive equipment if the economics are such that independent generation capacity is needed)

Fortunately, the government of Nigeria and the banks are serious about rectifying this situation, and many very tough reform programs and bold initiatives are underway. These include restructuring of the Development Finance Institutions (DFIs) and the rural banking system, as well as the launching of the Small Scale Industry Equity Investment Scheme, whereby all banks set aside 10 per cent of pre-tax profits for SME equity investments.

Access to Finance—Indicating the Problem

RPED Survey and SME Map

Firm Perspective

Two recent analyses that have looked in detail at the issue of access to finance for the private sector are the SME Map and the RPED Survey of Nigeria. The SME Map focused specifically on SMEs using an interview and focus group methodology, whilst the RPED Survey used structured questionnaire interviews, and included larger firms and foreign firms in its survey of 232 companies in the manufacturing sector.

According to the findings of the RPED survey, inadequate access to finance ranked as the third most important constraint on the activity of private firms after general uncertainty in the business environment and infrastructure problems. The high costs and limited availability of credit is a major factor that raises the cost of doing business, and lowers the competitiveness of the Nigerian private sector.

The survey reports that 38.5 percent of the full sample of firms considered themselves to be credit constrained (Table 3.1). Predictably, a breakdown reveals that the proportion is higher the smaller the size of firm with 48 percent of micro-enterprises viewing credit as a constraint, but only 25 percent of very large enterprises. Also, indigenous companies were far more credit-constrained than foreign companies.

These proportions could easily have been higher. However the findings may reflect such issues as a

Table 3.1. Percentage of Firms Reporting Being Credit Constrained

Group	Percentage
Full Sample	38.5
Micro	48.2
Small	38.6
Medium	36.7
Large	36.1
Very Large	25.0
Foreign Owned	33.3
Indigenous	42.5

lack of awareness amongst entrepreneurs of how greater access to capital might be effectively mobilized, or access to finance being something of a moot issue given other problems of uncertainty and poor infrastructure. For example, 50 percent of surveyed firms said they had never applied for a loan, of whom over half did not cite high interest rates, heavy collateral requirements or expectation of rejection as a reason.

Seventy per cent of the RPED survey sample had access to overdraft facilities, and most bank debt takes this form. Overdrafts are commonly rolled over (unless a borrower's financial situation changes), and are often used to finance long-term investments. Overdrafts must be fully collateralized, and interest rates range from 25 percent for small and micro firms to roughly 21 percent for large firms. Short term loans have similar interest rates, and many firms treat these interchangeably. Short term loans, based on the survey sample, typically required 151 percent of the loan value in collateral, thus tying up substantial assets.

Long term finance is very rare and only the most creditworthy have access to it. Less than 16 percent of the sample reported having loans of more than one year in term, mainly medium and large firms. Service sector companies such as hotels have better access to long term loans because of collateral availability.

Another source of external finance for Nigerian companies is trade credit, i.e. short-term credit extended by companies to their suppliers, and by companies to their customers. Seventy-five to 80 per cent of the RPED sample reported giving or receiving trade credit. However, the practice is not as widespread as it could or should be with trade credit being extended only to the most valued and trusted customers due to the lack of confidence in the legal system to enforce contracts. Amongst SMEs there is anecdotal evidence of widespread "reverse" credit with larger companies effectively using suppliers as a source of credit, receiving goods and not paying for them for extended periods.

Bank Perspective

Banks meanwhile insist that they would like to make more loans to industry, but there is a common belief amongst many that lending to the manufacturing sector is not justified in terms of balancing risk and cost. This perceived risk seems to come from a number of sources:

- Difficulty of obtaining accurate and reliable information on a firm's true financial condition and performance.
- The judicial system makes contract enforcement difficult.
- The risky/uncertain business environment leads to the fear that firms will not be able to repay debt.
- A history of non-repayment and general suspicion of SMEs leads them all to be tarred with the same brush, and loan officers are not sufficiently trained in the skills and methodologies for discriminating between high and low-risk SMEs.
- Shareholders naturally expect that banks will pursue the best absolute and risk-adjusted returns whether through government paper or quick-

turnover loans against shipments of imported products.

Consequently banks charge high interest rates, demand high levels of collateral and make few loans of more than a year in term.

Nigerian Financial System

Financial System Overview

The Nigerian financial system is one of the largest in sub-Saharan Africa consisting of a fairly dense array of bank and non-bank financial institutions, but dominated by commercial banks. The system consists of some 80 plus commercial and merchant banks, hundreds of rural-oriented community banks, the People's Bank, seven development finance institutions (DFIs), over 240 licensed finance companies, about 170 federal mortgage banks, over 180 insurance companies, 190 discount houses, various pension schemes and over 900 bureaux de changes. However, the apparently diversified nature of the system is deceptive since the commercial banks dominate the financial sector accounting for 93 percent of non-central bank assets in 2000. Moreover, the four largest banks accounted for 38 percent of non-central bank assets.

Life insurance companies are usually a major and natural source of long-term domestic funds in developing countries, but in Nigeria the insurance industry is grossly underdeveloped. Premiums received currently amount to less than one per cent of GDP, and the market is steadily shrinking. There is a serious problem with unpaid premiums, especially by government agencies and parastatals, with overdue premiums amounting to some 38 percent of annual premiums. Insurance companies in Nigeria are presently investing almost entirely in short-term securities or real estate. The National Insurance Commission (NAICOM) is tackling these issues as positively as it can, but is hampered by a lack of resources.

The pension fund industry is another potentially important source of long-term domestic funds, but is similarly underdeveloped and chaotic. Composed of the Nigerian Social Insurance Trust Fund (NSITF), a number of government-run pension funds for public employees, about 2000 occupational pension plans, and personal pension schemes, the system if very fragmented. The NSITF, a mandatory, defined-benefit program faces challenges in collection due to widespread evasion It also has high administrative costs amounting to 60 percent of total contributions, and an investment portfolio concentrated in a small number of risky assets and industries.

Loan Financing for the Private Sector in Nigeria

The dominance of the financial sector in Nigeria by commercial banks means that they must play a central role in financing the sustainable growth of the private sector in Nigeria. However, they have a poor record to date of providing longer term finance to the private sector, of which there is a chronic shortage in Nigeria. Indeed, some 96 percent of bank loans have a maturity of 12 months or less, and many businesses must rely on overdrafts.

The problem of poor access to longer term funds in Nigeria is all the more serious because sources often relied upon in other countries—development finance institutions, insurance companies, pension funds, capital markets, equity investors—are currently not in a position to fulfill their potential. The near absence of equity type investors in the SME sector and the dismal performance of Nigeria's Development Finance Institutions in recent years (see below) have been of particular concern. However, the DFI situation should soon change with the start-up of the merged Bank of Industry in 2002, and the Small and Medium

Industry Equity Investment Scheme (SMIEIS) of the Bankers Committee should begin to provide some equity funding to the SME sector from 2002.

Overall, the financial system is not effectively supporting real sector development, and is currently not capable of acting as a propeller of economic growth and development. The formal financial system has been relatively shallow with an M2/GDP ratio of roughly 13 percent and a relatively low level of credit to the private sector at 9.5 percent of GDP.[18]

Commercial Banks

The financial condition and soundness of the commercial banks that dominate the Nigerian financial system has strengthened significantly in the last several years. Nevertheless, the continued resistance or failure on the part of commercial banks to engage in longer term lending needs to be investigated, and to change.

The Nigerian banking system has been significantly strengthened in recent years. The authorities have closed more than 30 banks, increased minimum paid-in capital requirements ten-fold to N2 billion for new banks, and forced the majority of the remaining banks into compliance. Evidence of banking system strengthening, largely as a consequence of these actions and macroeconomic improvements, include[19]: i) aggregate banking system capital increasing from a negative 74 percent to a positive 5 percent of risk adjusted assets: ii) aggregate non-performing loans dropping from 34 percent of gross loans to 18 percent; iii) a drop in insider lending of 66 percent in absolute terms to 15 percent of capital for healthy banks; iv) a drop in non-interest expense from 12.8 percent to a still high 10.3 percent of average total assets; and v) clearly evident but hard to quantify improvements in banking system profitability which is reported at 5 percent of assets for the most recent period available.

Structural improvement in the commercial banking system is clear: the four largest banks now have 38 percent of non-central bank assets, and the number of government-controlled banks fell from 20 in 1996 to 10 at the end of 1998 with a combined 4.6 percent of system assets. Also, 23 banks holding a 53 percent market share are listed on the stock exchange. Distressed bank are gradually being eliminated, and the last CBN-owned bank classified as distressed was handed over during 2001 (African Continental Bank).

As a driver of the real sector of the economy, however, the commercial banks are not performing well. The reasons for this are partly internal to the banks themselves, partly a function of systemic weaknesses in the financial system, and partly on the demand-side both at the level of the firm and the general business environment. The following are some of the factors at play.

SELECTED BANKING/FINANCIAL SYSTEM FACTORS

- Many banks are taking high foreign exchange risk with 36 banks representing 52 percent of system assets holding net foreign exchange positions in excess of 50 percent of net worth.
- Government failure to sterilize oil revenue windfalls has impacted the banking sector's propensity to lend to the private sector. In other words, the government has not invested oil windfalls in either economic infrastructure, or liquid dollar investments. Consequently, when oil prices have fallen, the government has resorted to borrowing to sustain public expenditure. Such actions have led to many fluctuations in domestic money supply, the rate of inflation and the cost of credit to the private sector.
- Inadequacies in the legal environment including long delays in adjudicating cases of debtor delinquency, and problems with contract enforcement in general, also discourage term lending. In the absence of an adequate institutional framework for the enforcement of

financial contracts, coupled with the cost and difficulties of using the legal system to seek redress, lenders have favoured short-term credit which makes it easier to control borrowers and minimize losses.

- High, unremunerated deposit requirements at the central bank, and high interbank lending rates, the latter partly due to high costs of sorting cash and inadequate financial infrastructure (e.g. poor payments system).
- Need to pay best returns to shareholders, especially in view of these deposit requirements and high administrative costs, means that banks need to generate high, liquid returns, and to search out the short term activities that produce them (e.g. Forex roundtripping).
- Lending to parastatals may have crowded out SME sector lending, although this should improve with the advance of the privatization program.
- Many banks still appear to be badly distressed, and the government (in conjunction with international organizations) is conducting an in-depth review of individual banks to separate the healthy from the distressed.

SELECTED FACTORS INTERNAL TO BANKS

- Banking malpractices such as forex roundtripping starve the real sector of funds, despite the estimated N1 trillion of local currency deposits. The CBN has been accused of not applying enough sanctions to erring banks in this regard.
- Administrative inefficiency also appears to be a problem for banks in general, although the situation has been improving. The Nigeria Financial Sector Review points out that non-interest expense for banks as a whole had fallen from 12.8 percent to a still high 10.3 percent by the late 1990s.
- Inadequate banking skills and training amongst loan officers and other bank staff. Apart from stories of loan contracts being poorly understood by loan officers, the more pervasive problem is a lack of training in how to differentiate good risk SMEs from bad risk ones. The tendency currently is often to turn away potential borrowers who do not have excellent collateral in the form of clear land and building ownership.
- Some commentators also feel that banks in general have done a poor job in communicating their contribution to private sector development, and reaching out proactively to deserving SME sector projects. Examples of how this is gradually changing include Citibank's Extended Target Market (ETM) program supported by IFC, micro-finance initiatives by Guarantee Trust Bank and UBA, and the involvement of various banks in overseeing small start-up funds.

DEMAND-SIDE FACTORS

- Effective demand for term finance from the real sector—i.e. lack of bankable projects due to business environment constraints. It is useful to distinguish between the real sector's *need* for term finance, and the *effective demand* for it. The industrial sector's huge need for long-term debt capital is not in doubt. However, effective demand is constrained by the limited motivation for new investment in the private sector where sales and profits have been low and declining in recent years. Problems faced by the private sector include: i) erratic power supply which forces most manufacturers to resort to high cost private generation of power; ii) extremely poor infrastructure; iii) strong competition from cheaper, used consumer items imported from Europe, the Americas or elsewhere; iv) continuing Naira depreciation resulting in increased costs of raw materials and spare parts.
- Many SMEs have poor financial records due to the "costs of exposure" in Nigeria, and so no track

record to support them in a loan application. They also have limited skills in how to approach banks, and in how to manage a business.

For the private sector, one important potential effect of banks withdrawing from public sector lending, and larger companies either going to the equity market or finding cheaper debt financing than through Nigerian banks, is that banks will face increasing pressure to downscale their lending to SMEs.

Bond Issuance

As a source of capital for Nigerian companies, equities are the preferred vehicle amongst both borrowers and investors due to high interest rates (on the borrower side) and low liquidity (for investors). Consequently, Nigerian bond markets are generally immature, although there has been much recent activity amongst state governments, and some potential exists on the corporate side.

In the public sector, the federal government has been inactive in the capital markets for financing capital projects in recent years (only 15 federal government bonds are listed on the NSE, and most have not traded since the early 1990s). Past patronage has also been limited due to unattractive coupons.

State governments, meanwhile, have been increasingly active since late 2000. Delta, Edo and Lagos state governments alone have raised over N30bn in financing for capital projects, and some ten other states are in the preparatory stages. These are typically floating rate bonds with coupons at roughly 2.5 percent over the Minimum Rediscount Rate (MRR—CBN lending rate to commercial banks).

State bonds (or bonds from other issuers) may appeal to individual investors for whom bank deposit rates are very low. Indeed, the first of two tranches of the 2000 Edo state 20 percent Floating Rate Revenue Bond (MRR + 2.5 percent, roughly 20 percent), with maturity of 2002/2006, for example, was 100 percent oversubscribed. Yet to be seen, however, is the repayment ability of state governments, especially given (a) the federal government's refusal to guarantee state bond issues, and (b) a possibility, however small, that state governments may claim that their ability to pay interest or repay capital is dependent upon transfers from the federal government.

The corporate bond market, however, is very much underdeveloped. One reason for this is that the appetite for shares is greater amongst both issuers and investors, helped partly by their greater liquidity. If the bond market as a whole becomes more liquid, a stronger corporate bond market may develop. As far as the bond market is concerned, there is also a significant need to build appropriate skills amongst investment banks and stockbrokers.

Development Finance Institutions (DFIs)

The establishment in late 2001 of the Bank of Industry (BoI) has the potential to revitalize the DFI business in Nigeria. The Federal Government has set aside N150bn to fund the new bank, and interest rates on loans are expected to be below ten per cent. The BoI was formed in 2001 from the merger of:

- Nigerian Industrial Development Bank (NIDB)
- Nigerian Economic Reconstruction Fund (NERFUND)
- Nigerian Bank for Commerce and Industry (NBCI)

The merger went ahead after considerable uncertainty and some strong resistance. One concern was that by merging NIDB (theoretically concentrating on larger companies) and NBCI (SME-focused), in particular, the interests of SMEs would suffer. In fact, the relatively better performance of NIDB led to it becoming the larger lender to SMEs. Other reasons included the intention to overhaul the staffing structure, as announced by the consultants appointed for the restructuring process. The new bank's modus operandi and performance will become clearer in 2002 when it begins new lending activities.

The pre-merger picture of the Development Finance Institutions (DFIs) was desperate. According to the World Bank's Financial Sector Review (2000),[20] they had total assets in the region of N24bn amounting to roughly 3 percent of commercial/ merchant bank assets. Also, they do not have access to public deposits, and are therefore subject to a relatively hard budget constraint. In 2000 there were seven main DFIs: the Nigerian Industrial Development Bank (NIDB); the Nigerian Bank for Commerce and Industry (NBCI); the Nigerian Export-Import Bank (NEXIM); the National Economic and Reconstruction Fund (NERFUND); the Urban Development Bank (UDB); the National Education Bank (NEB); and the Nigerian Agricultural and Cooperative Bank (NACB). The Review highlighted the following elements of their financial situation.

- A combined annual loss of N2.1bn for the most recent year for which data was available;
- Accumulated losses of N10.2bn;
- Negative net worth of N5.8bn;
- No 1998 disbursements for four out of seven DFIs, and a net yoy decrease of N2bn for the group of seven; and
- A gross loan portfolio of N17bn—for the four DFIs for which details were available 78 percent of the loan portfolio was non–performing.

While each DFI has had unique problems, a number of more generic causes of their problems and inefficiency can be identified that must be addressed as the new Bank of Industry begins operations.

i) non-commercial governance that gives a higher priority to developmental than commercial objectives, and breeds corruption;
ii) politicization of lending due to government ownership;
iii) lack of quality internal direction given and absence of qualified Boards of Directors;
iv) a poor environment for credit discipline in which many borrowers may not take their responsibility to repay seriously (especially when government-owned lenders are involved);
v) a lack of sub-sector diversification that raises already high risks associated with DFIs that lend predominantly long-term in developing economies;
vi) inadequate appraisal, supervision and collection skills and procedures;
vii) inappropriate funding vehicles (e.g. that involve assumption of forex risk by borrowers with little overseas exposure;
viii) demoralization and loss of quality staff;
ix) cumbersome administrative structures and lending patterns dictated by regional considerations;
x) inability to compete for the best customers;
xi) use of subsidized funds that encourages diversion of funds to unintended purposes; and
xii) lack of market discipline.

NIDB (owned primarily by MoF and CBN) had operated successfully for much of the time since its establishment in 1964, but not in recent years. Although a relatively larger number of NIDB's loans have been repaid, 55 percent of borrowers as of December 1998 (total 77 borrowers) were either losing money or being liquidated. Consequently, NIDB largely ceased new lending activity and focused almost entirely on collecting old loans. It had also operated without a formal Board of Directors since 1992.

NBCI was fully-owned by MoF and CBN and specialized in 5 to 7 year loans, although 10 percent of loans were for working capital, and it made some limited equity investments in earlier years. In addition to being longer term than commercial bank loans, NBCI also lent at slightly lower than commercial rates:

at about 21 percent (roughly the prime rate offered by commercial banks) for term Naira loans; 14.5 percent for forex loans; and 30 percent for working capital loans. Despite promising early years as primary financier to SMEs in Nigeria its performance deteriorated substantially. By 1995, 92.7 percent of its loans were in default. Subsequent restructuring and downsizing did not improve the situation. By end-1998 it had a loan portfolio of N1.25bn (430 projects), 98 percent of which was overdue (74 percent by more than 24 months). Since the early 1990s NBCI unable to lend money on a viable basis, and the lending skills it did have in the past were eroded by a lack of activity and the departure of better staff. Also its client base developed a culture of non-repayment over the years.

NERFUND was established in 1985 as an apex agency to promote SME development through the provision of credit to DFIs and commercial banks for lending.[21] During the last decade NERFUND had disbursed roughly $160mn for 260 projects, mostly in foreign exchange. As of 1998, however, new disbursements were limited to collections with the exhaustion of foreign exchange resources. Administrative efficiency was relatively good with administrative costs at only 1 percent of assets, but its 85 employees also only managed to disburse just 0.3 projects per staff member per year. NERFUND's collections have been relatively healthy since it was able to develop other DFI and commercial banks' accounts at the CBN. Nevertheless 20 percent of the 1997 year-end loan balance had been made to banks then under liquidation proceedings. That said, repayment default by final borrowers appears to have been very high given that most loans were forex denominated, and borrowers were not exporters. Indeed, SME borrowers faced repaying loans made at $/N22 at prevailing exchange rates (and typically did not do so) until the government decided last year to permit repayment at $/N22.

The track record of DFIs in most respects over the last decade has been extremely bad, and radical restructuring of the sector was clearly well overdue. Although the commercial banks must emerge as the main source of financing for the private sector, especially SMEs, the DFIs can play an important role especially if they can successfully lend for longer terms at lower interest rates. However, for this role to be fulfilled a new structure and standards of operation are essential for the new Bank of Industry. If the DFIs are recapitalized and/or restructured but continue to operate as they are, they will impose significant costs on the economy. These included wasted resources, the perpetuation of inefficiency and corruption in the financial sector, and discouragement of the commercial banks from entering into the long-term lending business.

Microfinance

The scale of microfinance operations in Nigeria is limited. SME support from state governments in Nigeria tends to be in the form of microcredit schemes. These schemes are sometimes managed independently, and sometimes jointly with financial institutions of donor organizations.[22] A few notable schemes are the N31 billion program of the Delta State Government and four banks (Standard Trust Bank, Oceanic International Bank, Zenith International Bank and Societe General Bank), and the N30.5 billion program of the Lagos State Government. Unless bank funds are involved, these programs often prove unsustainable due to the culture of non-repayment of government loans.

