

## Recommendation on MSME Reclassification Report

**Prepared by**



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## Table of Content

<b>List of annexes</b> .....	3
<b>List of acronyms</b> .....	4
<b>Executive summary</b> .....	7
<b>Review of Nigeria's macroeconomic environment</b> .....	14
<b>MSMEs in Nigeria</b> .....	17
Overview .....	17
Review of National Policy on MSME .....	18
Impact of MSME Intervention Programmes and Support Institutions .....	24
Major challenges of the MSME sector .....	33
<b>Government procurement</b> .....	36
The Procurement Lifecycle .....	38
The nature and characteristics of government procurement in Nigeria .....	39
Segmentation of government procurement .....	40
MSMEs suitable for government procurement .....	44
Opportunities available to MSMEs in Government Procurement .....	45
Review of Local content policy (Executive order 003) .....	46
Barriers to effective MSME participation .....	47
<b>Cross- country comparison</b> .....	50
Insights from other economies with thriving MSME policies .....	51
<b>MSMEs Reclassification Recommendation</b> .....	56
Re-categorization considerations .....	58
<b>Annex 1</b> .....	69
<b>Annex 2</b> .....	73
<b>Annex 3</b> .....	80
<b>Annex 4</b> .....	88
<b>Annex 5</b> .....	90
<b>Annex 6</b> .....	93

## List of annexes

Annex 1:	Project background and approach
Annex 2:	Characteristics and performance of MSMEs
Annex 3:	Select MSME intervention fund
Annex 4:	MSME and Private Sector Procurement
Annex 5:	Summary of BPP interview
Annex 6:	Project work plan

## List of acronyms

ADB	Africa Development Bank
BOI	Bank of Industry
BPP	Bureau of Public Procurement
CAC	Corporate Affairs Commission
CBN	Central Bank of Nigeria
CBN – EDC	Central Bank of Nigeria - Entrepreneurship Development Centre
CSDP	Competitive Supplier Development Programme
DFID	Department for International Development
ECOWAS	Economic Community of West African States
ERGP	Economic Recovery and Growth Plan
EY	Ernst & Young
FCT	Federal Capital Territory
GDP	Gross Domestic Product
GEF	Graduate Entrepreneurship Fund
ICT	Information and Communication Technology
IFC	International Finance Corporation
LSETF	Lagos State Employment Trust Fund
MANCAP	Mandatory Conformity Assessment Programme
MDAs	Ministries, Department and Agencies
MSME	Micro Small and Medium Enterprises
MSMEDF	Micro Small and Medium Enterprise Development Fund
NBS	National Bureau of Statistics
NEDEP	National Enterprise Development Programme
OECD	Organisation for Economic Cooperation and Development
PDF II	Policy Development Facility phase II
PPA	Public Procurement Act 2011
PEBEC	Presidential Enabling Business Environment Council
RSSF	Real Sector Support Facility

SDP	Supplier Development Programme
SMEDAN	Small and Medium Enterprises Development Agency of Nigeria
SMEEIS	Small and Medium Enterprises Equity Investment Scheme
SMECGS	Small and Medium Credit Guarantee Scheme
SOE	State Owned Enterprises
TVET	Technical and Vocational Education and Training
UNDP	United Nations Development Programme
VAT	Value Added Tax
YEDP	Youth Entrepreneurship Development Programme
YES – P	Youth Entrepreneurship Support Programme

## Executive summary

### *Key highlights*

- *MSMEs are the primary providers of employment but the least beneficiary of government spending*
- *Government intends to increase MSME involvement in government procurement as a means of growing the sector*
- *The MSME ecosystem is characterized by high levels of informality and low scale businesses.*
- *Despite the preponderance of intervention funds targeted at enhancing the capacity of MSMEs, MSMEs are largely unaware of these funds*
- *An additional MSME categorisation to be called Nano business categorisation. This is a one-man operated business with no known record of a paid employee*

## Executive summary

### 1. Context Setting



The Micro, Medium & Small enterprises (“MSME”) sector plays a pivotal role in driving socio-economic growth, particularly in emerging economies. In the Nigerian context, the sector’s status as the largest employer of labour makes it an effective supporting sector for fostering entrepreneurial innovation and local capital formation. However, the Nigeria MSME sector is characterized by high levels of informality and preponderance of small-sized low scale enterprises - a dynamic that has been a constraint on scale mobility and a key driver of the high mortality rate experienced in the sector.

