

Legal hurdles to accessing the Small & Medium Enterprises Investment Scheme

You may have heard the tale of the man who travelled on a long international flight for the first time and rejected all the meals offered to him by the air hostess. Why? He did not know that the ticket was inclusive of in-flight meals and was conserving his money for when he arrives. For many Small Scale Businesses in Nigeria this is the level of ignorance displayed regarding the Small & Medium Enterprises Equity Investment Scheme (SMEIS). Very many businesses need capital but how many seek to understand whether they qualify for SMEIS funds? This article seeks to be of some benefit in this regard.

What is SMEIS?

It is a fund established by Banks in December 1999 to assist small and medium enterprises raise capital for their business. It is part of the industry's contribution to Federal Government efforts to stimulate economic growth. Every bank is obliged to contribute 10% of their profit after tax into the fund. There is no legislation to date backing this initiative of the Bankers' Committee. SMEIS report as at July 2004 shows that approximately N24 Billion has been contributed to the fund by 82 banks and only about N9 Billion had been disbursed as at that date. Is that not amazing? And who was it that said: "water, water everywhere, not a drop to drink"?

Who qualifies for the loans?

An applicant needs to possess the following:

- A Limited Liability Company
- A business plan for any legal business
(Note that there are only 2 disqualified businesses: Trading/merchandising and financial services)
- An Asset base not exceeding N200 Million (excluding land & working capital)
- The company must have a staff strength of 10-300

Note that the funds can be applied to new businesses, expansion projects, working capital, and management buy-outs.

What are the dynamics of the Scheme?

- In computing an asset base of N200 Million land and working capital owned by the company are excluded. This means assets like Plant & Machinery, Office Equipment, Prepayments, and the like are what should not exceed N200 Million. But the company may own land and working capital in excess of N200 Million.
- No collateral is required and no interest is charged on the investment.
- The ceiling for funding on each project is N200 Million Naira.
- The promoter should come up with 60% equity contribution in cash or kind.

- The Bank becomes an equity shareholder (maximum 40%) in the company and holds only ordinary shares for the period of the funding which is a minimum of 3 years.
- An appropriate shareholders agreement is signed which includes a proposed exit plan based on projected cash flows and a given time when the bank should have reaped its principal plus an agreed premium by way of dividends
- The corporate documents are amended to reflect the new equity holding and re-amended after the exit.
- The bank and beneficiary work out a participation in the running of the company for the period of participation.

Why will many not qualify for the Scheme?

The requirements do not seem very daunting but if the statistic is anything to go by many are yet to benefit from the funding. Why? The reasons are perhaps both cultural and legal. Here are some of my thoughts on the possibilities:

The cultural standpoint:

Could it be that the average Nigerian is not used to doing a business plan? Not to talk of having someone pick holes in them. The norm in Nigeria is to have your own money and take your own risk. Or to have your collateral traded to a friendly bank. Equity participation by total strangers (even if it is a Bank) is not in our culture. We typically want to do it alone, or at best with our kith and kin. The thinking is: Why should we have to be answerable to anyone? The self made man syndrome is the order of the day. Does it occur to several of the entrepreneurs that the banks involvement amounts to free managerial and technical advice from personnel who are tried and tested fund managers? I have my doubts!

The legal standpoint:

One major hurdle for the parties will be working out a transparent and agreeable exit strategy for the Bank. This typically determines the comfort level of the beneficiary from the onset. I think that to be fair to all concerned the strategy should be based on agreed income indices and dividend levels rather than time lines. That way the beneficiary can drive the income streams hard to target pay out and the bank is certain of its reward structure.

Another legal issue that typically arises is where the applicant company presents its 60% equity in the form of assets rather than cash and a due diligence shows that some of the assets are in a personal name or a sister company name. These are deducted and create a shortfall in the desired 60% equity. For example: where the landed property being used as the factory is in a shareholders name, and not the name of the company applying for funding. The true reflection of the company's assets after bank investigations will not include that property. In such a situation one suggestion is for the shareholder to lease the property to the company for a handsome cash consideration - although there need not be an actual cash exchange. This lease now becomes an unused deposit in favour of the company which accountants call a "prepayment" in the asset column of the Accounts. The asset base of that company is now richer to the tune of the lease consideration.

One argument banks have proffered for shying away from doing SMEIS is that the equity partner (venture capital) relationship offers the bank no recourse to any

collateral should the business fail. So from the banks perspective they are depending mainly on the entrepreneur's skills and the control the bank is able to emplace. One suggestion on this is that with businesses that are asset heavy e.g construction or real estate development, the bank being a 40% equity partner should have "breaking point" clauses in the shareholders agreement which indicate certain indices to determine when the parties can say that the business is a failure. At this point either party should be able to call for a voluntary liquidation and/or an asset stripping to enable the bank recoup its principal investment in the least - after all they are equity partners, and the typical scenario when a business fails is for equity partners to work out a pay out from the assets in proportion to their shareholding. Talking about assets brings to mind the question of adequate insurance. Banks should not forget to mitigate their risks by inserting Insurance clauses in the shareholders agreement and ensuring compliance.

Another problem the funding banks face is that many SME'S being small companies have no succession plan in their management structure. Therefore ill-health or death of the founder may ground the business. This can be addressed in the shareholders agreement and the Articles of Association by providing options for appointing manager's in such an eventuality. Someone to play a role akin to the Receiver/Manager role under company law would suffice, or perhaps a full time manager hired by the company or any other agreed fall back plan.

Banks are often saddled with the responsibility of working out participation/control levels in the day to day administration of the company. This can be an issue particularly where the business is not a start up. In this regard it is a careful balancing act between the 60% majority holder/owner and the bank's 40% which comes with a great responsibility as custodians of shareholders funds. There is no hard and fast rule, save to say that the antecedents of the entrepreneur and the trappings of the business will dictate the rigidity of the controls.

In conclusion, I think the whole idea of SMEIS funding is more than salutary. Let's be honest with ourselves at what point did you imagine a Nigeria where a start up business could access funding without collateral from a bank of all places? Clearly, so much is happening, but how many are participating?

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