The Community Banks (CBs), the People's Bank of Nigeria and other microcredit/microsavings organizations are in the midst of substantial restructuring. Community Banks (CBs) specialized in predominantly short-term loans to farmers, and small-scale urban and rural commerce and manufacturing businesses, and interest rates have been capped at 21 percent. Whilst collectively important, the majority are weak, undercapitalized, and with limited outreach. The performance of the group as a whole has been poor. The system of 1368 Community Banks in existence in 1995 had shrunk to some 880 with nationwide assets of N12 billion before the Central Bank of Nigeria (CBN) instigated a system-wide audit in 2001. As a result of the audit CBN is likely to grant new operating licences to perhaps only 230 CBs based upon strict criteria including financial health, transparency, diversified ownership, and a track record of profitability.

In October 2001 the People's Bank of Nigeria (PBN), the Nigerian Agricultural and Cooperative Bank (NACB) and the Family Economic Advancement Programme (FEAP) were merged into a single institutions, the Nigerian Agricultural Cooperative and Rural Development Bank (NACRDB). The PBN offered retail banking services and provided some loans without collateral, whilst NACB and FEAP provided loans for agriculture and cottage industries as rural DFIs. The mandate of the new NACRDB is to provide funds to farmers and rural industrial projects at affordable interest rates, but issues like the location of the new headquarters and collection and payment of outstanding (pre-merger) debts have still to be resolved. NACRDB is expected to begin lending operations during 2002.

Several donor organizations also have micro-credit funds with a capacity development component. However, since these programmes have traditionally been grant-based, they have also suffered from repayment problems and non-sustainability in the past. One recent programme—the UNDP's $1.5mn microstart programme—aims to produce far better repayment rates by lending the funds to seven or eight partner Microfinance Institutions (MFIs) and monitoring performance closely through a technical advisor.

A variety of NGOs are also involved in microfinance programs, sometimes managing grants made by oil companies (such as a $14mn programme by Shell for SME development), and sometimes from other sources. Many NGOs involved in microcredit programmes claim repayment rates of close to 100 per cent, but the overall scale of operations is limited.

The advent of the Small and Medium Industry Equity Investment Scheme (SMIEIS) may be an opportunity for banks to take equity stakes in successful microfinance institutions (MFIs).

Other Sources of Financing

Equity

Equity financing for the private sector in Nigeria, for smaller companies in particular, is extremely scarce. Only the largest firms currently have access to equity or bond financing through the capital markets in Nigeria, and the listing requirements are prohibitive for smaller companies.[23]

In addition to some angel equity investors for smaller companies, some banks have started to take equity in selected SMEs but on a very small scale. However, the scale of equity involvement by commercial banks in SMEs is set to change with the implementation of the Small and Medium Industries Equity Investment Scheme (SMIEIS).

Under the SMIEIS, which has an initial life of five years, banks will set aside ten per cent of their previous year's profit before tax each year for equity investments in SMEs. The concept was originally floated by the Bankers Committee, and subsequently gained the support of the President as part of his support for revitalization of the real sector. The scheme began in June 2001, and banks, under a recent CBN circular, have 18 months to disburse the first year's tranche, and 12 months for each subsequent year's amount. Ten per cent of PBT amounts to roughly N5 billion per year. By mid-November 2001 sixty-five banks had already set aside N5.9 billion.

In December 2001 the Governor of the Central Bank inaugurated the Presidential Advisory Committee on the Small and Medium Industries

Equity Investment Scheme for Realistic Economic Development. The committee, with a mandate to advise the president on the disbursement of the ten per cent fund, was set up by the President as a sub-committee of the Presidential Consultative Committee (PCC) on the revitalization of the Nigerian economy. The new committee is expected to meet quarterly and provide periodic assessments of the scheme through the PCC.

Furthermore, the Advisory Committee of the SMIEIS is led by the Organized Private Sector (OPS): three banks, MAN, NACCIMA and NASME. Government participation includes the Ministries of Finance and Industry and the CBN whose Development Finance Department also serves as the committee's secretariat. Such a governance/advisory structure represents an encouraging and practically-oriented partnership between the public and private sectors.

Some of the main guidelines given for the scheme by CBN are as follows.

- Participating banks will be expected to monitor, guide and nurture enterprises financed under the scheme.
- Each bank will also be required to have a Small Scale Industries (SSI) Unit which will have responsibility for appraising and making recommendations.
- Banks will be able to sell their holdings once the target enterprise has been properly nurtured subject to prior approval by the Central Bank.
- For an enterprise to benefit from the scheme it must be properly registered at the Corporate Affairs Commission (CAC), maintain good financial records, and be subject to annual audit by a firm of qualified accountants.
- The scheme will be operational for five years in the first instance.

Potential benefits for banks include: investment dividends; capital gains at divestment which will be subject to income tax but not capital gains tax (CGT); the initial 10 per cent of PBT set aside is tax-exempt; and banks will have a 100 percent investment tax credit in the year an investment is made under the scheme.

The excellent and necessary objective of the scheme notwithstanding, it has been criticized by some commentators. This is because of its as-yet poorly defined implementation arrangements, the potential for abuse, and moral hazard given the shortage of appropriate skills. The concerns that have been expressed now seem unlikely to derail the scheme, but many need to be treated urgently if the disbursement deadline for the first tranche of late 2002 is to be met, and the scheme as a whole is to be successful. Some of the key issues are as follows.

- Given that banks are expected to be represented on the board of companies, and that few bank loan officers have adequate experience in assessing and managing equity investments, the scheme will represent significant investments in manpower and training.
- Under the scheme's guidelines banks can either invest themselves the ten per cent they have set aside, or establish fund management companies to make and monitor the investments. Given the shortage of equity investment skills, this may be the preferable approach.
- The issue of whether it is proper for the investment decisions of publicly-held banks to be subject to CBN approval will need to be considered. An independent fund management structure for the SMIEIS may make that situation less controversial.

Leasing

Leasing has tremendous potential to address effectively the shortage of medium to long-term finance, in particular for SMEs, which encounter the biggest obstacles in raising finance through conventional bank loans. In Nigeria, commercial and merchant banks are the main sources of lease financing. Historically, merchant banks have dominated the industry as commercial banks were only allowed to participate in the market after 1990. Apart from the banks, there are also a few “stand alone” commercial lessors, borrowing from commercial and merchant banks to finance their leasing activity. Finally, other leasing firms are subsidiaries of major conglomerates and typically obtain funding from their parent companies.

The range of assets handled by Nigerian lessors is quite extensive.

- *Communication and administration equipment*: radio telephones, answering machines, computers, accounting and copying machines, air conditioners.
- *Industrial and manufacturing equipment*: construction equipment, machine tools, oil exploration and extraction equipment, printing presses, quarrying and mining equipment, water drilling rigs and textile machinery.
- *Transportation equipment*: aircraft, motor vehicles, locomotives, ships, fishing trawlers and oil tankers.
- *Miscellaneous*: agricultural equipment, hotel equipment, medical equipment, medical and dental equipment, and vending machines.

Finance leases are most common, and are common for larger equipment. The lessor normally buys the equipment at the end of the lease period. Operating leases are normally for smaller equipment, which is not completely amortized over the lease period, and the lessor expects to recover costs and profit by secondary leasing and/or sale at the end of lease period(s).

The equipment leasing industry has grown significantly since the mid-1980s. The Equipment Leasing Association of Nigeria (ELAN) was established in 1983 by a group of merchant banks, but growth in the industry has primarily been due to deregulation and a variety of new market entrants (as described above) after 1987. The value of total assets on lease grew by 200 percent between 1993 and 1997 to N5.2 billion but the growth pattern was erratic indicating the still underdeveloped nature of the industry. Also growth has primarily been for plant and equipment reflecting the dominance of the oil and gas (N1.7bn, or 32 percent of total leased assets in 1997), and manufacturing sectors (N2.0bn or 39 percent).

The leasing market however remains underdeveloped, and accounted for only one per cent of domestic investment in 1997. Leasing activity has since increased, but remains far below its potential. Further growth of the leasing industry is hampered by various factors including the lack of a coherent legal framework for leasing transactions; widespread problems of contract enforcement; difficulties in repossessing leased equipment from defaulters; and a lack of domestic long-term funds to finance leasing.

Further development of the leasing industry would therefore require efforts in the following areas.[24]

- Promulgation of a Leasing Law that would indicate the rights, duties and obligations of participants, and facilitate the adjudication of cases involving breaches of contract. ELAN is currently drafting such legislation.
- Increasing the number of skilled professionals, especially in cash-flow-based credit analysis, asset-liability matching, supervision of clients as well as equipment insurance procedures.
- Educating SMEs and the general public on the potential benefits of leasing through workshops, seminars and other channels.
- Diversifying the sources of leasing finance by tapping insurance firms and pension funds, exploring opportunities for raising equity or bond financing, and seeking foreign direct investment.
- Considering the introduction of fiscal benefits for leasing arrangements as exist elsewhere (e.g. USA), and addressing issues such as the double VAT effect of financial leasing.

The fact that the leasing industry is underdeveloped despite the presence of banks as the largest potential participants suggests that a lack of long-term financing is just part of the problem and that legislation, redress and financial track records of lessees are perhaps more important.

Needs and Initiatives

The comprehensive financial reform efforts currently being undertaken by the authorities in Nigeria will make an enormous contribution to supporting rural/private sector development. The organized private sector, in particular the banking industry, has also been very proactive in pushing such projects as SMIEIS. Furthermore, the high-level but very pragmatic public private sector advisory and monitoring committee that has been set up by the President to oversee the SMIEIS is also groundbreaking. That said, implementation of these various schemes and structural reforms needs to be carefully handled.

Government Initiatives

- Establishment of Bank of Industry through the merger of the Nigerian Industrial Development Bank, the Nigerian Economic Reconstruction Fund, and the Nigerian Bank for Commerce and Industry;
- Establishment of the Nigerian Agricultural Cooperative and Rural Development Bank (NACRDB) through the merger of the People's Bank of Nigeria, the Nigerian Agricultural and Cooperative Bank, and the Family Economic Advancement Program;
- Rationalization of Community Bank from over 800 to around 200 banks based upon strict criteria of financial soundness and diversified ownership;
- Establishment of a high-quality public-private Presidential Advisory Committee to oversee the implementation, and monitor progress of, the SMIEIS; and
- Possible creation of a National Credit Guarantee Scheme (NCGS). In the context of the establishment of the new Small and Medium Enterprise Development Agency of Nigeria (SMEDAN), the government continues to consider the idea of such a scheme. The banking industry supports it as a way of promoting lending to the SME sector through both mitigating lending risk and probably reducing the amount of collateral required for a loan.
- The government has become increasingly concerned about bank lending to the public sector crowding out private sector lending, and has recently responded to this with a 50 percent provisioning requirement even for healthy credit, and a higher requirement for "classified" loans. This will cut off a large part of the banks' lending market to date, and create an imperative for downscaling of lending activity to SMEs.

Privatization

- The government's privatization strategy has as one of its key objectives to increase shareholding by Nigerian savers. Given the low deposit rates available from banks, and the sort of returns that Nigerian companies must normally make in order to cover their cost of capital, share ownership is likely to be popular.
- The government aims to have Nigerian savers own up to 49 percent of privatized companies. With about 100 companies targeted for privatization in the 2001–05 period, this could lead to a major expansion in the capitalization and liquidity of the Nigeria stock market. Through the Bureau for Public Enterprises the Government is currently

assessing the absorptive capacity of the Nigerian capital markets.

- Strategic equity partners will also provide capital for the privatization process, and become a growing source of finance for the private sector. The deregulation accompanying privatization of utility industries, in particular telecommunications, will also increase the number of operators, and thereby create a need for substantial new investment capital.
- Larger companies (including those soon to be privatized) needing domestic financing are more likely to go to the equity markets in the future. Those clients (as already discussed) will gradually cease to be loan clients of banks, resulting in a need for banks to downscale their lending. Banks are also, it seems, being squeezed on the public sector lending front as a result both of new CBN guidelines that require 50 percent provisioning of even *performing* credits to the public/parastatal sector, and a revival of bond issuance by state governments.

Banking Sector Initiatives

- The Small and Medium Industry Equity Investment Scheme (SMIEIS). Under this scheme banks will set aside 10 percent of their PBT for equity investments in SMEs. Banks are still working on the modalities of how they will implement the scheme, and face a deadline of December 2002 for disbursement of the first tranche.
- Bankers training school and other capacity building initiatives. One group of banks is considering the establishment of a banking training school to build skills amongst loan officers, especially with regard to downscaling lending to SMEs. The WBG as part of its support for SMEs, as well as through its support for the African Management Services Corporation (AMSCO) is also helping to build banking skills.
- Downscale lending initiatives. Banks already recognize the need to downscale their lending activities as a result of decreased borrowing amongst larger companies, shrinking margins and increased competition.

The outlook for greater private sector access to finance in Nigeria, especially for SMEs, actually seems quite positive. The financial sector reform efforts and banking initiatives are, however, just part of the story.

There is a supply side imperative to downscale lending on the part of the banks. This stems from the fact that most large enterprises have reduced their borrowings from banks due to high interest rates and short terms. Over time more of them may be able to raise necessary finance from the equity (or bond) markets, especially with the advance of the privatization program. As things stand, a large number of banks are chasing after a dwindling amount of low-risk, high-return business, and margins are falling.

The dwindling amount of real sector business from large companies could result in more speculative activity such as Forex round-tripping, or consumer import financing, or purchases of high interest rate treasuries issued by the government to mop up excess liquidity and support the exchange rate. It is up to the authorities to address these issues beginning with the most egregious. On the positive side, one important effect of banks withdrawing from public sector lending, and of larger companies either tending toward the equity markets or finding cheaper debt financing than through Nigerian banks, is that banks will face increasing pressure to downscale their lending activity to SMEs.

The development of the insurance and pension industries also needs to be encouraged in order to channel this natural source of long-term funds into the domestic financial system. The greater the supply of funds that can be generated, and the greater the extent to which unconstructive bank practices can be discouraged, the greater the imperative facing banks to lend to viable projects and companies in the SME sector.

Furthermore, the ongoing new initiatives and restructurings will only be effective if banks and other financial institutions develop the ability to assess and manage viable SME sector companies and projects. The capable and viable SMEs themselves also need to learn to differentiate themselves from their less able counterparts. More and more bankers (and equity fund managers) with the necessary skills will be needed if the flow of funds to the SME sector increases. This translates into a great need for training of loan officers and equity managers, and for introducing best practice mechanisms for assessing SME risk, such as credit scoring and credit bureaus. Entrepreneurs will need to be trained in how to manage credit effectively.

Stepping back further, the reform initiatives, increased flow of funds, and better training must all happen in parallel with the government's continued and concerted efforts to improve the business environment. The following are of particular relevance.

- Improving the quality of infrastructure;
- Decreasing uncertainty in policy-making;
- Reducing predatory and arbitrary taxation practices at all levels of government, so reducing the costs of exposure, and encouraging companies to build financial track records;
- Promoting better enforcement of commercial contracts.

Ongoing/Potential Support Initiatives and Needs

The international donor community can help, and is helping, private sector access to funding in various ways.

- The World Bank Group through IFC is supporting the downscaling of bank lending through the provision of credit lines to proactive financial institutions.
- The World Bank Group has also convened a Roundtable on "Making Small Business Profitable in Nigeria" that is expected to lead to banking skills training for selected banks.
- Some new microfinance initiatives are underway including the UNDP's MicroStart program with international project managers from Bangladesh, carefully screened domestic MFI partners, and detailed monitoring program.
- The Nigerian financial system would also benefit from international support in the establishment of effective credit assessment mechanisms such as credit bureaus and credit scoring systems. These mechanisms would help SMEs build credit/ financial records, and so increase their access to finance.
- SMEs themselves also need to be trained in understanding the benefits of exposure. Whilst the "costs of exposure" continue to be high in Nigeria, SMEs in particular need to see the benefits of establishing financial track records if they are to access credit or equity funding. Track records can also help reduce collateral requirements on loans. Certainly, the "costs of exposure" need to be reduced through business environment improvement—for example, curbing predatory and non-transparent taxation practices at federal and subnational levels—but many of the new funding mechanisms and the more successful microfinance institutions *require* formal registration with the Corporate Affairs Commission (CAC).

By the end of 2002 the financial landscape in Nigeria, as far as the private sector is concerned, will have changed substantially. Government and private sector support appears to be firm. Nevertheless, careful implementation of the new schemes and governance structures, and handling of past non-performing loans, are challenges for the next twelve months, and will be important determinants of successful reform. One final point is that the success of these bold initiatives will, at the end of the day, depend upon parallel efforts to deal with broader issues in the financial system and the business environment, and on building human and institutional capacity in the financial and SME sectors.

Notes

18. Based on World Bank's Nigeria Financial Sector Review (2000) using 1998 figures.
19. These figures are drawn from the World Bank's 2000 Nigeria Financial Sector Review and are typically based upon FY1998 figures.
20. The World Bank Financial Sector Review of Nigeria (2000) used the most recently available non-audited and audited data for the DFIs, typically FY1998.
21. NEXIM operates on a similar principle but is far less efficient.
22. This section draws on the note "SME Finance in Nigeria" by Clive Carpenter (AMSCO) prepared for the Roundtable, "Making Small Business Finance Profitable in Nigeria" held on Wednesday, 28 November 2001.
23. There are some 260 listed securities including over 180 ordinary share listings, including over 20 banks.
24. This section draws on the note "SME Finance in Nigeria" by Clive Carpenter (AMSCO) prepared for the Roundtable, "Making Small Business Finance Profitable in Nigeria" held on Wednesday, 28 November 2001.

Soon after winning the 1999 elections, the administration of President Olusegun Obasanjo signaled its strong commitment to privatization of state-owned enterprises as a critical element of its strategy for economic recovery and accelerated growth. This commitment has been underscored by a number of actions described in detail in this chapter, such as the creation of a National Council on Privatization (NCP) chaired by the Vice President of Nigeria, the early adoption of a list of major public enterprises (PEs) to be privatized and the restructuring of the Bureau of Public Enterprises (BPE) to strengthen its leadership in the privatization process.

As laid out in the *Joint Interim Strategy Update* of May 2001, creating the conditions for rapid private sector-led poverty-reducing growth is one of the main pillars of the World Bank Group's framework for assistance in Nigeria, (the other two pillars being the improvement of economic governance and the empowerment of local communities to play an active role in their own development). The privatization of public enterprises, especially in infrastructure sectors such as power and telecommunications, is of immediate importance to fostering economic growth.

The World Bank Group's overall strategy in Nigeria is to build the country's capacity to effectively utilize its own resources in each area of activity. In this context, efforts to help bring about privatization will emphasize the provision of advisory services to the Federal Government of Nigeria (FGN).

Background

In the early 1970s, oil revenues enabled Nigeria to embark on an ambitious public investment program, aimed at extending and improving infrastructure and social services. Many projects were undertaken without sufficient attention to their economic viability or the capacity of government agencies and public enterprises to implement them. Until the mid 1980s, Nigeria continued to develop a public enterprise sector that included large public utilities supplying telecommunications, power, steel and petrochemicals, as well as banks, small agricultural firms, manufacturing and services, including hotels. Currently, there are an estimated 1,500 public enterprises.

The poor functioning of pubic enterprises in general has resulted in unreliable delivery and availability of services to both firms and individuals. This unpredictability and inaccessibility negatively impacts growth, productivity and investment. The poor performance of public enterprises has been due to a) excessive bureaucratic controls and government intervention b) inadequate policy and regulatory frameworks which impede competition and discourage private entry and private investment c) weak capacity to implement reform and d) mismanagement, corruption and nepotism.

Attempts have been made in the past to improve the performance of public enterprises through partial privatization, commercialization and corporatization. It is clear, however, that the renewed commitment on the part of the government should help to create new incentives and programs to change and reduce the role of the government in many of these enterprises.

Public Enterprises in Nigeria

As noted above, there are an estimated 1,500 public enterprises (PEs) in Nigeria, of which the Federal Government holds six hundred. State and local governments own the remaining 900, relatively smaller firms. Table 4.1 sets out the federal public enterprises according to the government ministry in charge of its operations.

By African standards, Nigeria's public sector is substantial. In 1997, public sector output was equivalent to about half of GDP, the sector accounted for about 66 percent of overall employment and for 57 percent of total investment in the formal sector.