To address these issues, the government has taken actions aimed at building the resilience and potential for growth of the sector by creating an enabling environment for increasing the involvement and capacity of MSMEs to compete in the formal economy. The Federal Government, through the Ministry of Industries, Trade and Investment (“the Ministry”), has identified increasing MSMEs participation in government procurement at the core of its strategy.

To define this strategy, the Ministry through the Policy Development Facility Phase II commissioned Ernst & Young (EY) to conduct a market analysis of the MSME sector, which at its basic premise will investigate the current categorization of enterprises within the MSME sector and how such categorization impacts MSME’s competitiveness in government procurement and intervention programs.

The outcome of the market analysis will inform whether a reclassification of the MSME categories is required to improve involvement in government procurement, what underlying value drivers should be factored in the reclassification consideration; ultimately for the purpose of recommending strategies that will enable a sustainable means of better positioning MSMEs for government procurement.

This report consists of the following sections:

- **Section 1** provides an overview of **Nigeria’s macroeconomic environment**, as well as discussions of the implications of the current market dynamics on MSMEs. Implications of the trend in key indicators such as GDP, inflation, interest and exchange rates are examined.
- **Section 2** includes an overview of **MSMEs in Nigeria** and also deals with the review of the current state of play in the MSME ecosystem. A detailed analysis of the findings from interviews and surveys of MSMEs is presented. The survey, among other things, inquired about MSMEs awareness of, and participation in government procurement and intervention programs, as well as the key challenges impinging on their access to information and participation in government procurement.
- **Section 3** presents an overview of the **Government procurement** process with a focus on the nature, cycle, and product segmentations of government procurement. The described procurement process is then analyzed in the context of the findings from the market analysis and survey of MSMEs regarding involvement in government procurement.
- **Section 4** presents a **Cross-country comparison** of MSME programs in other countries. South-Africa, Ethiopia and India were the benchmark countries and were selected based on their similar political and economic characteristics with Nigeria.
- **Section 5** presents our **Reclassification Recommendation** of the MSMEs categorizations. Among other things, we recommend the inclusion of a value based restricted tendering as a complementary classification criterion for MSME procurement, as well as defining contract value limits that is industry specific.

## MSMEs at a glance



At 37 million, they are the highest employer of labour but the least beneficiary of government procurement

... the high level of informality is a primary reason the MSMEs are excluded from the government procurement process

.... 95% of the MSMEs have not received any loans from the government intervention programmes while 66% of the MSMEs are unaware of the various government intervention funds. This trend reflects a weakness in the implementation of the funds

... Presentation of financial statements is a key provision of government procurement; a standard most MSMEs are unable to meet.

## 2. Diagnostic review of MSMEs Nigeria



In recognizing the role of MSMEs as the engine for economic growth, the Nigerian government established an agency, the Small and Medium Enterprise Development Agency of Nigeria (“SMEDAN”), with the core task of driving development and growth for the entire sector. Adding to the efforts of SMEDAN, other government agencies also have mandates to deploy interventions funds directed primarily at MSMEs with the objective of activating the sector’s potential as a catalyst for economic growth.

However, despite the interest and committed resources, the sector’s demographics have remained largely unchanged and is still characterized by high rate of exclusion from the economic mainstream, as well as enterprise sizes that are dominated by entities at the bottom of the pyramid with little or no path for scalability.

The government recognizes that active engagement of the MSMEs in the formal economy is critical to the sector’s growth and has identified participation in government procurement as a key means of engagement and a critical path for creating opportunities for growth. However, the high informal nature of the sector has forestalled efforts at engagement and have tempered the rate of anticipated engagement gains, as the outcome has been low participation by the MSMEs and low awareness of such engagement programs.



To understand the current state of the MSME sector, and in particular how the sector's stratification might affect awareness and involvement in government procurement, a market analysis of the sector was conducted to identify the issues stifling MSME competitiveness and to seek ways for improvement.

The market analysis was conducted to provide answers to the following:

- The characteristics of the MSME segments;
- Understanding of the government intervention funds and the level of MSME participation;
- Understanding of the government procurement process and analysis of the opportunities and challenges facing MSMEs.



- **Primary research:** this involves direct contact with MSME stakeholders through the use of interviews, questionnaires and site visits to gather information about the MSMEs participation in government procurement and intervention programmes.
- **Secondary research:** includes review of literature and analysis of data regarding MSMEs definition, classification and involvement in government procurement process and intervention programmes.