Major inefficiencies in these public enterprises substantially raise the costs of production for private

Table 4.1. Federal Enterprises by Reporting Ministry (1998)

Reporting Ministry	Number
Education	189
Health	57
Agriculture	43
Industry	43
Presidency	40
Petroleum	34
Information	24
Science	23
Finance	17
Federal Capital Territory	14
Power	13
Transport	13
Water	13
Commerce	9
Others	56
Total	**588**

Source: Nigeria: Technical Committee on Privatization & Commercialization Final Report (June 4, 1993).

firms. For example, the unreliable power supply from the Nigerian Electric Power Authority (NEPA) results in unnecessary additional costs to the Nigerian economy of around $1 billion annually. Nigeria Airways has accumulated a negative net worth of US$367 million. Fixed telephone line density remains one of the lowest in Sub-Saharan Africa and is confined primarily to major urban centers.

In addition, funds are diverted from investment in other sectors such as education and health to support these public enterprises. Government data suggest that the fiscal cost of public enterprises in 1998, in transfers, subsidies and waivers amounted to about N265 billion.

Successive Nigerian governments have invested about Naira 800 billion (approximately US$90 billion) in public enterprises. Returns have generally been poor, and in many cases negative. Most large-scale capital projects have not proved cost-effective due to misallocation of resources; poor selection of technologies; and grossly inadequate maintenance. For example, the steel plant at Aladja, which opened in 1981, has generally operated at less than 20

Table 4.2. Public Enterprises in Selected African Countries

Country	Number	% of GDP	% of Investment*	% of Employment*
Nigeria	600	50%	57%	66%
Cote d'Ivoire	150	n/a	18%	n/a
Ghana	181	n/a	25%	55%
Kenya	175	n/a	21%	9%
Tanzania	420	13%	26%	n/a
Burkina Faso	44	5%	20%	n/a
Senegal	50	9%	33%	n/a

*formal sector only

Source: "Commercialization and Privatization Policy in Nigeria," *Obadan Mike, I. and Ayodele A. 'Sesan, National Center for Economic Management and Administration, Ibadan, Nigeria, 1998.*

Table 4.3. Fiscal Transfers to Parastatals and Agencies (1998)

Transfers	Amount (N bn)	Percent of Total
Subsidized Foreign Exchange	156.5	59%
Import Duty Exemptions	12.5	5%
Tax Exemptions/Arrears	15.0	6%
Unremitted Revenues	29.5	11%
Loan/Guarantees	16.5	6%
Grants/Subventions, etc.	35.0	13%
Total	265.0	100%

Source: Federal Ministry of Finance, Various Government Records.

percent capacity. Reopened in 1998 following closure in late 1996 and 1997 owing to a lack of funds to carry out repairs, it produced 1,678 tones of billets, representing 0.04 percent of installed capacity. Aggregate output from all three rolling mills was only 0.9 percent of their combined capacity. The centerpiece of the steel industry, the Ajaokuta complex has experienced enormous cost overruns, indebtedness and delays and has still not been completed.

Misuse of monopoly powers in various sectors has resulted in unreliable service, especially for the poor, and contributed to gross inefficiencies. Only 12 percent of Nigerians have metered access to electricity, although many others have access through illegal connections. Nigeria's fixed line telephone density of about 0.40 lines per 100 inhabitants is one of the lowest in the world, comparing unfavorably to 0.61 in Sub-Saharan Africa (excluding South Africa), 2.24 for Africa as a whole, and 14.26 globally. Despite tremendous growth globally, mobile telephone density in Nigeria is also one of the lowest in the world, at 1 per 10,000 people, as compared to 7 in Ghana and 225 in South Africa.

Undoubtedly, unreliable utility services impose exceptionally high costs on the Nigerian economy. Almost all firms suffer from serious frequent interruptions of electricity, water, phone and transport. Private firms often invest large amounts in dedicated power generators, boreholes and treatment plants. Inefficient capital-intensive publicly owned operations have raised the cost of intermediate inputs to private firms. By producing such consumer goods as textiles, salt and beer, public firms have discouraged the entry of private investors into these potentially profitable business ventures.

First Privatization Program (1989–1993)

Earlier administrations have attempted to improve the efficiency and performance of state-owned enterprises. The first program, implemented between 1989 and 1993, pursued the objectives of:

- Improving the productive efficiency of the public enterprise sector;
- Reducing the dependence of public enterprises on government financial support;
- Increasing the participation of Nigerian citizens in economic activities through share ownership in productive investments; and
- Removing government from direct involvement in economic production.

Under this program, 110 mostly industrial, financial and commercial public enterprises were selected for full or partial privatization. Of those selected, 77 were actually privatized with 60 fully privatized and 17 partially privatized, (the FGN ended up holding a minority equity stake of 40 percent or less in these partially privatized companies). A total of 48 of the 77 total privatizations occurred in agriculture, food processing, beverages, insurance and banking. Privatization has not proceeded for the remaining 33

Table 4.4. Telecommunications: Selected key indicators (Dec. 1998)

	Nigeria	Ghana	South Africa	Argentina	Brazil	India	Indonesia	Africa	High Income Countries
Telephones per 100	0.39	0.57	10.71	20.27	12.05	1.86	2.70	2.24	54.06
Rural teledensity	0.06	0.07	5.22						6.19
Payphones per 10,000	0.11	0.24	28.73	26.17	29.19	3.52	8.08	3.50	51.22
Waiting years	3.50	2.90	0.60	0.20		1.30	0.20	2.30	0.00
Cellulars per 100	0.01	0.07	2.25	1.61	1.58	0.03	0.26	0.45	13.17
Internet hosts per 10,000	0.04	0.10	32.60	18.40	12.97	0.13	0.75	2.07	171.88
Lines per employee	34	40	84	345	236	51	131	64	209
Telecom revenue (B US$)	0.40*	0.13	4.38	5.58	15.02	4.37	2.53	12.19	514.83
Telecom revenue (% GDP)	0.83	1.93	3.39	1.73	1.87	1.21	1.18	2.00	2.21
Investment (B US$)	0.19	0.01	1.53	1.35	6.93	2.38	1.50	4.65	122.20
Investment (% GDP)	0.13	0.11	1.18	0.42	0.86	0.66	0.70	0.87	0.53

**According to NITEL's 1998 audited accounts. Figures use a N 87 to 1 USD exchange rate for 1998.*
Source: ITU.

enterprises which include some of the largest, such as Nigerian Airways, Nigeria National Shipping Lines, paper mills, steel mills, sugar companies, fertilizer companies, and vehicle assembly plants.

Public offer was the preferred method used in privatizing state-owned enterprises. Table 4.6 sets out the different modalities used for the 77 enterprises that underwent partial or full privatization.

Gross proceeds from privatization through April 1993 were N3.4 billion excluding N309 million in interest from receipts invested in treasury bills. By August 1994, the amount actually received was N 2.3 bn comprising only half the gross amount owed to the government. One and one half billion shares were offered on the stock market to 800,000 new shareholders. The market's capitalization increased from N8bn in 1989 to N347 bn in 1997.

In addition to these privatization efforts, a 1988 decree called for the commercialization of some public enterprises. The enterprises were expected to start covering operational expenses and capital expenditures without recourse to government funding. However, according to the Technical Committee on Privatization & Commercialization (TCPC) Final Report, (1993), despite signed Performance Agreements and apparent progress in commercialization (see Table 4.7), nothing changed in the relationship between government Boards of Directors and enterprise managers and performance did not improve.

Lessons Learned

Important lessons which were derived from the first phase of privatization are summarized below:

Strategic foreign investors. When the privatization of banks was being undertaken, shares were sold equally to every state of the Federation. However, no foreign investors were allowed to participate directly

Table 4.5. First Privatization Program (1989–1993)

No.	Sector	Type of Privatization	Planned	Actual
1	Development Banks	Partial	4	1
2	Commercial/Merchant Banks	Partial	12	10
3	Oil Marketing	Partial	3	3
4	Steel Rolling Mills	Partial	3	0
5	Air and Sea Travels	Partial	2	0
6	Fertilizer	Partial	2	0
7	Vehicle Assembly	Partial	6	0
8	Paper	Partial	3	0
9	Sugar	Partial	3	0
10	Cement	Partial	5	3
11	Hotel/Tourism	Full	4	2
12	Textile	Full	3	3
13	Transportation	Full	4	4
14	Food and Beverages	Full	6	6
15	Agriculture and Livestock	Full	18	18
16	Salt	Full	2	2
17	Wood and Furniture	Full	2	0
18	Insurance	Full	14	14
19	Film Production	Full	2	1
21	Cattle Ranching	Full	2	2
22	Construction and Engineering	Full	4	4
23	Dairy	Full	2	2
24	Others	Full	2	2
	Total		**110**	**77**

Source: The Nigerian Privatization Program: The Journey So Far and Future Outlook *by Nasir El-Rufai (Economic Indicators,* The Nigerian Economic Summit Group *(Volume 6 No. 1, March 2000).*

in the program despite the fact that they could have brought in substantial capital and new technology.

Failure of Commercialization. The commercialization program was implemented largely without liberalization or appropriate regulation.

Retrenched workers. There were no general guidelines on how to conduct the retrenchment of workers, especially with respect to compensation.

The impact of the first privatization program has been limited. Proceeds from sales represent less than five percent of the original value of investment. Furthermore, the government has actually added to its portfolio through additional investment in some major projects, notably the Ajoakuta Steel and Aluminum smelter. Moreover, the companies that were corporatized and partially privatized since 1990 failed to improve their performance records significantly. This failure was in large part due to continued government interference with policy decisions, price regimes and the appointment of Boards and senior staff members.

Table 4.6. Modalities Used for Privatization

Modality	Enterprises
Public Offer	35
Deferred Public Offer	2
Sale of Assets	7
Private Placement	7
Management Buy-out	2
Others*	15
Total	77

**Sold by private treaty before the program formally started.*
Source: The Nigerian Privatization Program: The Journey So Far and Future Outlook *by Nasir El-Rufai (Economic Indicators,* The Nigerian Economic Summit Group *(Volume 6 No. 1, March 2000).*

Current Privatization Program

Having recognized the ineffectiveness of earlier approaches to improve public enterprises, the FGN passed the Privatization and Commercialization Act of 1999. This act was based on the government's realization that far-reaching, market oriented reforms were necessary to achieve the efficiency gains of private participation. The act established the National Council on Privatization (NCP), chaired by the Vice President, to oversee the privatization program. It also stipulated that the Bureau of Public Enterprises (BPE) be the implementation agency and secretariat to the NCP.

In July, 1999, the FGN adopted a three-phased privatization program for the 1999–2004 period as follows:

Phase 1: Full divestiture of FGN's shares in banks, cement companies and oil marketing firms listed on the Nigerian Stock Exchange;

Phase 2: Full divestiture of FGN ownership in hotels, vehicle assembly plants, and other industrial, agricultural and service sector enterprises operating in competitive markets; and

Phase 3: Partial divestiture of FGN shares in major public enterprises operating in non-competitive, but potentially competitive, sectors such as the

Table 4.7. Commercialization of Public Enterprises

No.	Sector	Type	Planned	Actual
1	River Basin Development	Partial	11	11
2	Air and Sea Transportation	Partial	3	3
3	Power	Partial	1	1
4	Telecommunications	Partial	1	1
5	Security Printing and Minting	Partial	1	1
6	Steel	Partial	2	0
7	Media	Partial	3	3
8	Machine Tools	Partial	1	1
9	Housing/Real Estate	Partial	2	2
10	Recreation/Tourism	Partial	2	2
11	Petroleum/Mining	Full	3	3
12	Insurance	Full	3	2
	Total		**33**	**30**

telecommunication company (NITEL), the national power company (NEPA), Nigerian Airways, and the oil refineries; as well as privatization of two major fertilizer companies.

Phase 1 is now nearing completion after delays due to problems in completing the sales of some companies jointly owned with state governments—notably in the cement sector. Of one hundred PEs in the FGN's privatization program, over fifty are in Phase 2. The FGN has also tried to advance the privatization of selected PEs from Phase 3, notably those representing the most pressing constraints to the economy and requiring major sector policy reforms such as telecommunications and electric power.

Overall Program Objectives

The objectives and specific goals for achieving progress in privatization during the next several years are outlined below. These objectives will be accomplished by the FGN with the support of the World Bank Group and other organizations whose various activities are summarized in the following section.

- *Expanded private investment, productivity and employment:* Under the FGN's proposed privatization program, about one hundred PEs in industry, agriculture, services and infrastructure will be transferred to private ownership. This will reduce fiscal drain to PEs and is expected to accelerate economic growth through significant improvements in output, investment, efficiency and employment in the privatized and liberalized sectors. In addition, privatization will contribute to capital market expansion.
- *Increased Private Participation and Efficiency in Infrastructure:* In telecommunications, opening up all segments of the market competition is a stated priority. Licenses for mobile telephony are now being sold. In electric power, the National Electric Power Authority (NEPA) is proposed for restructuring from a fully integrated utility into separate business units for transmission, generation and distribution. Some generation plants are being concessioned to private operators, distribution entities will be privatized in the future, and some generation plants will be sold to private investors and operators. In the Lagos State water sector, an international tender for private sector participation through concessions took place at the end of 2001.
- *Creation of Competitive and Transparent Markets and Regulatory Frameworks in Infrastructure:* It is proposed that the FGN will create pro-competitive regulatory frameworks, with cost-effective institutional set-ups, for the principal infrastructure sectors to be privatized. This will permit entry of new private operators to a competitive, level playing field. In telecommunications and electric power, FGN has adopted policy statements that clearly differentiate the public and private roles and responsibilities in terms of policy-making, regulation and ownership. Based upon these, new telecommunications and electricity laws was presented to the National Assembly for approval. The Nigerian Communications Commission (NCC), as an independent agency, has extended its mandate to regulate all telecommunication services and infrastructure providers. A new independent agency will be established to regulate the power sector.
- *Increased Basic Infrastructure and Utilities in Rural and Urban Areas:* The Privatization Support Project (further details on this project are provided in the following section) will support expanded and lower cost access to basic infrastructure services, through expanded private participation in these sectors: (a) in telecommunications, tele-density is supposed to increase to over 1 line per 100 inhabitants in the next couple of years; and the number of villages with access to communication facilities is to be doubled by 2005;

(b) in electric power, metered connections are proposed to increase by 1 million households by 2006, from the present level of about 2.5 million, and operational generation capacity and revenues earned will be increased substantially; (c) in Lagos State, water production by Lagos State Water Corporation (LSWC) is hoped to double by end-2005 through the efficiency gains of private operators in terms of market coverage, reduced technical losses and customer billings and collections, (which will increase by fifty percent).

- *Reduced Public Deficit for PEs, notably in Infrastructure:* The fiscal drain from PEs' claims on FGN's budget will be reduced: (a) in telecommunications, tax revenues from service providers will substantially increase; and (b) in electric power, FGN funding for rehabilitating NEPA's generation and distribution facilities will cease once appropriate steps are taken. In the Lagos State water sector, government subsidies will cease, but concessional finance will be sought and lent to private operators as part of the privatization program.

Privatization Support Project

The FGN has enlisted the technical and financial support of the World Bank Group, along with the British Department for International Development and the United States Agency for International Development to aid in the implementation of its privatization agenda. The World Bank Group's Privatization Support Program is comprised of the following key policy and institutional reforms:

- Strengthening of the policy framework for PE divestiture including streamlining of procedures for divestiture, capacity building in BPE and NCP, and adoption of a consistent policy for PE severance compensation. Key elements of the project are adoption by FGN of (1) transparent guidelines and bidding procedures for PE divestiture transactions; and (2) institutional arrangements for strengthening coordination of decision-making on privatization with related sector policy reforms.
- Implementation of legal and regulatory reforms in the electric power sector and restructuring, unbundling and divestiture of NEPA, including a short-term action plan, aimed at: (1) major improvements in supplies and service reliability (2) efficiency improvements for private businesses and (3) expanded access generally and for rural areas. This will be achieved through competitive private sector entry, investment and operation.
- Implementation of telecommunications sector liberalization, regulatory reform, and privatization of NITEL aimed at major expansion in connectivity through private investment and entry of new private operators. This will improve service quality, expand rural access and lead to more affordable tariffs, due to competition.
- Implementation of Phases Two and Three of FGN's privatization program, focused upon roll-back of state involvement in key productive sectors, services and infrastructure, through divestiture of about one hundred PEs. This will improve economic efficiency in the non-oil sectors and expand private sector led growth.
- Facilitation of private sector participation in the Lagos State Water Corporation, through emergency repairs and interim management strengthening to prevent system failure prior to divestiture, as well as provision of specialized consultancy services. Improvement of water sector in Lagos is part of a broader objective to rejuvenate the city which is the center of the Nigerian economy and its most vibrant, energetic and entrepreneurial locality.

Priority Focus on Infrastructure: Telecommunications and Power

Priority has been given to the reform and privatization of the telecommunications and electric power sectors because of: (i) their importance to increased economic efficiency and activity, growth and employment—especially in the private sector; (ii) their scope for improving living standards by expanding access to services in these sectors from their present low levels; (iii) their large investment needs, that cannot be financed and managed by the state alone and require private sector participation; (iv) their requirements for longer term capacity building support to achieve the transition from state-operated to privately-run, more competitive sectors.

The FGN began preparation of the reforms in telecommunications and power in early 2000. This work is now somewhat advanced with Project Preparation Facility financing of consultants and advisors to help prepare modern, market-oriented policies, design legal, regulatory and institutional frameworks; and prepare the corporate restructuring of NEPA. The FGN has adopted new national policy frameworks for both sectors and a new law for each sector has been presented to the National Assembly for approval and implementation.

Telecommunications Sector Reform Program. In telecommunications, a new National Telecommunication Policy (NTP) was adopted in September 2000. This provides for full liberalization of the market to private operators and divestiture of the two principal, state-owned telephone companies—NITEL (the fixed line operator) and M-Tel (the mobile operator). The NTP limits the role of the government to policy formulation and expands the mandate and strengthens the legal and institutional framework of the Nigerian Communications Commission (NCC). It aims to establish a competitive industry structure through fixed-line and wireless licensing. As a first step in implementation of the NTP, the FGN successfully completed a public auction of three digital mobile licenses in January 2001, and appointed technical and financial audit consultants to carry out the necessary due diligence to prepare for the divestiture of NITEL. As a preparatory step for this, FGN allocated a digital mobile license to NITEL at a price of US$285 million (the auction price of the other digital mobile licenses).

The FGN's goals are to: (1) achieve a major expansion in access to connectivity in 2001–03 to a total of 2 million fixed and mobile lines; (2) strengthen the capacity of the National Communications Commission (NCC) as an independent telecommunications regulator, to create a flexible regulatory environment in the medium-term, taking account of new technologies and international trends towards convergence; (3) establish a National Frequency Management Council (NFMC), and upgrade equipment and facilities at NCC for improved management of the radio spectrum. The NTP and strengthened regulatory framework will reduce the market power of NITEL, through adoption of improved interconnection rules and pricing arrangements. Initially, regulatory discretion will be limited by building regulatory rules largely into contracts and licenses.

A controlling share of NITEL was awarded to International Investors Limited (ILL) for $US 1.3 billion in November 2001. ILL paid a deposit of $131.7 million at this time. But it failed to come up with the rest of the money and the deal fell through in March 2002. IIL forfeited its deposit in March and the BPE has been directed by the National Council on Privatization to proceed with an accelerated initial public offering (IPO) of the government's stake in NITEL.

The FGN recognized the need to demonstrate that the benefits of telecommunications reform will accrue to both urban and rural areas. To avoid increased polarization in service provision between urban and rural areas and to enhance rural connectivity, a demonstration rural telecommunications program is under preparation. This will test alternative approaches to expanding access through private investment, including rural telecom licensing.

The Privatization Support Project will support the design and implementation of the new legal and regulatory framework for telecommunications, the strengthening of NCC's capacity; the privatization of NITEL; the purchase and installation of upgraded radio frequency equipment; and the design and implementation of a demonstration rural access program.

Because telecommunications is one of the first large and important sectors to be privatized, the degree to which implementation is successful, in terms of increased access and improved reliability, will affect future support for other privatization efforts in government, business and the general public.

Power Sector Reform Program. The FGN is preparing a major reform of Nigeria's electric power sector that included early opening to private participation. The FGN has recently approved a new policy statement, the National Electric Power Policy (NEPP), setting out institutional arrangements for introducing competition and for an appropriate regulatory framework for the sector. Under the NEPP, the government will focus on providing the overall direction for power sector development, ensuring the general consistency of electric power policy with other national policies, and enacting the necessary laws, regulations and other measures required to support its policies. The Federal Ministry of Power and Steel (FMPS) will propose policy options to GFN concerning legislation, policy on investments, etc., monitor and evaluate the implementation and performance of government policy and establish and monitor policies for increasing access to electricity, particularly in rural and semi-rural areas. State governments will have responsibility for the development of off-grid electrification.

The new policy lays the basis for creating an industry structure that will develop competition by establishing a number of privately owned or concessioned generation companies that will compete for the business of distribution companies and large users of electricity. This structure would be achieved by the following steps: (i) unbundling NEPA's vertically integrated structure into several generation and distribution entities and a transmission entity that would also act initially as the national electricity dispatch entity/system operator, (ii) divestiture of the state's ownership in the thermal generation and distribution facilities and either divestiture of the state's ownership or long-term concessioning of the hydropower facilities, (iii) allowing private independent power producers (IPPs) and electricity suppliers to enter the power market, and (iv) establishment of arm's length trading mechanism among these entities.

Competition in the wholesale power market would be developed in stages once the industry is restructured. In the first stage, competition would be limited to competitive bidding to take over some of NEPA's thermal power stations under medium term Rehabilitate-Operate-Transfer back (ROT) concession agreements with NEPA. This stage would also cover the competitive procurement of long-term power supply from up to 1500 MW of new generating plants developed by IPPs with the benefit of the FGN's credit support. The second stage will start once the new entities formed from the restructuring of NEPA are formed and largely privatized and the new sector regulatory agency and regulations are in place. It will focus on developing competition through rights to enter into bilateral contracts between generation and distribution companies. Each distribution company would have a portfolio of power purchase contracts with various generators, and each generator would have a portfolio of power sales contracts. Short-term imbalances between power demand and supply would be handled during this stage through a system of imbalance tariffs. Under this, generators will be required to provide power in excess of or to curtail production below contracted supply.

Competition in the market would be further developed over the medium-to-long term by: (i) allowing large users of electricity to purchase directly from generators or electricity suppliers; (ii) removing retail sales monopolies from the franchises of distribution companies and (iii) separating the retail sales business of distribution companies from the low voltage distribution business with limits on cross-ownership.

The new power policy provides for the establishment of the National Electricity Regulatory Commission (NERC) as an agency independent from the government and all companies operating in the sector. The NERC would regulate the sector with powers, duties and a constitution laid down in a new Electricity Act and would issue licenses to companies operating in the Nigerian power market. Through these licenses, the NERC would be responsible for (i) decisions on regulatory approval for electricity tariffs: (ii) business and capacity expansion plans for generation, transmission and distribution; (iii) enforcement of competition over the transmission network including regulation of transmission connections, transmission access rights and fair cost reflective use-of-system prices; (iv) enforcement of competition over electricity generation, distribution and sales; (v) ensuring that major investments for expanding generation capacity are carried out by; (vi) setting and enforcing national quality standards; and (vii) enforcing the legal rights of consumer. The NERCs activities would be funded from a source independent from FGN's budget such as license fees and charges for its services to the industry. The detailed design of the new power regulatory body will be based upon a review of institutional options, taking account of recent international experiences.

Preparations for NEPA's restructuring and ultimate divestiture are being accompanied by a major effort to ensure improved basic availability and reliability of power supplies in the short term. The FGN has to address the following four short-term priorities to have a reasonable prospect of successfully moving power generation, distribution and supply into private ownership and management: (i) manage the process of private entry into power generation without jeopardizing sector viability or unduly increasing the costs of power supply; (ii) attract reputable investors to the Nigerian power sector; and (iii) restructure NEPA's functions in preparation for privatization and the development of a competitive trading environment for power. NEPA's action plan to deal with the shortages proposes to: (a) rehabilitate its existing supply facilities, through contracting out management of NEPA generation plants to private operators on a ROT basis; (b) competitively engage new private independent power producers (IPPs); and (c) implement an emergency power program (EPP).

Also included under the short-term action plan are steps to: (d) implement a substantial interim tariff increase to start the process of moving tariffs to cover costs fully, and put in place an automatic tariff adjustment plan that accounts for changes in the exchange rate, inflation and fuel prices; (e) contract out to private agencies the billing and collecting of payments for some of NEPA's customers; (f) establish a Special Purpose Entity to take over NEPA's obligations to purchase power from private producers, with adequate financial support for this purpose, and (g) undertake a program to eliminate vandalism to major power supply facilities and substantially reduce vandalism to other supply facilities.

The Privatization Support Project will finance technical assistance and capacity building required for the design and implementation of the FGN's power sector reform program, including priority measures in the short-term action plan. The main components cover: the creation of the new legal and regulatory framework, and of the revised tariff system; the establishment of a the new regulatory body; the creation of the new dispatch and settlement system; the unbundling of NEPA and privatization of the generation and distribution unites of the restructured NEPA as well as the establishment of a regulatory and institutional framework for rural power supply. The project will play a pivotal in putting in place the framework within which the massive future investments required in power supply would be undertaken. Consultancy support for the ROT, EPP, and IPP programs will be provided under PSP.

Key Privatization Issues

Privatization Modalities and Procedures. The FGN's privatization program is being implemented through the appointment of competitively selected investment advisors to undertake the preparation and execution of especially larger PE divestiture transactions, under the supervision of the BPE. Sector-specific inter-ministerial divestiture committees under the auspices of the NCP and chaired by the concerned sector ministers are responsible for overseeing preparation of related sector reforms. They include other top officials and stakeholder representatives—including from the private sector, labor unions, professions and academia. For major PE divestitures, especially those that are currently monopolies, notably in infrastructure, the NCP's procedures involve two stages: (a) review and reform of the sectoral policy environment and regulatory framework to ensure transparency, efficiency and competition; followed by (b) preparation and implementation of a divestiture strategy for the PEs in the sector.

The 1999 Privatization and Commercialization Act, categorized PEs slated for divestiture based upon: (1) the percentage of FGN shareholding to be sold; (2) the percentages to be sold to strategic investors and to Nigerian individuals; (3) the percentage to be retained by FGN; and (4) those PEs to be commercialized rather than privatized. It thus distinguished the following categories: (a) 36 PEs—mainly the large strategic ones in infrastructure, utilities, heavy industry and mining—slated for maximum 40 percent sale to strategic investors, and at least 20 percent to Nigerian individuals, with a maximum of 40 percent to be retained by FGN; (b) 25 PEs (cement, oil marketing, agro-allied, vehicle assembly, banks, and hotels) slated for full divestiture; and (c) 33 PEs slated for partial or full commercialization—including river basin authorities, media, game parks, and the Nigerian National Petroleum Company (NNPC).

Subsequently, the FGN recognized that the Act's limitations upon the percentage of share holding the FGN could divest to strategic investors, coupled with the minimum to be held for sale later to Nigerian individuals, could significantly limit government withdrawal from PE ownership. This risks limiting the interest of private, and especially foreign, strategic investors in acquiring these enterprises, and reducing the sales prices. In July, 2000, the FGN therefore adopted a revised policy that: (a) permits sale of up to 51 percent of a PE's share capital to strategic investors; (b) eliminates the long-term requirement of a residual shareholding by FGN; and (c) provides for sale to Nigerian savers and investors of the balance of shares not sold to strategic investors, subject only to the absorptive capacity of the capital market.

Privatization Process Guidelines. As other countries' privatization experiences indicate, the process and procedures for PE divestiture transactions are key to ensuring transparency, efficiency and timeliness of implementation. Recognizing this, in 1999 FGN adopted guidelines and a blueprint for implementation, pursuant to the 1999 Privatization and Commercialization Act. These guidelines established a streamlined process by which the NCP sets the broad parameters of policy and strategy for divestiture transactions, and delegates detailed preparatory work and execution to sectoral divestiture committees, subject to NCP clearance of key strategic decisions. Stakeholder consultation and participation are emphasized to ensure the sustainability of the program. The BPE serves as executing agency, while BPE's director-general is a full member of the NCP. Two modes of divestiture were adopted: (a) For very large PEs, a strategic investor is selected first, followed by subsequent sale of shares to Nigerian investors on a broadly distributed basis across the country and phased over time. (b) For other PEs, privatization proceeds directly through offerings of government shares on the stock market to Nigerian investors.

While the guidelines aimed at ensuring greater transparency and efficiency, they had a number of important potential short-comings: *First,* by mixing technical and price criteria in the process of bidding and selection of strategic investors, they left open a significant element of subjectivity in the final selection process. In effect, the final selection of the winning bidder could be subject to negotiation and agreement by the NCP, rather than being based upon the outcome of competitive price bidding. *Second,* while in several cases they have been very effective—e.g. in power and telecommunications—the sectoral reform committees have not always worked effectively in ensuring coordination between the key government agencies concerned. This lack of coordination has been most notable between the privatization agency, the sector ministries and, where they exist, the sector regulatory agencies. Lack of coordination has resulted in difficulties in establishing regulatory policy in some sectors, as in the case of air transport. *Third,* the NCP has lacked oversight and control over key PE management decisions (such as major new investments, incurring of new debts, disposal of assets, hiring of new employees) in the period prior to divestiture. This lack of authority leaves open the possibility of PE management actions at odds with the reforms.

The FGN has decided to take actions to strengthen its privatization procedures, through: (1) strengthening and improving transparency of bidding procedures; (2) formally establishing NCP authority over all key PE decisions prior to divestiture; (3) formalizing arrangements for sale to Nigerian savers and investors of remaining FGN shares in privatized PEs through regional allotments to ensure balanced geographic and regional distribution, and (4) warehousing of shares through a privatization trust, The following bidding procedures are recommended in the Privatization Program:

- pre-qualify all bidders on a pass-fail basis where they meet the standard technical requirements spelled out in the information memorandum, in terms of government policy requirements and the firms' technical and financial credentials;
- base final selection of the winning bidder upon a single pre-defined financial parameter—most probably highest share purchase price;
- open financial bids publicly in a publicized and broadcast forum, followed by expeditious approval by the NCP;
- front-load the divestiture process, requiring bidders to conduct due diligence before submitting financial bids, together with pre-signed contracts and bid bonds. This would facilitate timely closure without need for *ex post* negotiations.

Sectoral Reform. FGN's current privatization program includes requirements that prior to privatization, legal and regulatory frameworks and sector-specific regulatory rules will be established. These will be aimed at balancing the interests of investors, consumers and government; providing clear, consistent and independent regulation and minimizing government interference and the scope for corruption.

Initially, regulation will be largely based upon standard rules (governing such issues as price adjustments, interconnection, contract negotiation, conflict resolution, etc.) built into licenses, contracts and concession agreements, with limited scope for regulatory discretion. Discretionary approaches, where needed, will be adopted gradually once regulatory capacity and experience are established.

The need for coordination between sector policy reforms and privatization will be addressed through issuance of official instructions in the Official Gazette conferring authority on the Sector Reform Implementation Committees (SRICs) for coordination and for submission of policy recommendations to the NCP.

There are a number of difficult issues that may affect the level of success achieved by the FGN and the organizations supporting its efforts. Efforts will be made to address these issues and reduce or eliminate their effects.

Social and Political Risks. Vociferous and influential stakeholder groups and political groups may mount strong efforts to discredit and weaken the FGN's privatization and sector reform efforts. PE managers, employees, senior government officials and civil servants, notably in sectoral ministries perceive that their current power and perquisites will be reduced as the privatization program is implemented. In the National Assembly, a range of politicians view privatization as a threat to national sovereignty and an unwarranted reduction in the role of the state. In addition, the deep-seated ethnic and regional differences in Nigerian society could complicate the sale of public enterprises, generally and in particular PEs located in different regions, unless it is fully supported by the local elites and local population.

Decades of neglect and lack of investment in key sectors of the economy appear to have made Nigerians supportive of the need for change to rebuild the economy and public institutions as a basis for longer run prosperity. However, significant changes will be made in the structure of the economy and the social risk accompanying these changes will be addressed through the following means (a) stakeholder participation (in the NCP and in public awareness programs); (b) upfront design of adequate mitigation measures, including opening markets to competition, as well as; (c) adoption of consistent, equitable and efficient policies in areas such as PE retrenchment and environment. The President of the National Labor Congress is an active member of the NCP. BPE has implemented an effective program of consultations with unions, involving focus groups with PE workers for discussion of workers' concerns about issues such as severance pay, redundancy issues, employee share-ownership, and service benefits. In the power sector, a Rural Electrification Agency will be established to accelerate the access of rural population to electricity. The new power policy also explicitly recognizes the importance of lifeline subsidies being extended to the poor.

PE Severance Compensation Policy. FGN recognizes that a critical element in implementation of PE divestitures will be efficient and equitable handling of necessary pension funding, severance payments and employee retrenchment. Many PEs to be divested have staffing levels substantially above international norms for their sectors, and will need to retrench significant numbers of employees to enable private operators to achieve efficiency gains. It will be critical that FGN develops and adopts at an early stage a consistent overall policy governing severance compensation (including pensions), particularly where these may exceed statutory severance provisions. Other countries' experiences have shown this to be vital to ensuring an efficient, equitable, and sustainable privatization program, and to containing the fiscal costs of retrenchment. The PSP will finance technical assistance for a review of policy options in this area. The project will go on to support consensus building and implementation for a consistent PE retrenchment strategy and policy framework. Work has already begun to prepare this framework, including consultations with key stakeholders.

Competition Policy. The FGN recognizes that privatization of PEs in sectors where competitive pressures from international markets may initially be limited and where monopolies exist, will call for effective competition and regulatory policies. To provide a consistent economy-wide setting for these, and to cover other sectors, FGN has decided to commission a review to draw up options for a competition and anti-trust policy. No single solution has yet been determined to be the most appropriate at this time for Nigeria's needs for competition policy and general infrastructure regulation. Whichever institutional approach is adopted in the medium term, the regulatory rules will need to be established at the individual sectoral level, although they should be based upon common principles linked closely to competition policy.

PE Debt Restructuring Guidelines. To accelerate the PE divestiture process, FGN has identified the need to determine, early on, a clear policy and operational guidelines for treatment of PE debts. By setting standard approaches for handling similar classes of PE debts, this will enable financial restructuring of PEs by transactions advisers to proceed more rapidly, while allowing FGN decision-making to focus upon exceptions requiring high-level government attention. FGN has decided that the PE debt guidelines will be prepared and adopted by NCP by end 2001.

Capital Market Absorptive Capacity Review. A key element of FGN's privatization strategy is to encourage a rapid growth in shareholding by Nigerian savers and investors throughout the country, through issuance via public offerings of up to 49 per cent of shares in privatized companies. With about 100 large PEs slated for divestiture during 2001–05, this would result in a major expansion of Nigeria's stock market, which is currently quite small by international standards. It will be important to conduct early on an empirical assessment of likely capital market absorptive capacity. FGN commissioned this review through BPE during the past year.

Regulatory Reform. Modern, pro-competitive regulatory reform is relatively new concept in Nigeria. There will be early design and adoption of pro-competitive regulatory frameworks and creation of independent regulatory bodies, prior to PE divestitures. In addition, a major effort at public education and awareness raising will be mounted to help build constituencies in support of the reforms. Actions already taken by the FGN include a) adoption of the National Telecommunications Policy and strengthening of the NCC through appointment of an independent Board of Directors and Chief Executive, coupled with the recent successful auction by NCC of four digital mobile licenses; b) the replacement of the management of the National Electric Power Authority (NEPA) with a pro-reform, private sector oriented Technical Board, reporting directly to the President, as well as adoption by FGN of a new Electric Power Policy. Major capacity building will take place in new regulatory bodies.

Governance and Business Environment. The NCP will adopt clear publicized procedures for transactions, as well as make efforts to streamline business regulations. The NCPs recent decision to further liberalize the extent of shareholding by strategic investors from 40 to 50 percent will provide a greater degree of comfort to investors. Adoption of the Anti-Corruption Act and establishment of the Independent Corrupt Practices and Other Offenses Commission are also important steps by the FGN to address this risk. FGN's new procurement systems and procedures and financial accountability guidelines will aid in the transparency of activities.

In particular, numerous local and foreign investors have shown interest in the telecommunication sector. Resolution of the legal and regulatory framework will be key to growth in this sector. In power, the investor response to opportunities in power generation has been good, with numerous expressions of interest to bid on emergency power generation capacity. In distribution, however, there is a risk that foreign investors may focus on only a few larger markets leaving smaller systems to local investors. Early recruitment of privatization advisors, to work alongside the NEPA unit restructuring advisors and legal/regulatory advisors is important so that market risk perceptions can be addressed. Greater coordination and effective implementation of investment promotion activities as well as simplification of business regulations and red tape are also necessary to improve the general business climate.

Capacity for Implementation. Early and sustained efforts at capacity building and training, especially on procurement, will help minimize the risk that implementation will be compromised. In particular, USAID has already conducted a series of training programs for BPE staff and several senior BPE professionals have attended a World Bank Group procurement training program. Other actions include: (a) appointment of two procurement specialists by BPE in 2001; (b) BPE's recruitment of a core team of Nigerian professionals, with international project and corporate finance experience; as well as (c) enhancement of BPE employees' salaries to levels substantially above civil service scales, thus contributing to a strongly motivated workforce.

Annex

List of PEs in the Privatization and Commercialization Act No. 28 1999

Ministry	Public Enterprise	Proposed Action	Phase
Agriculture	National Parks Board	Commercialization	
Agriculture	Ore-Irele Oil Palm Co., Ltd.	Commercialization	
Agriculture	Ihechiowa Oil Palm Co., Ltd.	Commercialization	
Agriculture	Ayip Eku Oil Palm Co., Ltd.	Commercialization	
Aviation	Federal Airport Authority of Nigeria	Privatization	
Aviation	Nigeria Airways Limited	Privatization	
Commerce & Tourism	Nigeria Hotels Ltd.	Privatization	
Commerce & Tourism	Festac 77 Hotel Ltd.	Privatization	
Communications	Nigerian Telecommunications Limited	Privatization	
Communications	Nigerian Mobile Telecommunications Ltd.	Privatization	
Communications	Nigerian Postal Service	Commercialization	
Defense	Tafawa Balewa Square Investments Ltd.	Commercialization	
Employment, Labor and Productivity	Nigerian Social Insurance Trust Fund	Commercialization	
Finance	Nicon Insurance Ltd.	Privatization	
Finance	Nigerian Reinsurance Company Ltd.	Privatization	
Finance	Nigerian Bank for Commerce & Industry	Commercialization	
Finance	Assurance Bank Ltd. (former Arab Bank)	Privatization	
Finance	FSB Int. Bank plc (NNPC/NMA/etc. shares)	Privatization	
Finance	Afribank Nigeria Ltd. (BIAO Shares)	Privatization	
Information & Culture	Daily Times of Nigeria plc	Privatization	
Information & Culture	Federal Radio Corporation of Nigeria	Privatization	
Information & Culture	New Nigerian Newspapers Limited	Privatization	
Information & Culture	News Agency of Nigeria	Commercialization	
Information & Culture	Nigerian Television Authority	Commercialization	
Industries	National Fertilizer Company of Nigeria	Privatization	
Industries	Federal Super-phosphate Fertilizer Co. Ltd.	Privatization	
Industries	Nigerian Machine Tools Co., Ltd.	Privatization	
Industries	Nigerian National Paper Manufacturing Co.	Privatization	
Industries	Nigerian Newsprint Manufacturing Co. Ltd.	Privatization	
Industries	Nigeria Sugar Company Ltd., Bacita	Privatization	
Industries	Sunti Sugar Company Ltd.	Privatization	
Industries	Lafiaji Sugar Company Ltd.	Privatization	
Industries	Ashaka Cement plc.	Privatization	
Industries	Benue Cement plc.	Privatization	
Industries	Cement Company of Northern Nigeria plc.	Privatization	

Annex *(continued)*

List of PEs in the Privatization and Commercialization Act No. 28 1999 *(continued)*