*\* please refer to appendix 1 for detailed analysis of study methodology*

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#### Definition of MSME

There is no universally accepted definition of MSMEs, though there is a near global consensus on the classification criteria used to determine which businesses falls under the MSME category. The commonly used classification includes employee base, asset base and turnover amount.

The employee base is the globally accepted primary classification criteria for the MSMEs as it is the only classification criteria not easily affected by inflation, exchange rate and manipulation by company management.

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*MSME definition by selected Nigeria government agencies*

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Category	SMEDAN	BOI	National policy on MSMEs	CBN
<b>Micro</b>	Employee: <10 Asset: < N5m	Employee: <=10 Asset: <=N5m Turnover: <=N20m Loan amount: <=N10m	Employee: <10 Asset: < N10m	NA
<b>Small</b>	Employee: 10 – 49 Asset: N5m – <50m	Employee: <= 50 Asset: <= N100m Turnover: <=N100m Loan amount: <=100m	Employee: 10 - 49 Asset: N10m – <100m	Employee 11 - 300 Asset: N5m - <N500m
<b>Medium</b>	Employee: 50 – 199 Asset: N50m – N500m	Employee: <= 200 Asset: <=N500m Turnover: <=N500m Loan amount: <=500m	Employee: 50 - 199 Asset: N100m – <N1000m	Employee 11 – 300 Asset: N5m - <N500m



## Summary of our survey on MSMEs in Nigeria

*The market analysis included surveys and interviews conducted to cover MSMEs operating in the six geopolitical zones of the country.*

A summary of the analysis of the survey result is shown below

1. The Nigerian MSME ecosystem is characterized by high levels of informality with over 70% being unregistered as well as having low scale businesses
2. The Nigerian MSMEs have a Low level of financial record keeping.
3. Sole proprietorship constitutes over 85% of the Nigerian MSME ecosystem
4. Over 70% of the Nigerian MSMEs are unregistered
5. The micro enterprises are the largest employer of labour within the MSME ecosystem
6. There are several MSMEs intervention funds but the funds have had a lower than anticipated impact on the operations of the MSMEs.
7. Low accessibility of the MSMEs intervention funds by the MSMEs especially the micro segments of the MSMEs who do not have the necessary collaterals to guarantee the intervention funds loans
8. Lack or non-existent records on the participation rates of the MSMEs in government procurement opportunities
9. Government procurement basically categorised into three which includes provision of goods, services and works
10. Perception among the respondents of lack of transparency in the government procurement process

### **Our recommendation**

*The absence of a restricted tendering process targeted at MSMEs limits their competitiveness in government procurement, particularly for small and micro enterprises, as they are crowded out by larger and better financed entities.*

We have analysed various classification criteria such as employee number, asset base and turnover that have been used in classifying the MSMEs. We, however found a distinct set of enterprises – the Nano enterprises, included within the Micro category. This category is typically a one-employee (with pseudo workers usually family members) enterprise, with revenue less than N1 million. We recommend that this category be reclassified separately from the Micro category.

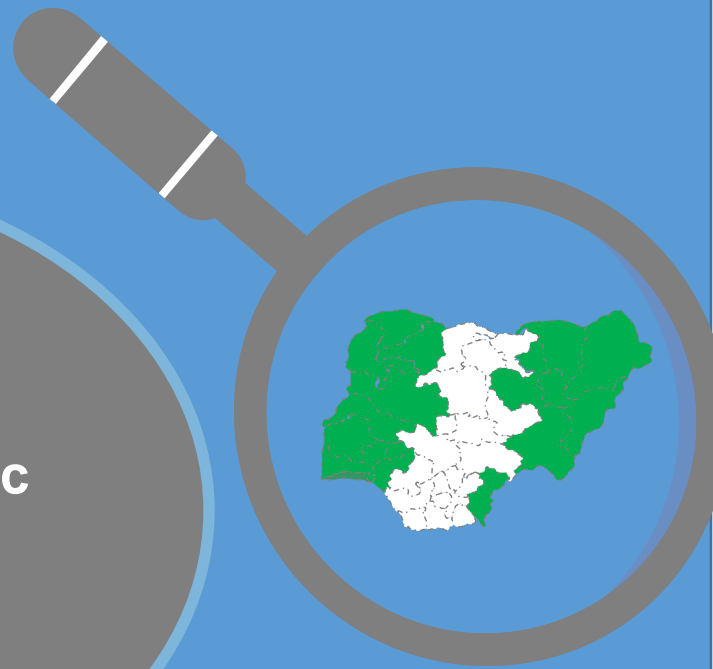
We do not find any reason to suggest the current classification criteria hinders the active participation of the MSMEs in government procurement. However, based on our market analysis, we observed a correlation between levels of formality and size to higher levels of participation in government interventions and procurement. Notably, medium sized MSMEs, who in comparison to the other segments exhibit higher levels of formality, are more aware of government intervention funds and also participate more in government procurement than the other MSMEs categories. Consequently, it appears the benefits of government interventions disproportionately flows to Medium size business to the detriment of other MSME classes.