Ministry	**Public Enterprise**	**Proposed Action**	**Phase**
Industries	Nigeria Cement Company Ltd., Nkalagu	Privatization	
Industries	Calabar Cement Company	Privatization	
Industries	Anambra Motor Manufacturing Co. Ltd.	Privatization	
Industries	Leyland Nigeria Ltd.	Privatization	
Industries	Nigerian Truck Manufacturing Co. Lt.	Privatization	
Industries	Peugeot Automobile of Nigeria Ltd.	Privatization	
Industries	Volkswagen of Nigeria Ltd.	Privatization	
Industries	Steyr Nigeria Ltd.	Privatization	
Industries	Nigeria Romania Wood Industries Ltd.	Privatization	
Industries	West African Portland Cement plc	Privatization	
Petroleum Resources	Nigerian National Petroleum Corporation	Commercialization	
Petroleum Resources	Port Harcourt Refinery & Petrochemicals Ltd.	Privatization	
Petroleum Resources	Warri Refinery and Petro-chemicals Ltd.	Privatization	
Petroleum Resources	Kaduna Refinery & Petro-chemicals Ltd.	Privatization	
Petroleum Resources	Eleme Petrochemicals Company Ltd.	Privatization	
Petroleum Resources	Nigeria Petroleum Development Co. Ltd.	Privatization	
Petroleum Resources	Nigerian Gas Company Ltd.	Privatization	
Petroleum Resources	Pipeline Products Marketing Company Ltd.	Privatization	
Petroleum Resources	African Petroleum plc.	Privatization	
Petroleum Resources	Unipetro plc.	Privatization	
Petroleum Resources	National Oil & Chemical Marketing plc.	Privatization	
Petroleum Resources	Dresser Nigeria Ltd.	Privatization	
Petroleum Resources	Solus Scholl Nigeria Ltd.	Privatization	
Petroleum Resources	A.C.M. Nigeria Ltd.	Privatization	
Petroleum Resources	Baker Nigeria Ltd.	Privatization	
Petroleum Resources	Sedco Forex Nageria Ltd.	Privatization	
Petroleum Resources	Flopetrol Nigeria Ltd.	Privatization	
Petroleum Resources	Schlumberger Wise Line Co.	Privatization	
Petroleum Resources	Dowell Schlumberger Nig Ltd.	Privatization	
Petroleum Resources	Key Drill Nigeria Ltd.	Privatization	
Petroleum Resources	Baroid Nigeria Ltd.	Privatization	
Petroleum Resources	D.C.P. Ltd.	Privatization	
Power & Steel	Steel Rolling Mill, Oshogbo	Privatization	
Power & Steel	Steel Rolling Mill, Jos	Privatization	
Power & Steel	Steel Rolling Mill, Katsina	Privatization	

Annex *(continued)*

List of PEs in the Privatization and Commercialization Act No. 28 1999 ***(continued)***

Ministry	Public Enterprise	Proposed Action	Phase
Power & Steel	Delta Steel Company Ltd.	Privatization	
Power & Steel	Ajaokuta Steel Company Ltd.	Privatization	
Power & Steel	Aluminum Smelter Company Ltd.	Privatization	
Power & Steel	National Iron Ore Mining Company Limited	Privatization	
Power & Steel	National Electric Power Authority	Privatization	
Solid minerals	Nigerian Mining Corporation	Privatization	
Solid minerals	Nigerian Coal Corporation	Privatization	
Solid minerals	Nigeria Uranium Mining Co. Ltd.	Privatization	
Transport	Nigerian Ports Authority	Commercialization	
Transport	Nigerian Railway Corporation	Commercialization	
Transport	Nigerdock Ltd.	Privatization	
Transport	NAHCO	Privatization	
Water Resources	River Basin and Rural Development Authority (12 in number)	Commercialization	
Works and Housing	Federal Mortgage Bank Nigeria	Commercialization	
Works and Housing	Federal Mortgage Finance Limited	Commercialization	
Works and Housing	Federal Housing Authority	Commercialization	
African Investments	Save Sugar Company	Privatization	
African Investments	Onigbolo Cement	Privatization	
African Investments	Royal Swaziland Sugar	Privatization	
African Investments	Chemical Company, Senegal	Privatization	

Statistics on the number, size, geographical distribution and activities of the SME[25] sector are very partial and highly unreliable, but small and medium scale enterprises may comprise as much as 87 percent of all firms operating in Nigeria. This figure *excludes* the *informal* business sector which is a major source of income and employment.

1. Infrastructure and Corruption.

Focus group discussions with SMEs and other business sector stakeholders revealed that their overriding concerns are poor infrastructure and corruption.

Infrastructure: As noted elsewhere in this report, the burden of poor infrastructure imposed on Nigerian enterprises, including SMEs, is profound. An SME that is forced to supply its own water, electricity, and security and required to transport its goods on poor roads, cannot compete with large producers or with foreign firms. Results of the Regional Program for Enterprise Development (RPED) Firm Survey in Nigeria shows that firms suffer up to 30 percent reduction in output due to inadequate supply of electricity. Consequently firms are spending a considerable amount of capital on private provision of electricity.

Access to basic telecommunication services, let alone information technology remains grossly inadequate in urban centers and non-existent in rural areas. SMEs confront very high costs in procuring telecommunication facilities, purchasing computer hardware and software, and in hooking up to the Internet. Price reductions (e.g. for telephone hook-ups) in recent years have been significant but remain well in excess of other Africa countries and competing markets such as East Asia.

Corruption: The FGN is combating the pervasive problem of corruption through various efforts including the approval of an Anti-Corruption Bill. Nonetheless, the challenge remains enormous, particularly for SMEs who are most hard-hit absorbing informal charges that they cannot avoid. In contrast, large firms are better able to afford the many informal charges associated with conducting business and to defray the cost of investing in infrastructure through economies of scale. Enterprises also pointed to the fact that this highly uncertain business environment fosters a general distrust towards Nigerian business which impedes access to foreign markets. For example, one company owner/manager reported that in order to conduct business with British partners, he had to open a virtual office in London simply to avoid using a Nigerian telephone and address.

2. Government Services.

Inter-Agency Coordination and the Regulatory Environment: There is weak coordination between government departments and agencies engaged in supporting SMEs. The manner in which the three levels of government—federal, state and local—interact in terms of both policy design and implementation and operational practices, has resulted in a business-regressive regulatory and taxation environment. SMEs are liable for payment of corporate, withholding, and value-added taxes to federal authorities. Then there is the burden of multiple licenses, permits, and fees, administered inconsistently by resource-constrained state and local governments. For instance, in addition to registering with the Federal Corporate Affairs Commission (CAC), SMEs are required to pay state governments levies for business premises and registration as well as “right of occupancy” fees to state and local governments. There are also shop and market fees to be paid to local governments. Those in Abuja also pay a capital gains tax. A complex array of regulations, taxes, fees, licenses, and fines provide opportunities for rent-seeking that further ratchets up the cost of doing business. This insecure and expensive environment motivates many SMEs to remain informal by not registering under existing legislation.[26]

This problem is further exacerbated by the insufficient degree of consultation between the public and private sector actors. Progress is being made as a result of the work of such bodies as the Banker's Committee, the Nigerian Economic Summit Group (NESG), and other private-public sector *fora*. However the underlying approach of many government officials and private sector representatives is still rooted in past practices. It presupposes the need for direct public intervention. An indirect approach, based on government actions that influence firm behavior and development through market forces, needs to be accorded greater attention by the decision-makers from both the public and private sector. Another problem in the public-private sector relationship which revealed itself in firm interviews is a deep-rooted distrust between putative "partners" from the private and public sectors.

Past public mismanagement, capital flight and the weight of recent Nigerian political history have all played a role in entrenching the distance that currently exists between the public and private sectors in Nigeria. The successes that are now starting to breach this dialogue impasse need to be supported. Innovative approaches building up engagement between local private sector actors (e.g. business associations, *think tanks*) and governments at federal, state and local levels need to be promoted and piloted. Success in these early stages of re-engagement is crucial. Areas where this potential could be realized include a collaborative effort to address specific constraints in the legal and/or regulatory and administrative framework.

Legal Framework: Inadequacies in the legal framework are especially harmful to the operations of SMEs. These include inadequate property rights, bankruptcy laws and leasing contracts. SMEs suffer from an inconsistent interpretation of the law by the courts as well as inadequate enforcement of existing laws and commercial contracts. The credibility and efficacy of the judicial system was also put in question by many of the SME respondents involved in the mapping exercise.

Business Linkages and Networks: Business linkages in Nigeria tend to be formed through business associations. Chambers of Commerce are more widespread than most types of organizations, but focus predominately on Lagos, Kano, Kaduna and Enugu, where they organize regular trade fairs and exhibitions. The plethora of other SME-oriented business associations often lack strategic direction and an operational sense of their comparative advantage to their members. Current business services provided are modest and irregularly supplied. However there is considerable potential to strengthen the role of business associations, particularly in regions of high SME density, such as Onitsha, Nnewi, Aba, or Kano. Whereas these organizations are often highly resource and skill constrained, they contain talented and committed individuals and within Nigeria there is a strong business culture in support of the role of independent business associations in the provision of business and advocacy services to their members. These are significant assets on which to build.

3. Financing SMEs.

SMEs have minimal access to long-term finance. What exists is very short-term, often comprising collateralized overdraft facilities. These are made available only to the larger and more established SMEs. Continuing macroeconomic instability, coupled with banks' memories of past losses, provides little hope that the situation can be rectified in the foreseeable future.

Lending Products: Although liquid, banks are willing to lend to SMEs on a short-term basis only. Even then, access to working capital in the form of short-term loans, over-draft facilities, letters of credit and other trade credit remains seriously limited. While some banks are beginning to offer more financial products, including leasing, trade finance, mutual funds, insurance credit and guarantees, these are reserved for the larger companies. Even the most successful SMEs have major problems in establishing a simple overdraft facility. Long-term capital is mainly provided by the government through large, inefficient development finance institutions. Experience in targeted lending, including World Bank sponsored credit lines, has not been successful. Banks have lacked the motivation to disburse the funds properly and/or the skills necessary to evaluate risk and monitor loans. Less traditional “second generation” banks that were once willing to lend on a medium term basis are cutting back because they lack appropriate skills and find the environment too risky.

Equity: SMEs are unable to satisfy minimum requirements for listing in the Nigerian Stock Exchange (NSE). There is little capital, domestic or foreign, available for private placement possibly because anticipated returns are low in relation to perceived risk and competing uses for such funds. A new mechanism—the SMIEIS[27]—is the most recent effort to introduce new equity financing into Nigeria’s SME sector. It is premature to draw any conclusions about the success of this initiative, although evidence to date suggests that the deal flow from this initiative will tend to gravitate towards the largest and least risky segment of the SME market.

Innovative Financial Products: There are other promising financial innovations. For example, Citicorp has established the Extended Target Market (ETM) program. It combines a special force of sales staff, which identifies potential clients based on such criteria as sales levels, sectors, and minimum period of operation (3–5 year financial record), together with an independent assessment of credit worthiness that ascertains the financial capacity of any company being considered for a loan. This program will provide a range of financial products including overdraft facilities; micro finance; financing of accounts receivable; debt financing; contract based loans; bills for collection; and asset-based trade finance (leasing). Repayment performance to date exceeds 95 percent. There is clearly potential to extend this program, although once again the risk profile that the ETM looks to finance is such that the program will be focused principally on the top more established end of the SME market.

4. Business Services for SMEs.

Business Development Services: Although Nigeria has some high-quality providers, consulting firms, and training institutions, SMEs cannot afford their fees—consulting businesses are invariably attracted to the oil industry and related services. The multi-donor funded, IFC-managed Africa Project Development Facility (APDF) and African Management Services Company (AMSCO)[28] are active in Nigeria but their activities have until recently been targeted to the upper-end of the SME spectrum, leaving the vast majority of smaller industries without reasonably priced and available business development services. Other business planning and support service providers, including some limited BDS services provided by the Organized Private Sector (OPS)[29] tend to be subsidized products that have not been appraised in terms of their impact on firm performance. Generally the enterprise viewpoint is that these services are of limited quality and there is no willingness to pay increased user charges.

Training: The quality of training provided through government programs, notably the Technology Business Incubation Centers (TBICs) of the Ministry of Science and Technology needs improvement and their outreach is limited. Other institutions providing training relevant to the needs of SMEs include the

National Directorate of Employment (NDE), the Center for Management Development (CMD), the Industrial Training Fund (ITF), the Work-For-Yourself program (WFY) and the Center for Industrial Research and Development (CIRD). Overall, their outreach is limited, the institutions are poorly equipped and funded and they lack a sufficient complement of trained staff. In many cases their programs are not tailored to SME needs.

Trade Clusters and Co-operatives: These exist principally outside the major urban centers and are dominated by micro-enterprises that exist on the border between informal and formal. Of particular note is Nnewi, featuring a thriving auto parts industry and entrepreneurs who have successfully transferred technologies, drawing on Taiwanese expertise in particular. They have self-financed trips to Taiwan to work directly with their partners and learn first hand how the auto part machines works. A similar experience can also be observed in Aba, which features clusters primarily in the garments and leather-based products sub-sectors. An estimated 11,000 firms are in operation in the Aba leather and allied products sub-cluster providing employment to some 27,000 people and a further 20,000 on seasonal basis. The garments sub-cluster comprises an estimate 2,400 firms employing 10,000 people, plus 2,000 seasonal workers. A more careful assessment is required of ways in which to assist these clusters improve competitiveness and the potential for replication of these types of support programs to foster cluster development elsewhere in Nigeria.

Access to Information: Information available to SMEs on domestic and foreign markets as well as new technology development is poor. SMEs cannot access the internet, a cheap, timely and comprehensive source of information, on a regular basis. The poor quality of data and other business information on the domestic market curtail the development of local business linkages and evolution of domestic supply chains. There are major disconnects between the informal sector and formal SMEs and between SMEs and major companies.

The Nigerian Investment Promotion Center (NIPC) is the main agency providing information on exports and imports, trade policy regimes, trade promotion programs, trade shows, and design and quality requirements. Associations in the Organized Private Sector (OPS) complement its effort. Multilateral agencies, particularly the World Bank, UNIDO, and UNDP also assist through publications and periodicals as do some diplomatic missions, particularly the Commerce section of the American Embassy which issues certifications to help Nigerian companies improve their image in US markets. As noted earlier, the negative image often associated with Nigerian businesses hampers *bona fide* firms, particularly SMEs, in their initial approaches to foreign companies.

Major sources of general information on the domestic market include the OPS, the Ministries of Commerce and Industry, the Central Bank of Nigeria (CBN) and the Nigerian press. Information on domestic suppliers and purchasers is provided through firm-level publications, trade fairs and exhibitions. Industry news are also available through private journals, economic and business publications, and daily newspapers. Access is mostly confined to the larger cities and urban areas. Information on quality standards, design and sales agents is seldom available to SMEs.

SME Mapping and Key Policy Recommendations: The environment confronting small and medium enterprises (SMEs) in Nigeria is not a very conducive one. The problems of operating in a very uncertain policy environment are compounded by major deficiencies in infrastructure, insecurity, corruption and an inadequate legal and regulatory framework. Although these issues affect all Nigerian enterprises, for SMEs they translate into particularly prohibitive cost structures. The incentive for them to remain informal is considerable, further compromising their ability to obtain important services, both financial and non-financial. The result is a static sector, operating at some 50 percent of its capacity[30] and able to offer only rudimentary employment and services. This impasse precludes the growth that can only be achieved through the provision of more competitive and higher value-added goods and services.

This difficult enabling environment also affects the market for a critical range of services that can help improve SME competitiveness. There remains a dearth of affordable financial and other business services accessible to SMEs. Because of the declining value of the Naira in recent years, firms that have contracted debt denominated in foreign currency have been unable to repay it. This situation has deepened bank unwillingness to provide credit of any sort to SMEs, with the possible exception of term lending to the strongest enterprises. SMEs' capacity to best exploit any financing made available to them has been further constrained by the high cost of quality, privately supplied business services and the limited, varied quality of other forms of technical assistance.

Past government subsidized credit targeted at SMEs has been on the whole disappointing. Government sponsored efforts have included the creation of specialized development finance institutions (DFIs) namely NIDB, NBCI and NERFUND. Many DFIs have incurred major losses. According to the recently completed World Bank/IMF survey of the financial sector, the vast majority is not financially viable. The newly established Bank of Industry—which has yet to commence its operations—has indicated that it will be providing term lending at 10 percent. This would be a significantly subsidized credit program which—based on currently available information—does not appear to have been designed in light of lessons of experience about the poor performance (financial and developmental) of prior publicly-run subsidized credit programs.

There is a significant network of business associations in Nigeria. In addition to the network of Chambers of Commerce (represented by NACCIMA), the is the Manufacturers Association of Nigeria (MAN), the National Association of Small and Medium Enterprises (NASME), and the National Association of Small Scale Industries (NASSI). Additionally there is the publicly financed services through the Nigerian Investment Promotion Council and the Nigerian Export Promotion Council. While the business associations have a substantial membership base, there are many constraints that limit their effectiveness in servicing these members. Lack of resources, inability to adapt to changing circumstances and new demands constrain outreach and relevance and weak product quality inhibits impact. All this has a negative effect on membership fee payments (running at less than 50 percent even in the stronger associations) and compromises members' willingness to pay user fees for specific services.

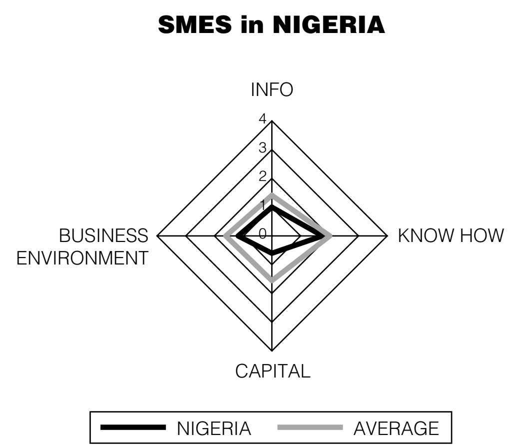
Over the past three years there has been a resurgence of government interest in SMEs. In addition to the establishment of the Bank of Industry, legislation is before Parliament to set up a Small and Medium Industries Development Agency (SMIDA) to coordinate and facilitate SME development. This agency, whose mandate and specific operations have yet to be finalized, would serve as an umbrella agency overseeing the activities of publicly-funded agencies directly supporting SMEs. SMIDA may also supply some services directly—in particular through a network of regional offices. As with the Bank of Industry, it is unclear at this stage whether SMIDA is taking sufficiently into account the growing body of best practice in SME Support programs. This emphasizes a "wholesale" or "market development" role for public and donor funding to the SME sector, rather than retailing subsidized services directly to enterprises.[31]

Another major new initiative, first announced in the CBN's *"Monetary, Credit, Foreign Trade and Exchange Policy Guidelines for 2000 Fiscal Year"* and discussed with the Banker's Committee would set aside 10 percent of the commercial banks sector pre-tax profits to "finance and promote small scale industries." This program—known as the Small and Medium Equity Investment Scheme (SMIEIS) is now in operation and commercial banks are setting aside the funds as per the operational guidelines that have been established for the program. Some banks have joined different *consortia*, managed by fund managers, who seek to make the investment in SMEs on behalf of the banks. Other banks have created subsidiaries charged with making equity investment in SMEs.

Whether this new round of initiatives will fare any better than earlier ones is questionable if these initiatives fail to address fundamental problems of the environment in which SMEs must operate and if they do not build on lessons learned about best practices in support of SME development. An overview of the environment facing SMEs in Nigeria is highlighted in the summary of the findings of an SME country mapping exercise conducted by the World Bank Group in 2001 and updated in 2002 (see Section 6). The mapping highlights constraints as well as opportunities for improving the business environment; supporting enterprise service providers; obtaining capital; and providing information. The document summarizes our principal findings and recommends possible actions.

The figure below summarizes the situation of Nigerian SMEs with respect to Information; Know How[32]; Capital; and the Business Climate. Access is rated on a scale of one (poor) to five (excellent). The graph offers a pictorial image of how Nigeria compares to the average of conditions prevailing in a number of countries (including Cambodia, Indonesia, Vietnam, Bosnia—Herzegovina, and Macedonia) where a similar study was conducted recently.[33] It shows Nigeria lagging in all four areas.

Figure 5.1. SME Mapping—Nigeria



Some of the major obstacles holding back the growth of SMEs, particularly corruption and poor security, are not going to be solved quickly. Even so, a strategy based on the growing body of applied knowledge concerning the principles, products and practices behind SME development, can yield positive results. Getting the enabling environment right and providing demand-driven services that build on local capacities lies at the heart of these proven "good practices." Adoption of this new approach to SME development must begin with attitudinal change and institutional "buy-in." Some officials remain attached to outmoded government-led interventions, in part because of their lack of exposure to successes achieved elsewhere with new approaches. Reacting to past experience, Nigerian entrepreneurs either seek handouts from government and donors or try to keep as far as possible beyond the reach of government.

Our recommended initiatives seek to take account of the need to raise confidence and trust and to demonstrate the value of new approaches to SME development. They focus on nurturing a more suitable environment through interventions at the state and local levels; supporting SME access to new market niches; improving SME access to capital and financial services; developing SME capacities; and strengthening their associations.

Nurturing a Suitable Environment: Much can be done at the state and local levels to rationalize institutional mandates, public policies, regulations, taxes and other charges. Municipalities—where there are supportive local leaders and officials and active interest in the private sector—can be selected for pilot efforts. Public-Private consultative bodies for business development, representing the principal stakeholders, could formulate initiatives for improving the business environment. They would review state and municipal laws, regulations and policies impinging on SMEs and recommend tangible, concrete actions for implementation. Such initiatives could conceivably include the abolishment or amendment of laws and regulations; the streamlining of procedures; the formulation of investment plans; the establishment of commercially-based industrial parks; improvements in government procurement procedures and practices; and government contracting out and/or devolution of selective administrative functions.[34] Possibly with support from global organizations pursuing best practices, associations, institutions and companies within these pilot municipalities could help implement agreed measures aimed at improving the business environment. If successful, these pilot initiatives could be replicated elsewhere in Nigeria.

New Markets through Privatization: Considerations of efficiency and budget are prompting municipal governments to consider new arrangements for such services as water, waste collection and waste management. For SMEs, private provision of these services comprises a potentially important market. More generally, governments at all three tiers should be examining new ways of using SMEs to provide goods and services in ways that create employment and income locally and redress serious failings in infrastructure and the environment. Hence, procurement procedures should be simplified and made transparent in order to facilitate competitive bids from SMEs. Such new niches may also provide opportunities to introduce leasing schemes that can expand access by SMEs to the financing needed to underwrite the requisite investment in capital.

Improved Access to Financing: To a considerable extent, the problems confronted by SMEs in obtaining access to debt and equity financing on reasonable terms reflect a problem confronting the private sector as a whole. Consequently, longer-term solutions will depend on progressive reduction of the risks perceived by lenders and investors. Such risks, as noted elsewhere in this report, include problems in contract enforcement; commercial law, a general absence of trust; questionable business practices; accurate financial information and disclosure; and uncertain property rights, notably land. Likewise, returns from longer-term investment must be sufficiently competitive with competing uses for shorter-term speculative and commercial ventures and investment outside Nigeria.

Nonetheless, SMEs by their very nature confront more specific problems in obtaining access to financing on reasonable terms. Past attempts to funnel credit on concessionary terms through mechanisms operating independently of the market have generally been unsuccessful, not only in Nigeria but most other African countries. Typically, Development Finance Institutions, often established to satisfy specialized financing needs of a target clientele, have failed to achieve their objectives and proven financially unviable without repeated injections of public funds. Likewise, attempts to force financial bodies in the private sector to lend to a particular target group on concessionary terms have proven expensive, because of the public guarantees and support required as inducements, or the higher costs incurred by other borrowers.

The new approach works within financial markets, redressing those failings that significantly constrain legitimate financing requirements of a group that for economic and social reasons merits public support. Credit bureau, credit scoring and specialized approaches to managing SME risk—such as with the Citicorp ETM program all merit further investigation in the Nigerian context. Training programs designed to assist commercial banks with a market interest in downscale lending to better assess SME risk and manage project (cash flow) lending can also be made available to a number of Nigerian banks—particularly the smaller "second tier" banks. Such downscale lending programs are probably particularly suited to SME clusters where the local bank branches would have ground level knowledge of many of the firms in a geographical locale thus improving their access to the information necessary for more character-based risk assessment.

Access to financing can be improved by expanding opportunities for sub-contracting, especially in the oil industry. Increased involvement by SMEs, along with training for financial institutions, would strengthen the latter's capacities to assess the soundness of requests for credit. Another possibility is greater use of other financial products, notably leasing, through changes in tax and related legislation.

Equity is another area where some potential innovations may be possible. In addition to the SMIEIS, recent thinking on how to mobilize more equity funds in African markets has focused on finding solutions to the principal causes behind the disappointing performance to date of equity instruments in fostering growth in anything but the top end of firms in the SME sector. This most often derives from the failure of these funds to achieve hurdle rates attractive to investors and fund managers, together with difficulties exiting from investments in countries. Recent assessments of good practices have suggested that combining debt and equity and providing an "income supplement" to investors (in the form of a share of revenues) does provide a more robust means to introduce equity into SMEs. It can allow for the right set of financial incentives to attract investors and fund managers and for the SME it ties outlays to investors to more clearly measurable performance indicators (i.e. turnover). For the SMEs, it provides a means to access investment funds beyond what would be available to them through collateral-based lending. Circumstances suggest that this model, currently being pioneered in South Africa, could be replicable, particularly in SME cluster areas in Nigeria.[35]

Building SME Capacities: SMEs in Nigeria require a wide range of supportive services, especially in such growing sectors as leather goods, ginger, fruit, garlic, carrot processing, gum arabic processing and metal fabrication. The World Bank Group is developing a greater response capability to these needs by expanding the services provided by the APDF and Enterprise Support Services (ESS) and AMSCO.

A comprehensive solution to the unmet demand for affordable services depends on developing local capacities through establishment of a commercial market. Donors can assist by supporting such market oriented interventions using suitably tailored matching grant and voucher schemes. In addition, the World Bank Group can draw on institutions that have successfully pioneered the commercial provision of supportive services in other countries and where there are needs assist in the development of appropriate local organizations to address these requirements.[36]

There are also plans to promote business linkage and networking approaches that build on the economics of concentration, along the lines of Nnewi and similar clusters elsewhere in Nigeria. These often comprise enterprises operating on the divide between the formal and informal sectors, with considerable potential to increase productivity and employment. Additional package of support services comprising targeted business and financial services built on a public-private partnership that also targets improvements to the legal and administrative environment can help them realize this potential. Possible initiatives must be assessed in terms of their commercial feasibility, with cost recovery assigned a high priority and subsidies and other grants used on a temporary, limited and transparent basis. In addition, they should reflect those local practices and traditions that have successfully promoted mutual trust and self-help within the local business community.[37]

Strengthening SME Associations: There remains a pressing need to rationalize SME associations, commencing with a review of existing ones. Emerging from this exercise should be an action plan to eliminate overlapping mandates and activities; strengthen those associations with a broader membership so that they can improve the quality and outreach of their core programs; and increase their ability to advance their members' interests through various advocacy activities. This action plan should be designed in partnership with key stakeholders and other interested donors.

Through rationalized and strengthened associations, initiatives could be launched to:

- Support entrepreneurship development especially in promising sectors. Possibilities include the supply of certain municipal services and the strengthening of quality bds services targeted at sectors with potential for productivity gains such as light manufacturing, textiles and leather goods;
- Create a database on foreign and local markets and production technologies and disseminate this information to their members; and
- Strengthen the management of SME associations and their ties with business associations outside Nigeria.

These programs of capacity building with business associations should be based on a clear strategic agenda and be clearly in line with a business plan that the association is committed to implementing. The strategic agenda and business plan would need to be developed as a result of a cooperative undertaking involving association members and in collaboration with relevant government authorities. This participatory approach will serve to ground the associations work in a way that legitimizes its strategic choices about comparative advantages and priorities. It will also help to ensure that its advocacy work with the government sector is recognized to be the voice of its membership. This in turn will enable Nigerian business and its representatives to lay a stronger foundation on which to "raise the bar" in terms of institutional transparency and accountability in the delivery of an enabling environment for private sector development.

Notes:

25. There is no single universally accepted definition of SMEs. In Nigeria, ministries, research institutes, agencies, private sector institutions, etc. use different definitions. The World Bank Group SME department has established the following definition:

    Micro enterprise
    (a) Employees ≤ 10 and
    (b) Total Assets ≤ US$ 100,000 or
    (c) Total Annual Sales ≤ US $100,000

    Small enterprise
    (a) 10 < (Employees) ≤ 50 and
    (b) US$ 100,000 < (Total Assets) ≤ US$ 3million or
    (c) US$ 100,000 < (Total Annual Sales) ≤ US$ 3million

    Medium enterprise
    (a) 50 < (Employees) < 300 and
    (b) US$ 3million < (Total Assets) ≤ US$ 15million or

(c) US$ 3million < (Total Annual Sales) ≤ US$ 15million

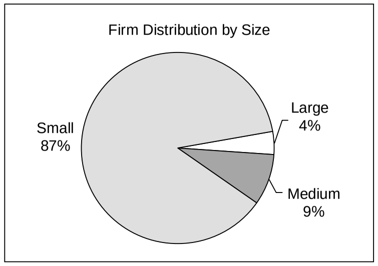
In the Nigerian context, SMEs are best defined as those with fewer than 100 employees and less than 50 million Naira in assets. For more information on definitions specific to Nigeria, refer to the SME Map below. Other useful references include I.S. Omisakin, *"Factors Influencing Success of Failure of Enterprises in the Informal Sector—The Case of Ibadan City," Niser Monograph Series,* No. 9, 1999, pp. 9–12. Nigerian Institute of Social and Economic Research (NISER), Ibadan.

26. Refer to the FIAS Administrative Cost Study and SME Map for details on the legal and regulatory environment.
27. While remaining committed and proceeding to implement SMIEIS, commercial banks express concerns about this initiative as to its implications for bank liquidity and many remain wary of entering into areas (i.e. equity) outside their core business. They are seeking a number of tax shields to compensate for the likely cost this initiative could pose. Another critical issue for those banks that are seeking an external fund manager for these funds is creating the incentive framework to attract these fund managers. This again tends to push the initiative to up-market SME clientele.
28. The Africa Project Development Facility (APDF) is a support service for African small and medium enterprises managed by the International Finance Corporation (IFC). The African Management Services Company (AMSCO) is a joint initiative of the United Nations Development Programme (UNDP), the African Development Bank (AfDB) and the IFC which supplies management and training services to SMEs.
29. The Organized Private Sector (OPS) is made up of the National Association of Chambers of Commerce, Industries Mines and Agriculture (NACCIMA), the Manufacturers Association of Nigeria (MAN), and the Nigeria Employers' Consultative Association (NECA).
30. RPED survey (2001).
31. Refer to the "Business Development Services For Small Enterprises: Guiding Principles for Donor Intervention, 2001 Edition; Committee of Donor Agencies for Small Enterprise Development, February 2001.
32. Includes consulting, business services, and training.
33. Further comparative analysis of the Nigerian environment for SMEs vis-à-vis other Africa countries that have been mapped will be undertaken on a periodic basis as the data becomes available and the methodology develops further.
34. For instance, it is often more efficient to have a municipal government administer a national level business registration scheme. Conversely, it may be more cost-effective to have local business associations manage this process on behalf of public agencies.
35. Refer to draft note; "Small and Medium Enterprise Investment Program—Program Overview," T. Gibson, SME Institute, June 2002. In a July presentation to the SME Cluster Break-Out Session of the DFID/USAID/World Bank "Competitiveness Forum" hosted by the African Institute for Applied Economics and the President's Office of the Government of Nigeria, these additional points are of note: (i) This Fund would be accompanied by close technical support/financial oversight of the *investee* firms by the Fund Managers; (ii) SME clusters, where the target firms would often be located in close

geographic area or be part of a common supply chain, would provide economies of scale for this type of Investment Fund.

36. The IFC has supported to development and expansion of a local micro-enterprise BDS provider known as STEP (Support and Training and Enterpreneurship Program) which provides various BDS services to microenterprises in Lagos and Eket. Through the WBG Capacity Building Facility, the IFC has also supported FATE Foundation to extend its entrepreneurial services to start-up and entry-level entrepreneurs to the Port Harcourt area. In addition to these project initiatives, the SME department is working closely with other agencies such as Fundes International and GTZ to identify suitable well-tested best practice products for introduction into Nigeria.

37. As a result of the recommendations arrived at by the Nigerian Economic Summit Group (NESG) SME Working Group at the Annual Meetings in October, 2001 UNIDO and the SME Department agreed to collaborate to develop an integrated Cluster Development Program targeted on the Aba and Nnewi clusters. This program—which is intended also to be a demonstration project on the basis of which potential roll-out of the approach would be mobilized for other regions of the country—is being developed in close collaboration with the State and local government authorities and with entrepreneur representatives of the leading association groups in the respective clusters. This pilot project has the following anticipated components: (i) an enabling environment component focusing on administrative and regulatory reforms based on a survey; (ii) enterprise support component entailing technology transfer, institutional and association development; (iii) financial support component comprising possible initiatives in micro-finance, bank downscale lending and piloting of possible debt/equity vehicles.



Definition of SME by Nigerian Institutions

	Assets exc. real state			Annual Turnover			No. Employees		
in million Naira	Med	Small	Micro	Med	Small	Micro	Med	Small	Micro
Central Bank	<150	<1		<150	<1		<100	<50	
NERFUND		<10							
NASSI		<40	<1		<40			3–35	
Min. of Industry*	<200	<50					<300	<100	<10
NASME	<150	<50	<1	<500	<100	<10	<100	<50	<10
Arthur Andersen				<500	<50				

*National Council of Industry under the Min. of Industry revises SME definition once a year

Summary of Country Facts

	1997	1998	1999	2000	2001
Economic Indicators					
GDP Growth	2.7%	2.4%	2.5%	38%	3.9%
Annual rate of Inflation	29.3%	8.5%	6.7%	6.9%	18.9%
Poverty Indicators	**1985**	**1999**			
GDP per capita (US$)	370	300			
Households below Poverty Line	35%	67%			
Unemployment Rate	N.A.	50.0%			
Policy Indicators (High, Med, Low)	**Degree of Liberalization**	**Trend** (Improving, Steady, Worsening)			
Banking Sector	Medium	Steady			
Trade Regime	Medium	Steady			
Interest Rate	High	Steady			
Tax Regime	Medium	Steady			

Sources: Nigerian Federal Office of Statistics, EIU, CBN, WB

Diagnostic

- **Business Environment**

Poor infrastructure constitutes a barrier to entry and hinders international competitiveness. Government committed to support SMEs through tax incentives, subsidized TA and special financing schemes, but support may not follow best practices and implementation remains a challenge.

- **Capital**

Lack of short and long term capital despite high liquidity. Banks view SMEs as a high-risk group: high number of non-performing loans given to Small Scale Industries in the past has left a legacy difficult to overcome.

- **Enterprise Support Services**

Inadequate management and marketing skills, few accredited and affordable providers of training and consultant services.

- **Information**

Very limited statistics on SMEs – registry data unreliable. Poor information on domestic and overseas markets.

Potential Growth sectors: light/heavy manufacturing (textile, leather), food processing, municipal services

- Lack of security and basic infrastructure (telecom., power, roads) undermines SMEs' competitiveness
- New government intends to curb high level of corruption. Success will require sustained political will.
- Ethnic tensions contribute to an unstable economic and political environment.
- Unstable macro-economic environment, with a high external debt burden (US$34.5 billion in 1999).
- Fairly decentralized government: important policy decisions and administrative procedures affecting. SMEs happen at the local and state levels.
- A number of SME-support institutions have been created following the recommendations of a 1999 Presidential Committee, but mandates are overlapping and weak linkages between these institutions and SMEs are factors which could hinder effectiveness.
- Heavy reliance on imports of capital and intermediary goods in manufacturing sector.
- Over 600 state-owned enterprises
- Job creation in rural areas is very important to stop large flows of internal migration to urban centers.

Recommendations

1. Strengthen legal, regulatory and business environment for SMEs—particularly at the State and Municipal level by supporting selective public-private collaborative actions highlighting successful international models.
2. Build capacity of selected business associations including member services, information collection and dissemination, and policy advocacy. Help foster greater collaboration between different business associations, especially at the sub-national level.
3. Assist in strengthening of local BDS supplier capacity for SMEs and microenterprises. Matching grant/voucher schemes to improve affordability could be considered.
4. Extend SME markets through supply chain initiatives, industrial clusters and municipal service delivery.
5. Extend Entrepreneurship programs using NGO schemes, local Universities and Technical Colleges
6. Deepen financial sector (Bank/MFI) linkages to SMEs and microentrepeneurs through innovative financial products and targeted TA to selected commercial banks for downscale lending and risk management vehicles.
7. Support better telecommunications and electrical (in particular) infrastructure provision for SMEs (to improve competitiveness) through pilot schemes, innovative private management contracts, technical assistance, including perhaps advising on effective industrial estate / other zone arrangements.
8. Support Federal and State governments in developing SME strategies and initiatives, and in adopting best practice from other countries in the design and functions of public institutions involved in SMEs.

II.A Snapshot – Business Environment

ISSUES	POSSIBLE ACTIVITIES / INITIATIVES
LEGAL FRAMEWORK Judicial system is slow and corruptible, and is not trusted by the business community. Knowledge of commercial law is low. Collateral redemption is very difficult and can take in excess of one year through the court system.	Continuing support through the WB Economic Management project to train judges and lawyers and develop a fast track to process small claims related to commercial activity.
TAXATION / COMPANY REGISTRATION Corporate tax level is fair (30%) but government capacity to administer collection is low. Tax structure is unclear and tax refunds are very difficult to get. Customs duty laws are unclear regarding the base for calculation and the classification of products, and duty drawbacks are seldom forthcoming (although the situation is improving since the switch from duty drawbacks to duty certificates).	Encourage simplification of the tax/custom structure, especially across different levels of government. Support GON\IMF efforts towards a transparent and growth-oriented tax system, while widening the tax base and increasing collection capacity. Help reduce the perceived “costs of exposure” in Nigeria. Build capacity at local business associations to articulate tax-related disincentives to business, and advocate policy reform. Despite the “costs of exposure” that come from registration in Nigeria, some SMEs must register, and many more could or will benefit from formalization, for example, in better access to credit. To this end, institutional capacity building at the Corporate Affairs Commission could be supported.
BUSINESS REGULATIONS SMEs face many administrative barriers in doing business. Multiple permits and fees are required at the state and municipal level, often spontaneously and with little justification. Land acquisition and construction procedures are particular problems, contributing to the difficulty of getting credit.	Nigeria needs to reduce administrative barriers to investment. A detailed study across all levels of government is underway. Clear guides to procedures at all levels should be compiled for the use of businesses and officials. Local business association capacity to represent members needs to be increased.

(Continued on next page)

II.A Snapshot – Business Environment — *Continued*

ISSUES	POSSIBLE ACTIVITIES / INITIATIVES
GOVERNMENT CAPACITY The Ministry of Finance and the Ministry of Industry, along with the Presidency, are the main branches of government responsible for developing and implementing Nigeria's support for the SME sector. However, policies are sometimes inconsistent, and better coordination between the Ministries of Industry and Finance is required. The relatively young Small and Medium Industry Department (Min. of Industry) is still developing its strategy, and has weak links with the private sector. It is also setting up the Small and Medium Enterprise Development Agency of Nigeria (SMIDA), which is addressing this problem to some degree, and a Credit Guarantee Scheme.	Concerted efforts are required to ensure transparency and the removal of corruption from public sector activities, including in procurement. Corruption perception surveys might be a useful monitoring device. Advice to the new SME Agency (SMEDAN) and SMID itself drawing on international experience could be helpful, complemented by efforts to increase dialogue between public and private sectors at national and subnational levels. Support best practice training of civil servants at the local/state level, and identify reform-minded subnational governments with which to develop a comprehensive capacity building and public-private partnership reform agenda. This could be replicated in other subnational regions.
BUSINESS CULTURE High entrepreneurial capacity, especially among microentrepreneurs, but there is a widespread culture of operating in the informal economy; low trust in the government, and low-compliance with laws.	
MACROECONOMIC POLICY Unstable and unpredictable monetary supply makes banks very conservative about their exposure, and limits funds available for SME lending	See "Access to Capital" Snapshot below.
INFRASTRUCTURE Transportation, telecom, water and electrical power supply are considerable problems for small businesses which cannot afford independent/alternative supply sources.	Continuing assistance through WBG-supported initiatives in infrastructure development and privatization. Further infrastructure/utility investment alongside improvements in the regulatory environment is extremely important. Encourage government efforts to create better infrastructure in certain commercially-attractive areas to begin with. Encourage SME participation in privatization schemes (e.g. privatization of water distribution and waste management). Promote commercially based clusters and incubators to encourage businesses to share infrastructure expenses Improving information infrastructure. (See "Access to Information" below.)