To correct this imbalance, we recommend the introduction of restricted tendering for MSMEs and inclusion of contract value as a complementary category driver for MSME procurement purposes. We recognize that most government buying is driven by size of the contract – as this provides a clearer and transparent way to estimate the potential capacity of the contractor for each respective opportunity - as well as assuring a pipeline of opportunities for each category of the MSME value chain.

## Recommended MSME procurement bands

Category	Procurement range	Major procurement opportunity
<b>Micro enterprises (including Nano)</b>	Less than N500,000	❖ “National shopping” window at the State and Federal levels
<b>Small enterprises</b>	N500,000 – N2.5 million	❖ National window at the National level ❖ State government procurement Class A
<b>Medium enterprises</b>	N2.5 million and above	❖ Federal government procurement Class E ❖ State government procurement Class B

## Review of Macro-economic environment



### **Key highlights**

- *Four successive quarters of economic growth confirms Nigeria economy's exit from recession.*
- *Population growth and largely youthful demographic makes a youth oriented MSME policy an economic imperative*
- *High interest rates (14%) limits MSMEs access to capital and is a major limiting factor to growth*
- *MSMEs provide a focal point for Nigeria's economic diversification and import substitution objective*

# Review of Nigeria's macroeconomic environment

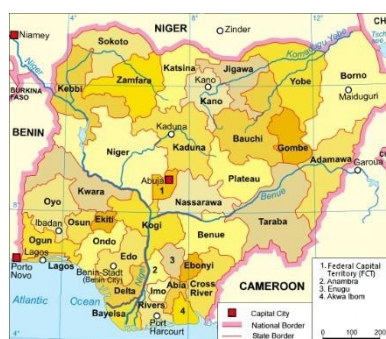
**Table 1.1: Key economic indices**

	GDP	Population	Unemployment Rate	Int. Rate	Inflation
2015	494.6m	181.2m	9.9%	10.2%	9.0%
2016	404.6m	185.9m	14.2%	14.7%	15.7%
2017	355.5m	190.9m	18.8%	17.7%	12.1%

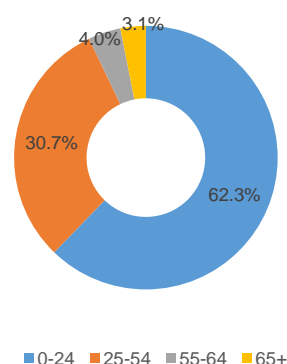
## Economic overview

- ▶ Nigeria has the largest economy in Africa with a GDP of US\$356 billion in 2017.
- ▶ Nigeria is a mono-economy with crude oil accounting for about 90% of the foreign income earnings and 75% of her national budget.
- ▶ The economy slumped into its first recession in 30 years in 2016 due to decline in crude oil prices and production disruptions due to political unrest in the Niger Delta region.
- ▶ Nigerian's unemployment stood at 16.9% or 17.3m job seekers in 2017. Majority of the employed population fall within the informal sector, indicating the crucial role this sector plays in sustaining a rapidly growing population.
- ▶ The economy emerged from recession in 2017 recording positive growths in the last five quarters since Q2 2017. The growth has been driven by the rise in global oil price, and the government efforts at managing the devaluation of the Naira, inflation and interest rate.