II.B Snapshot – Access to Capital

ISSUES	POSSIBLE ACTIVITIES / INITIATIVES
LOANS *Short and Long term, Microfinance* Despite high liquidity and large margins (commercial banks are lending at up to 35% annual rates with a margin of up to 15%), LT financing is scarce. Financial Institutions perceive SMEs as a high-risk segment of the market with a high failure rate. Short term loans are available but principally to established, larger SMEs engaged in trading, rather than small-scale industries. CitiBank is currently piloting a specialized SME lending window (Extended Target Market). It focuses on higher-end SMEs, and there are plans to expand this initiative. Some larger microfinance institutions are in operation, and there are some new initiatives underway by several Banks to support the industry (UBA, Guaranty Trust). USAID is investigating an expanded program of support, and IFC is pursuing innovative ways of expanding credit supply to SMEs.	Explore possible technical assistance support to banks interested in more effectively managing the risk entailed in downscale lending to SMEs. Clear need for training to both bankers on identifying bankable SMEs, and to SMEs on how to raise their bankability. For SMEs and Microenterprises encourage company registration, and the building of other records (including credit) in order to increase formal sector participation, access to loans, and so on. For small companies in need of capital for growth, on balance formalization may be an advantage, despite the “costs of exposure.” Explore possible support to microfinance initiatives underway (e.g. Smartcards program, Microstart) with a view to expanding sustainable microfinance services, and strengthening MFI-commercial bank linkages.
EQUITY *Domestic, Foreign Capital Markets* Few domestic equity sources. SMEs do not participate in the stockmarket because they can seldom meet the listing requirements; lack awareness of the advantages of the stock market as a source of financing; and fear that publicity will make them more vulnerable to arbitrary fees/harassment. Banks are now required to set aside 10% of their net profit for SME equity investments (Small Scale Industry Initiative – SSI), potentially through an independent fund management company run on a commercial basis.	Organize an awareness campaign to explain benefits and rules of the stock market and facilitate related technical assistance to companies that want to participate. Such initiatives could begin at the subnational level with pilot micro-capital markets. Many concerns have been expressed about the viability of this SSI scheme, and how it can be made to work effectively. However, the government appears fully committed. Expert advice on the management of such a scheme according to international best practice will be important. Useful assistance could include technical support for equity-related legislative reforms, and governance/capacity building support to investment fund-type vehicles established for placing equity investments from the SMIEIS.
OTHER *Supplier credit, Leasing* Limited sources of export finance. The larger, established SMEs can access limited leasing services through some stand-alone leasing companies and selected commercial banks.	With the absence of L/T lending, limited S/T lending without collateral and very limited equity, accelerating the development of the leasing industry is crucial to make Nigerian SMEs more competitive. Develop leasing legislation, increase leasing opportunities for SMEs; identify potential leasing companies for investment. Evaluate market for commercial export credit schemes.

II.C Snapshot – SMEs Access to Enterprise Support Services

ISSUES	POSSIBLE ACTIVITIES / INITIATIVES
BUSINESS SERVICES *Investment proposal preparation* *Finance/Accounting/Legal Consulting*	
Many donors (e.g. IFC, GTZ), NGOs (e.g. Fate Foundation) and state/federal governments support business plan preparation programs but much more is needed.	Extend training in business plan preparation and post investment BDS through extension of APDF/ESS programs, and increase support for the development of local BDS suppliers.
Very competent consulting/legal/accounting firms exist, but SMEs cannot afford their services	Further develop BDS support targeted at SME market niches such as local manufacturing clusters/centers (e.g. Kano, Nnewi, Aba), agro-processing, supply chain opportunities (Port Harcourt), and SME provision of municipal services. Promote implementation of International Accounting Standards (IAS).
TRAINING *Business skills, Foreign business knowledge*	
Good business degrees are offered at universities/research institutions in several cities, but there is limited reach outside these areas. Lagos Business School (LBS) has plans to open a Center for Entrepreneurship Studies in Lagos	Explore possible funding of SME enterpreneurship and related distance learning programs at the LBS Entrepreneurship center, or elsewhere.
IFC's STEP program was originally established with a grant of $0.2 million in mid-1999 to help diffuse business knowledge and assist the Nigerian informal sector through grass-roots delivery of advisory services. The project has proved very successful, received a positive independent evaluation, and is in the process of being extended through mid-2002. STEP is currently seeking partners to help it deepen activities in Lagos, and extend its scope to other regions of Nigeria.	Encourage the expansion of the STEP program to other regions, and its extension in Lagos.

II.C Snapshot – SMEs Access to Enterprise Support Services — *Continued*

ISSUES	POSSIBLE ACTIVITIES / INITIATIVES
BUSINESS ASSOCIATIONS / LINKAGES *Associations, Chambers of Commerce* There is a very extensive network of associations, including Chambers of Commerce, but some of their services, e.g. export promotion or advocacy have very limited effect because they are undermined by large macro-economic or systemic failures (e.g. rent seeking, the reputation of the country). There is also limited cooperation amongst them. They would benefit from greater capacity in the provision of membership services, information management and policy advocacy.	Support various business associations (preferably in areas where they cooperate well and pool skills and resources) to build advocacy skills, and to create forums for public-private debates on policy issues. Streamline and consolidate the efforts of existing business associations while establishing more effective dialogue mechanisms among associations for cooperation when policy issues are common across industries and the different sizes of small companies (which are the main distinguishing factors). Often the constraints on businesses are similar across size and industry, while marketing mechanisms, for example, may differ. Help build the capacity of Nigerian business associations by supporting partnerships with leading institutions overseas that are active in mainstreaming best practice. Particular efforts would be warranted where subnational government bodies show political will to support the SME sector.
OTHER BUSINESS SERVICES *Incubators* A few Technology Incubator Centers exist but they are run on a non-commercial basis. They lack managerial experience, and outreach is low.	Consider Technical Assistance to provide sound commercial business plans for incubators in order to improve effectiveness and cost sustainability.

II.D Snapshot – Access to Information

ISSUES	POSSIBLE ACTIVITIES / INITIATIVES
MARKET INFO *Domestic and foreign market info*	
Very limited information available, essentially from informal sources. Trade fairs supported by donor-backed organizations and Chambers of Commerce do take place, but more effort is needed to help build domestic production chains. Nigeria suffers from a poor image in its export markets, and needs to build an image of competitiveness and quality in selected products.	Establish Info Centers to expand business opportunities at the national and international level, and focus local efforts on improving performance in sub-sectors where there is competitive advantage. Potentially as part of business association capacity building, assess the role selected associations could play as a host for such Info Centers, and in time be an internet access point for SMEs/Microenterprises to communicate and gather information.
PROCUREMENT OPPORTUNITIES	
SMEs do not have fair access to government procurement opportunities due to inadequate information, and non-transparent/fraudulent award procedures.	Support World Bank efforts to make procurement procedures more transparent, and to introduce information dissemination mechanisms and TA to SMEs to increase their competitiveness in public contracting.

III.A Gap Analysis – SME Business Environment

	What SMEs Need	What is Available	Who?	Improvements / Initiatives for Consideration
Legal / Regulatory	Access to competitive prices (reducing monopolies, subsidies, price regulations)	Privatization is at the forefront of the government's PSD program (85 companies to be privatized by 2004 in three phases). There are currently over 600 heavily subsidized federal public companies and over 900 public companies at the state and municipal level, representing over 50% of formal sector employment. The WB, IFC and USAID are contributing to the privatization strategy with TA (WB, USAID) and direct transactions (IFC).	WBG, USAID	Support for current policies to break monopolies and privatize enterprises with technical assistance to ensure speedy and transparent process. Power and telecoms are of particular importance to SMEs given that generators are not economically viable for most, and, often being located away from commercial centers, SMEs suffer disproportionately from telecoms shortcomings. Revisiting Nigeria's Industrial Parks and various "zone strategies" with a view to providing communal infrastructure, and promoting cluster development in selected commercially attractive zones with strong local political leadership.
	Access to fair judicial system	The judicial system is inefficient and corruptible: it can take three years for a claim to be heard at a court of first instance, and firms have little confidence that the process will be fair. Underlying problems include inadequate funding, poor facilities, staff shortages and inadequate training for lawyers and judges at lower and intermediate levels of the judicial system. Inadequate enforcement of commercial contracts is a particular concern, and disputes are often dealt with through informal mechanisms. Alternative Dispute Resolution options exist through the Lagos Chamber of Commerce or the Nigerian Arbitration Institute, for example, but in many areas there is a reluctance to use them, an ignorance of the provisions, or an inability to enforce decisions.	WBG	The judicial process for contractual disputes needs to be accelerated through encouraging greater recourse to ADR mechanisms, and more training of lawyers, judges and clerks. There is a clear need to improve the efficacy of many areas of the judicial system, and so also a need to prioritize. An existing World Bank Economic Management project includes training elements on economic issues and the legislature, and could incorporate certain specific SME concerns. Task forces bringing together high-quality lawyers and judges, a few international experts, and targeted training and resource mobilization in selected areas of particular concern to SMEs is desirable (e.g. commercial contract enforcement and arbitration).
	Reasonable taxation and fees, and adequate tax administration	• Corporate tax level is fair (30%) but government capacity to administer tax collection is low (listed and foreign companies are the main payers), tax structure is unclear and tax refunds are not forthcoming. • Nigeria is a member of WTO and ECOWAS. • The government "intends" to lower and simplify the tariff schedule. The IMF is supporting a comprehensive tariff study; and USAID is providing TA to replace the current tariff schedule expiring in December 2001. • Customs duty regulations are unclear regarding the taxable base, and duty drawback payments are difficult to realize. Again, much exporting by SMEs is forced along informal channels by inspection and other costs, resulting in considerable foregone revenue for the govt. • A confusing array of incentives exists at the federal level, but take-up is extremely low amongst both local	IMF USAID	The challenge for Nigeria is to get more SMEs into the tax system. For governments this would increase revenues, and allow consideration of a lower headline corporate tax rate. SMEs would be encouraged by a less burdensome and more predictable tax system, and if combined with simpler incentive/support initiatives and greater banking/credit opportunities that require companies to be in the formal sector, such improvements could see greater formal economy participation by SMEs. In parallel to improving revenue distribution mechanisms from federal to lower level political units, there is a need to control arbitrary and predatory taxation and levies at lower levels of government, increase efficiency of FIRS through computerization, and simplify the federal tax and incentive system.

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III.A Gap Analysis – SME Business Environment — *Continued*

	What SMEs Need	What is Available	Who?	Improvements / Initiatives for Consideration
Legal / Regulatory		companies and existing investors. Given that few SMEs pay taxes, and few are formal exporters, many of these incentives are of little relevance. A) Generally applicable incentives: pioneer status, investment allowances to manufacturers and rural businesses, reinvestment and depreciation allowances, local raw materials use, labor-intensive mode of production, local value added, in-plant training, infrastructure, investment in economically-disadvantaged areas, and R&D. B) Non-oil sector export incentives: Export Development Fund (EDF), Export Expansion Grant Fund Scheme (EEGFS), Duty Draw Back and Manufacture-in-Bond Scheme (MBS), tax relief on income from bank loans supporting export activities and those to EPZ companies. C) Sectoral incentives cover the petroleum, solid materials, agriculture, and other sectors. • At the state and local level, incentives are granted on an ad-hoc basis, generating opportunities for corruption. Various taxes and levies are also imposed in an apparently arbitrary manner. SMEs are powerless to complain. • Incentives and taxes are administered by the Federal Inland Revenue Service (FIRS). • A new accounting system has been introduced ("Accounting for Taxes" SAS19).		• Conduct several micro-level case studies of tax procedures and tax burdens attributable to all levels of government in order to establish the main problems for SMEs (especially disincentives to enter the formal sector), and to help advocate for policy reforms. • Help increase the capacity of local business associations to articulate tax-related disincentives to business, and to provide a policy advocacy role. • Help design tax/incentive systems to encourage the entry of SMEs into the formal taxpaying structure, e.g. through pilot SME/microfinance arrangements that reward company registration and a track record of tax payment.
	Licensing/permits — red tape	Business registration with the Corporate Affairs Commission (CAC) is being streamlined, but much work, including computerization of the registry, still needs to be done. CAC needs to become more integrated into efforts to bring SMEs into the formal sector, and not just register companies that come its way more efficiently. • The Nigerian Investment Promotion Commission (NIPC) has been established with the aim of becoming a "one-stop-shop" for foreign investors, and for companies seeking certain incentives. However, neither role is yet being properly fulfilled, and the design of the incentives it manages discourages uptake. The incentives with the greatest potential relevance to SMEs are contained in the tax code and administered by FIRS. • Multiple permits and fees are required at the state and municipal levels, and arbitrary application of rules, as well as bureaucratic delays impose a serious cost on small firms. Land acquisition and registration is a major impediment to business. Overlapping ownership and occupancy	CAC NIPC	Nigeria needs to reduce administrative barriers to investment. This is particularly important for SMEs that may not be able to overcome these barriers through the exercise of the corporate influence enjoyed by larger companies (including parastatals) and foreign investors, or by offering substantial bribes. Administrative barriers must be addressed at all levels of government, but especially at local levels where many land, construction and other procedures occur. At the federal level reform of CAC is needed to (a) streamline registration process; (b) strengthen its role and capacity to promote (re)entry of SMEs into the formal sector; (c) possibly establish it as the central repository of company accounts to give companies an official track record that will help them access credit, (and so give them an incentive to register and enter the formal tax-paying structure). • Capacity building and training at CAC would be required to address human resources, computerization, and internet capability issues.

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III.A Gap Analysis – SME Business Environment — *Continued*

	What SMEs Need	What is Available	Who?	Improvements / Initiatives for Consideration
Legal / Regulatory		problems make it difficult to use land as collateral. This is compounded by delays of many years in registering land transfers, which, under federal law, must be approved by state governors for most commercial land. Construction-related permits and approvals are particularly subject to bureaucratic delays and corruption at the subnational level. Many of these red-tape related issues are being investigated in detail by a USAID-sponsored study of administrative barriers to investment that covers federal and subnational levels of government.	USAID FIAS	• A formal guide to company registration, and explanation of the value (e.g. access to bank or supplier credit) of keeping sound official records with CAC, needs to be prepared. Linkages with other institutions such as FIRS and the Statistical Office need to be strengthened. Systems (InfoCentres?) for public access to certain information about registration procedures and registered companies need to be established. • The capacity of local business associations to represent members, as well as to expose administrative barriers to business, and advocate for their removal, needs to be increased. Business associations could broker public-private sector task forces on these barriers. Priorities could be “taxation and other administrative levies” or “land and construction” issues. (Such initiatives should be seen as an extension of implementation of “roadmap” recommendations at the subnational level.)
	Opportunity for advocacy	A new Small and Medium Enterprise Development Agency of Nigeria (SMEDAN) is being set up within the Ministry of Industry in order to “coordinate” the activities of SMEs. Such agencies where the governance structure is weak (dependence on government, lack of strong private sector leadership and linkages) have historically had limited success.	SMID SMEDAN	The benefits to SMEs of an agency like SMEDAN will depend on a sound and relatively independent and private-sector linked governance structure, on clear articulation of its objectives, and on how it is to engage with other institutions supporting SMEs (e.g. Chambers of Commerce). • Global best practice in the area of SME agencies needs to be shared with SMEDAN, and help offered in developing consultative mechanisms and policy advocacy channels for SMEs (and their representatives).
Government Capacity	Transparency, consistency	The government has adopted an Anti-Corruption Act, an essential step in improving the environment for healthy, private business. Indirectly and eventually, the simplification of regulations and the privatization process will also reduce opportunities for corruption. However, official corruption persists, favoring businesses with good connections to public officials (usually larger firms), and this raises the costs of doing business, particularly for small firms. There are a few independent anti-corruption activities and publications (e.g. Scrutiny and Candour) supported by donors, NGOs, and foundations such as the Ford Foundation.		In order to bolster the Government’s anti-corruption drive, supportive components could be emphasized in several potential SME-related initiatives: • Ensure that all institutional initiatives are as transparent as possible, especially where financial resources are concerned, including, for example, publication on a website of accounts, procurement practices, suppliers, personnel appointments, and so on. • Given the corruption problem in Nigeria, it could be useful to administer a corruption perceptions survey, anonymously, amongst senior executives from different sizes of company, perhaps half-yearly, to assess how perceptions of corruption in Nigeria change or improve.

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III.A Gap Analysis – SME Business Environment — *Continued*

	What SMEs Need	What is Available	Who?	Improvements / Initiatives for Consideration
Government Capacity	SME Policy	• The Ministries of Finance and Industry are in charge of implementing SME Policy. Under the Ministry of Industry there is an SME Department. Within the same Ministry, a Small and Medium Enterprise Development Agency of Nigeria (SMEDAN) is soon to be launched to oversee the activities of SMEs. • An Economic Policy Coordinating Committee has been tasked to monitor economic reforms and ensure coordination in economic policies. The *Vision 2010* Report (1997) includes recommendations regarding SME Development Policy. However this document is increasingly dated and may not be so relevant to current GON thinking.	MoI (SMID) SMEDAN MoF Presidency	Nigeria would benefit from advice on international best practice to support the work of the SME agency. In particular, advice on how to build institutional links with private sector institutions, and empower and support enterprise development at lower levels of government, would be important.
	Consultative Mechanism	The government is fostering dialogue with the private sector through periodic consultations with bodies such as the Nigerian Economic Summit Group. However, SMEs have been under-represented in such fora, and the emphasis is very much top-down. A representative of the Min. of Industry participates in NASME's monthly meetings.	NESG	More frequent dialogue between Government and business associations and other members of the Organized Private Sector (OPS), and enhanced representation of SMEs, is needed. Help foster the bottom-up advocacy capacity and representative role of business associations. (See Enterprise Support section).
	Local Govt. Capacity	In several areas, including taxation and levies, construction and licensing procedures, and inspections, local governments have an extensive role but tend towards overregulation or predatory practices, rather than energizing local economies. This is because, in search of additional funds, local administrations burden SMEs with multiple licenses and fees. Lead Merchant Bank is considering supporting the establishment of a school to train civil servants in Abuja.		In addition to a holistic assessment of tax-related impediments to business across multiple levels of government, the following initiatives could be useful: • support for increased training of civil servants, perhaps through Lead Merchant Bank's initiative; • identification of state or local governments where there is pro-business leadership, and work with them to design various capacity building and proactive training programs to re-enforce public-private partnerships for enterprise development and growth. Success in such subnational regions could have a demonstration effect, and provide a local source of expertise to assist in rolling out reforms to other parts of the country (examples of this can be found in Russia).
	Statistics, Evaluation	Very little reliable data. The World Bank *Economic Management Project* includes support to the Federal Office of Statistics	WBG	Capacity building assistance to CAC should seek to improve the quality of company-related statistics.
Business Culture	Positive public perception of business	Negative perception of SMEs as high risk ventures with high failure rate		Nigeria would benefit from an awareness campaign to show the role SMEs can play in an economy if the right environment is in place. Success stories from Nigeria as well as from countries at similar level of development should be disseminated to the public and the banks. Business associations may be the most effective vehicle to implement this initiative.

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III.A Gap Analysis – SME Business Environment — *Continued*

	What SMEs Need	What is Available	Who?	Improvements / Initiatives for Consideration
Infrastructure	IT/ Telecommunications	Telephone connection by NITEL is unreliable and inadequate. Private entry and service is very limited, and regulated by unclear licensing rules. The government has plans to liberalize the sector and improve the Nigerian Communications Commission (NCC). The improvement in service from the latest round of GSM licensing will be judged in due course.		
	Transportation/ Logistics	Nigeria's extensive network of roads is in very poor repair, particularly in rural areas. The World Bank is providing assistance to the government to improve the road network (*Recovery Program*). Port facilities are inefficient causing delays due to long clearing procedures at customs.		Nigeria would benefit from assistance in developing a regulatory and legal framework for private sector participation in the rehabilitation of roads in rural areas. Procurement procedures to encourage the participation of SMEs in these public works would bring efficiency gains.
	Water/Waste Collection and Management	Only 50% of households have access to safe water (the proportion is much lower in rural areas) due to poor maintenance and ineffective management (state governments are the main owner and distributor). The WB has initiated two Water Projects. Waste collection and management services, a responsibility of the municipal government, only reach 40% of the households. Informal collectors are filling the gap but sanitary conditions are very poor. The Eti-Osa Local Government has recently launched an initiative called *Private Sector Participation in refuse collection and disposal* which intends to license informal waste collectors, but it lacks the resources to improve methods and work conditions.		SME participation in the provision of municipal services, particularly in water provision and waste collection and management, is highly desirable. Subnational governments require assistance in the development of regulations and procurement procedures, and in the formalization and upgrading of the existing roster of small-scale private providers, etc. • Provide technical assistance and financial support for better equipment to SMEs involved in municipal services, perhaps including support for leasing mechanisms. • Assist the government to develop a regulatory and legal framework for SME participation in water provision in rural areas.
	Power	Electricity supply from the state-owned NEPA is very limited and unreliable (the electricity law bans private providers from supplying third parties). Even small companies are forced to rely on private generators, raising their operating costs significantly. The government has launched a power sector policy to introduce competition in the sector. IFC will support private power generation projects through the Emergency Power Program for new generation capacity, and through the Rehabilitate-Operate-Transfer/Own program to refurbish existing capacity.		Continue support for privatization of NEPA, alternative providers and an adequate regulatory system. Promote commercially based clusters and incubators to encourage businesses to share infrastructure expenses, and get advice on legal and regulatory changes, at both federal and local levels, that would support such initiatives.

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III.A Gap Analysis – SME Business Environment — *Continued*

	What SMEs Need	What is Available	Who?	Improvements / Initiatives for Consideration
Infrastructure	Other	There is a chronic lack of business/industrial space, especially in urban areas. Nigeria's zone strategies are underdeveloped. Small businesses in particular find it difficult to access suitable sites with the necessary infrastructure, and streamlined business procedures.		Land acquisition procedures need to be simplified. Given Nigeria's infrastructure problems, and the legal control exercised by state governments over land transfers, subnational governments should take the lead in opening up new commercial zones, encouraging private provision of infrastructure and private management where possible, and then copying the experiment to additional locations. At the federal level, Nigeria is now beginning to revisit its EPZ experiment, but most existing industrial parks are subnational affairs, and at this level assistance would be most valuable. Proactive subnational governments should be encouraged and assisted to establish viable commercial zones (e.g. industrial, high-tech, cluster-based).
IT / Internet	Portals	Several portals exist but none specifically for businesses.		
	Application services	There are a few providers including Linkserve, Nova Hyperia, MicroCom, Cyberspace, ScanNet, Infoweb, Compuserve, Ross-Claytoa) WANGONeT.	Private Providers	Limited local business content available through the Internet. Pilot initiatives, linked to effective cluster/ industrial park operations with secured telecom services, merit further investigation.
	Hard/software vendors	Internet access and use has been limited due to deficiencies in the telecom and power sectors. Private sector hardware /software vendors have high charges.	Information and Technology Association of Nigeria (ITAN) and Computer Association of Nigeria (COAN) appear to have limited effectiveness	Initiatives to improve SME access to internet-related development tools will have limited effect without improvements in power supply and telecoms connectivity, and the government should give thought to pilot projects to support the provision of infrastructure and necessary deregulation in certain commercial areas. Assist Nigeria in drawing up financing, management, infrastructure and deregulatory plans for such zones. Work with ITAN and COAN to build capacity in policy advocacy and member services.
	Skilled technicians	Few technicians in informal private sector, and training is prohibitively expensive for the majority of people.		Assist Nigeria in the introduction of IT/Internet training through technical schools, business centers, and universities.

III.B Gap Analysis – Access to Capital

	What SMEs Need	What is Available	Who?	Improvements / Initiatives for Consideration
Commercial Lending	Short-Term Lending	Most available credit is short-term and the borrowers are mainly large firms and larger, established SMEs involved in trading. The investment climate must improve before Financial institutions (Fis) will lend to SMEs. Currently, FIs concentrate on quick-return investments (e.g. 90 day maturity for trade & Forex speculation), overseas investments and fee collection.	Commercial Banks	Establishment of credit scoring systems and credit bureaus, and a Credit Guarantee Scheme. Training to bankers to help them better assess SME risk and downscaling lending.
	Long-Term Lending	Long term financing is scarce despite high liquidity and large margins (commercial banks have margins up to 15% on annual interest rates of up to 35%). • FIs see SMEs as a high-risk, high failure rate market segment. The widespread non-repayment culture, CBN's unstable monetary policy, and a flawed legal system that makes capital recovery very difficult or time-consuming, typically make the risks for commercial long term lending unacceptable. • Commercial banks also lack adequate loan and project evaluation methods, skills, and manpower to lend to SMEs. Thus, only development finance institutions lend to SMEs through specialized funds (e.g. NERFUND, NIDB, NICB, NACB, and UDB), plus Union Bank, People's Bank, and Community Banks. Non-repayment rates are high. • A 10 billion Naira *Poverty Fund* has been set up which, inter alia, provides support to SME activities with a poverty reduction focus. • IFC has so far approved $120 million in term credit facilities to 5 commercial Banks operating in Nigeria, of which a $40mn facility with Citibank is designed to enhance the Extended Market Program lending specifically to SMEs. • One innovative approach developed in conjunction with Citibank recognizes that commercial banks often cannot increase exposure to economic sectors perceived as risky. By providing a risk mitigating mechanism under which IFC guarantees on a "pari passu" basis up to 50% of each transaction's principal, IFC anticipates Citibank will increase its exposure to SME customers by an additional $60mn.	Development Finance Institutions/ Government/ Bilateral and Multilateral Organizations/ selected commercial banks (e.g. Lead Merchant Bank and Citibank)	Long-term efforts to increase the quality of financial intermediation, and bring down interest rates and margins from current levels Encourage and support the establishment of Credit Bureaus. Look for less traditional forms of assets to collateralize. For example, in the area of SMEs servicing the oil sector, IFC is partnering with local banks to provide credit lines which take contracts with oil companies as collateral. The project involves the establishment of a US$30 mill. Niger Delta Contractor Revolving Credit Facility (the "Facility") by IFC, Shell and a local bank, with each providing one third of the required funding. The Facility aims to provide competitively priced term loans for capital investments and working capital to local SME contractors delivering services to Shell Petroleum Development Company of Nigeria Limited ("SPDC"), primarily in the Niger Delta. In conjunction with the Facility, IFC is working with SPDC to design a capacity building program for the latter's SME contractors. Promote bank training to increase supply of necessary skilled resources, as currently being implemented by AMSCO in conjunction with Lead Merchant Bank. Support training to commercial FIs in Management Information Systems (MIS), and in lending methods appropriate to SMEs

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III.B Gap Analysis – Access to Capital — *Continued*

	What SMEs Need	What is Available	Who?	Improvements / Initiatives for Consideration
Micro-finance	Credit & Savings	• Informal small savings, private savings in Community Banks. • The Poverty Reduction Initiative (PRI) has been introduced to tackle poverty by promoting micro-lending and microsavings. • UBA has set aside N90 million for microfinance. • Guarantee Trust Bank is co-financing with USAID a microfinance project targeted to NGOs in rural areas using "smartcards" • *Microstart* Program by UNDP with City Express Bank • Ford Foundation program in urban areas	Informal private small institutions, United Bank for Africa, Guarantee Trust Bank, USAID, UNDP	Community banks are a potentially important source of microfinancing. Savings in them should be further encouraged, and their active participation in local business associations encouraged. Community banks fall under the jurisdiction of state and local administrations. Consider ways of supporting the "smartcard" system being implemented by Guaranty Trust with support from USAID and the Ford Foundation as a way of helping the smallest borrowers establish a credit track record, and facilitating graduation from MFI lending.
Equity	Domestic Private Equity & Angels	Some Banks are starting to take equity in selected SMEs, but on a very small scale An SME-financing initiative has been launched by CBN and the Bankers Committee under which banks will reserve 10% of their pre-tax profits each year for equity participation in SMEs. The proposal has been criticized in many quarters not for its excellent objective, but for its questionable viability, and potential abuse in its implementation. This initiative could provide up to N5bn per annum. Mechanisms for implementing this lending and ensuring transparency are as yet unclear, although there are some initiatives to pool the funds from several banks, and administer them transparently through an independent asset management company.	All Banks represented by the Banker's Committee are—theoretically—expected to participate.	Should the initiative proceed in accordance with best practices, consideration could be given to TA to: (i) support equity-related legislative reforms that will be critical to the initiative's potential for success; (ii) support transparent, accountable mechanisms to manage the government-initiated "10% fund."
	Foreign Private Equity	Almost none as a result of the non-conducive investment climate. IFC made no equity investments in FY01, concentrating rather on loans to financial intermediaries for onlending.	IFC	Success of the above domestic private equity initiative could open the way for more foreign participation through such a risk-mitigating vehicle.
	Capital Markets	Capital markets are underdeveloped. Few SMEs are listed (mainly on the Second-tier Securities Market which has lower listing requirements than the NSE).		

III.B Gap Analysis – Access to Capital — *Continued*

	What SMEs Need	What is Available	Who?	Improvements / Initiatives for Consideration
Ohter Fin. Products	Supplier Credit	Credit purchases		
	Trade Finance	LPO Financing	Private Sector	
	Leasing / Factoring	Private Leasing—there are some specialized leasing companies, and some Banks are developing leasing services for selected clients. The legislative and regulatory environment should be improved. The viability of leasing services in Nigeria is shown by the relatively advanced state of this subsector despite the legal/regulatory constraints facing it.	Multinationals (e.g. Holt Leasing, CFAO, UTC, Leventis)	Investigate with the Equipment Leasing Association of Nigeria (ELAN) how fiscal code provisions might be used to encourage private leasing companies. Revise appropriate accounting regulations to reflect best practices for leasing services.
	FDI & FDI Promotion	Non-oil sector FDI is limited due to infrastructure and security problems, political uncertainty and various legal and administrative barriers. FIAS and USAID have prepared a detailed study on administrative barriers affecting foreign and domestic investment.		Build upon FIAS recommendations of particular relevance to SMEs, including various legal, policy and institutional issues.
	Insurance			Improvement in investment conditions could open the way for MIGA guarantees that would help attract more foreign investment.
	Other	The “SmartCard” initiative operates in urban and rural areas, with the participation of many banks (see under Microfinance).		

III.C Gap Analysis – Access to Enterprise Support Services

	What SMEs Need	What is Available	Who?	Improvements / Initiatives for Consideration
Business Services	Legal Services	High quality legal services do exist but supply is very limited; they are beyond the financial reach of SMEs; and due to legal and administrative distortions legal practitioners spend too much of their time on low-level activities or protracted court cases.	Private law firms	Provide training and technical assistance to lawyers and bar associations in order to spread knowledge of commercial law, and improve access by SMEs through consideration of alternative dispute resolution (ADR) mechanisms.
	Business Planning	• APDF gives one-on-one assistance to develop business plans. • Several donor-funded programs (e.g. GTZ support of a business service unit within the Lagos Chamber of Commerce) • NGOs: e.g. Fate Foundation provides courses for aspiring entrepreneurs • SMID (at the federal level) and the Industrial Development Centers (at state government level) provide some business planning support.	APDF (www.apdf.org), BESO (DFID program, www.beso.org), GTZ, NGOs (Fate Foundation)	Consider APDF/ESSA support for potential SME clients of Citibank's ETM program. Introduce international best practice and partners into the APDF\ESS program to create new initiatives for facilitating the expansion of affordable consultancy services, and for promoting the development of local BDS capacity. Support to strengthen internal capacity and expansion of Fate Foundation's program.
	Marketing Services		Nigerian Export Promotion Commission (NEPC)	Consider ways of improving export promotion capacity, including through NEPC.
	Incubators	Few Technology Business Incubator Centers (TBICs)	Ministry of Science and Technology	Assist in determining the most suitable business plans for technology incubators in order to promote adoption of best practice from other regions, commercial orientation and cost recovery.
	Other	Extension services by Industrial Development Centres (IDCs) in 21 States	Government	Assess current service provision in the light of international best practice. Consider how to equip existing IDCs adequately, and how to create additional ones.
Training	Vocational	Universities and Technical Colleges Vocational Training Centers in several municipalities (e.g. Eti-Osa Local Government), but funding is very limited	Government	Introduce vocational training programs relevant to SMEs' needs into Universities and technical colleges' curricula. Consider how to develop more effective training partnerships with the private sector and government bodies.
	Technical (by industry)	None	None	More industry-driven technical training is required to reduce the heavy reliance on imports of capital and intermediary goods in the manufacturing sector. Assess models for technical/vocational training partnerships between industry, educational institutions and the government.

III.C Gap Analysis – Access to Enterprise Support Services — *Continued*

	What SMEs Need	What is Available	Who?	Improvements / Initiatives for Consideration
Training	General Business/ Entrepreneurship	• The Government, with UNDP support, has launched a N10bn *Job Creation Program*, which will be implemented by federal, state, and local governments. • *Support and Training for Entrepreneurs Project* (STEP) To help diffuse business knowledge and assist the Nigerian informal sector—which contributes $20 billion to GDP—IFC established STEP, a Nigerian Registered Trust, in mid-2000 with an initial grant of $0.2 million. STEP specializes in delivering grass-roots advisory services to informal enterprises. In cooperation with the Lagos Business School, STEP has recruited and trained a team of 25 young business graduates to provide such services—initially in Lagos—under the guidance of experienced SME specialists. STEP also generates substantial information on the workings of the Nigerian informal sector, which will be useful in planning further engagement and support from IFC and others. A positive external evaluation was completed, and additional funding has been provided for 2001. IFC is looking for partners to help continue, deepen and geographically extend the program. Other sources of support include: • National Directorate of Employment (NDE), • The Centre for Management Development (CMD) • Industrial Training Fund. • Work For Yourself Program (WFY) • National Open Apprenticeship Scheme (NOAS). • Lagos Business School has a new Entrepreneurship Center • FATE Foundation offers workshops on different business topics open to entrepreneurs and NGOs • Centre for Industrial Research and Development (CIRD).	Government, NGOs, WB, DFID, GTZ, UNDP and other multi-lateral and bilateral institutions IFC e.g. STEP, Fate Foundation	Better coordination of entrepreneurship programs launched by the federal, state and local administrations is required. • Support initiatives to strengthen domestic training institutions through proper funding, staffing and modern training equipment. • Support the decentralization of training centers so the benefits can flow down to state levels • Special training programs for staff of the delivery institutions ("training the trainers"). • Assist Universities to include human resource development training for industry in their curricula • Assess potential support to the Lagos Business School Entrepreneurship Center

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III.C Gap Analysis – Access to Enterprise Support Services — *Continued*

	What SMEs Need	What is Available	Who?	Improvements / Initiatives for Consideration
Training	Financial Mgmt/ Accounting/Auditing	• Financial management/Accounts training programs in Business Administration Departments of Universities, as well as the Chief Executive Program at the Lagos Business School • International management consulting services by AMSCO • Occasional training courses by NASSI and NASME • GTZ program through the Lagos Chamber of Commerce • Seminars and workshops organized by the Friedrich Ebert Foundation (FEF)	• Government/ Institute of Chartered Accountants of Nigeria (ICAN) and Association of National Accountants of Nigeria (ANAN) • AMSCO • GTZ • IFC • APDF • Friederich Ebert Foundation (FEF)	Harmonization of programs and accreditation criteria of existing private bodies to avoid compromising standards. Encourage the incorporation of SME needs in their curricula, and perhaps the extension of basic programs to various subnational regions in association with local Chambers of Commerce (CoCs), for example.
	Exporting	Some export-related training to benefit from the provisions of the US's Africa Growth and Opportunities Act, coordinated by the Ministry of Commerce.	Min. of Commerce and interministerial group.	Nigerian Export Promotion Council (NEPC) should be supported in the organization of workshops to educate SME operators on export opportunities, trade regimes, and marketing, especially in the light of AGOA. These promotional efforts should be supported by capacity building at local business associations towards being able to address more effectively administrative and legal barriers to SME exports.
Consulting	Production technology, including environment-friendly technology	Production technology research institutions, Raw Materials Research Council. Few manufacturing firms seem to comply with international environmental standards; and clean technology consulting services for clean production are scarce. This will create a great problem for many firms when the government adopts international regulations in the near future.	Government	
	Management Information Systems (MIS)/IT	Private MIS/IT consultancy services of high quality exist, but SMEs cannot afford the fees.	Private consultants	Consider ways of bringing simple (including manual) systems within the reach of SMEs, again perhaps through training delivered through local business associations.

III.C Gap Analysis – Access to Enterprise Support Services — *Continued*

	What SMEs Need	What is Available	Who?	Improvements / Initiatives for Consideration
Business Linkages	Clusters	Local trade clusters exist but not amongst SMEs engaged in productive activities.	Local trades	Determine local demand for financial and non-financial support to industrial and manufacturing clusters. Consider implementation methods involving business associations, universities, and so on.
	Business Associations	• Manufacturers Association of Nigeria (MAN) focuses on trade issues. There are sector-specific MAN branches, but they largely represent the bigger companies. • Trade Associations. • Nigerian Association of Small Scale Industrialist (NASSI), founded in 1978 has 20,000 members, with branches in all states, focuses on advocacy and offers some training courses in management and accounting. • Nigerian Association of Small and Medium Enterprises (NASME) was founded in 1996 (300 direct members and 5,000 indirect members).	Organized Private Sector (OPS)	Support through training and capacity building business associations that show the potential to become effective, independent, membership-based organizations addressing SME needs, and support their entry into the formal sector.
	Chambers of Commerce	Well-organized, non-compulsory membership Chambers of Commerce exist in the major cities. All City Chambers are members of an umbrella organization, the National Association of Chambers of Commerce of Industry, Mines, and Agriculture (NACCIMA).	State Chambers of Commerce	The government needs to encourage more CoCs in States, and to increase their advocacy role, and ability to address marketing, MIS and other requirements of members. Support capacity building partnerships to spread expertise and knowledge from central to subnational levels.
	Oil Company Supply Chains	A large number of SMEs provide a range of goods and services to oil companies and their employees.	Oil companies in Niger Delta	Increase provision of non-financial services to SMEs to enhance the provision of goods and services to oil companies. Support capacity building program for SPDC contractors being designed and partially funded by IFC in parallel to the establishment of the Niger Delta Contractor Revolving Credit Facility. Consider ways of leveraging the oil-related zone in Port Harcourt, the new oil-revenue funded Niger Delta Development Commission, and other state-level institutions focusing on SMEs and employment creation.

III.D Gap Analysis – SME Access to Information

	What SMEs Need	What is Available	Who?	Improvements / Initiatives for Consideration
Foreign Market	Export Promotion Agents	Nigerian Export Promotion Council (NEPC)—has 12 offices across the country; plans to establish export production villages and export warehouses in foreign countries to facilitate storage of Nigerian export goods. Nigerian Investment Promotion Commission (NIPC). Federal Export Processing Zone (EPZ) in Calabar, Cross River State, designed to attract domestic and foreign export-oriented investment, has had very limited success.	Government MIGA, UNIDO, FIAS (WB)	Consider ways of strengthening NEPC's export promotion capacity. Support effective restructuring and strategy-building at NIPC.
	Foreign firm info	• Chambers of Commerce newsletters and other periodicals like the *Guide to Importers' Directories* (1999), the *Directory of Importers' Associations* (1999), or the *Directory of Importers* (www.export-leads.com). • GTZ is supporting a unit within the Lagos Chamber of Commerce to disseminate Foreign market information • NIPC Database (www.nipc-nigeria.org)	Foreign Embassies and Press, Chambers of Commerce, Business Associations	Establish modern trade information centers with focal points at State levels.
	Trade Fairs	International trade fairs in Lagos, Kano, Kaduna, Owerri, and elsewhere. Information on international trade fairs available via Chambers of Commerce newsletters and embassy publications.	Chambers of Commerce (for instance, inform@lagoschamber.com)	Replicate trade fairs in other States.
	Country Information	Information on different trade regimes (mainly ECOWAS, US, and EU), and on export opportunities in other countries, is available through publications, periodicals, and research papers, but the outreach is extremely limited.	• UNIDO, UNDP, WBG • NISER	Expand the outreach of existing publications, particularly in rural areas through electronic means business associations, and similar.

III.D Gap Analysis – SME Access to Information — *Continued*

	What SMEs Need	What is Available	Who?	Improvements / Initiatives for Consideration
Domestic Market	Domestic firm info	Few publications containing SME information, in particular, and few domestically-oriented trade fairs/ exhibitions.	Organized Private Sector (OPS) and Govt. (Ministry of Commerce).	Establish and provide broad access to an SME database—the Corporate Affairs Commission (CAC) could play a key role in the dissemination of information and on underlining the attraction of registering.
	Industry News/Info	Private Journals, Economic and business publications, Newspapers.	Central Bank, OPS and Nigerian Press.	Help establish small-scale trade fairs/exhibition centers at State levels (Gov't in partnership with OPS)
	Government Procurement	World Bank procurement study (1997) shows SMEs do not have fair access to procurement opportunities due to imperfect information. Government panel found widespread fraud in past practices; WB is now supporting government's intention to professionalize procurement staff and practices through training and introducing modern competitive bidding procedures.	World Bank	Consider ways of making procurement opportunities and rules more accessible for SMEs
Production Technology	Quality Standards		Standards Organization of Nigeria (SON)	Assist in building capacity, and introducing greater transparency and accountability at SON, including improvement of management information systems.
	Design Information		None	A greater emphasis on design and quality is needed in Nigerian manufacturing. Workshops in particular industries, along with attempts to introduce purchasing partners, could be very useful for simple (e.g. leatherware) and more complex industries.