*Nigeria is a federation of 36 states with Abuja the federal capital territory.*



**Chart 1.1: Population distribution**

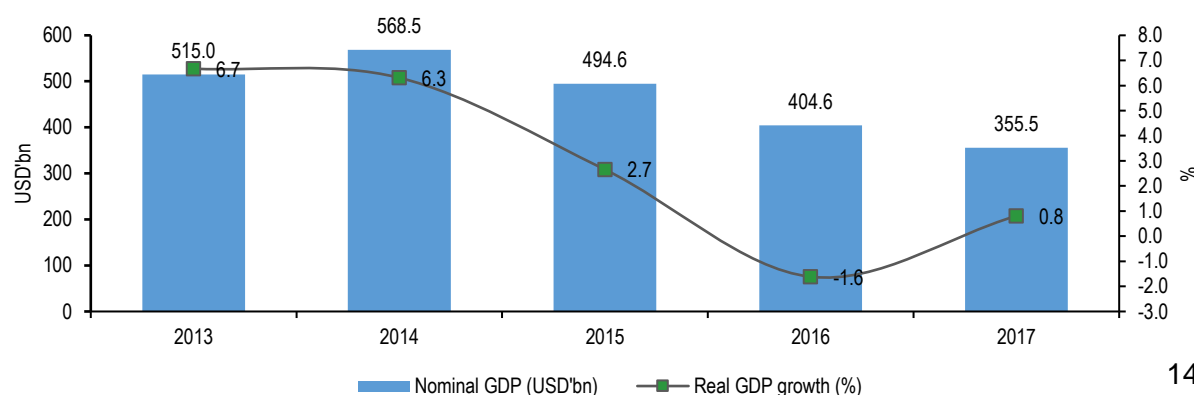


## Implications for MSMEs

1. At 97% of the population below 65 years, the country has a demographic that tilts to the young. A youth differentiated policy as part of any MSME growth stimulation intervention program should be considered. Sectors such as technology, media and entertainment with high youth participation should be a focus.

2. Double digit benchmark rate of 14% results in commercial lending rates that are cost prohibitive to MSMEs, thereby depriving limiting access to funding for working capital and growth, which further leads to lower grow rate. Lack of access to capital is also a major reason for the low financial inclusion and high mortality rate of MSMEs

**Chart 1.2: GDP and GDP growth**



## Macroeconomic outlook

**Table 1.2: Key economic indices (2018-2022)**

Indicator	2018F	2019F	2020F	2021F	2022F
Nominal GDP, US\$b	379.0	399.0	412.0	440.0	471.0
Nominal GDP real growth, % yoy	2.1	3.2	4.3	4.4	4.4
Nominal GDP per capita, US\$	1,932.0	1,982.0	1,997.0	2,078.0	2,167.0
Inflation, CPI % yoy	10.5	10.4	10.3	10.1	9.9
Interest rate %	14.0	12.5	12.0	12.0	12.0
Foreign reserves (US\$b)	57.0	56.1	57.6	58.5	59.4
Average exchange rate: NGN/US\$	343.8	374.6	420.4	455.6	490.8

Source: Oxford Economics

### **Diversification**

The federal government's effort to diversify the economy is expected to reduce Nigeria's reliance on crude oil, improve exports, encourage local production, improve industrialization and reduce demand for foreign exchange, thereby improving the value of naira. This will stimulate local trade, creating a viable atmosphere for MSMEs to thrive.

### **Monetary policy and inflation rate**

Nigeria's Inflation rate as at September 2018 was estimated to be 11.3%. The double digit inflation rate was one of the determinants that the CBN considered in retaining the MPR rate at 14% as at September 2018. It is expected that with the implementation of the ERGP, continual intervention of the CBN in the FX market and tightening of monetary policy, inflation rate would ease and MPR rate would be changed. This would potentially increase the lending activities of banks to MSMEs and will in turn have positive ripple effects on the economy.

### **Upcoming 2019 election**

The outcome of the 2019 general elections will further set the direction of activities in the Nigerian manufacturing sector as the re-emergence of the ruling party, APC at the federal level would mean continuity in the current government policies across the various sectors of the economy while these might be discontinued should any political party other than the incumbent emerges.

### **Implications for MSMEs**

Given the major policy underpinning the economic recovery growth program is the domestication of goods and services, MSMEs are well positioned to drive the implementation. With MSMEs contributing c.50% and 84% to GDP and employment respectively, they provide the perfect vehicle for accelerating the attainment of government's local content goals.

A photograph of a man and a woman in business attire looking at a laptop outdoors. The woman is smiling and pointing at the screen. The man is looking at the screen. They are standing next to a large yellow metal barrel. The background shows an industrial setting with various equipment and structures. The image is partially covered by a large grey oval shape on the left side.

## The Nigerian MSME

- *This section covers the characteristics of the typical operating MSME with a focus on registration status, ownership structure, staff strength, turnover and financial record keeping practices.*
- *A brief examination of intervention programmes and schemes initiated by the government as well as a review of the MSME regulatory environment is covered.*

### **Key highlights**

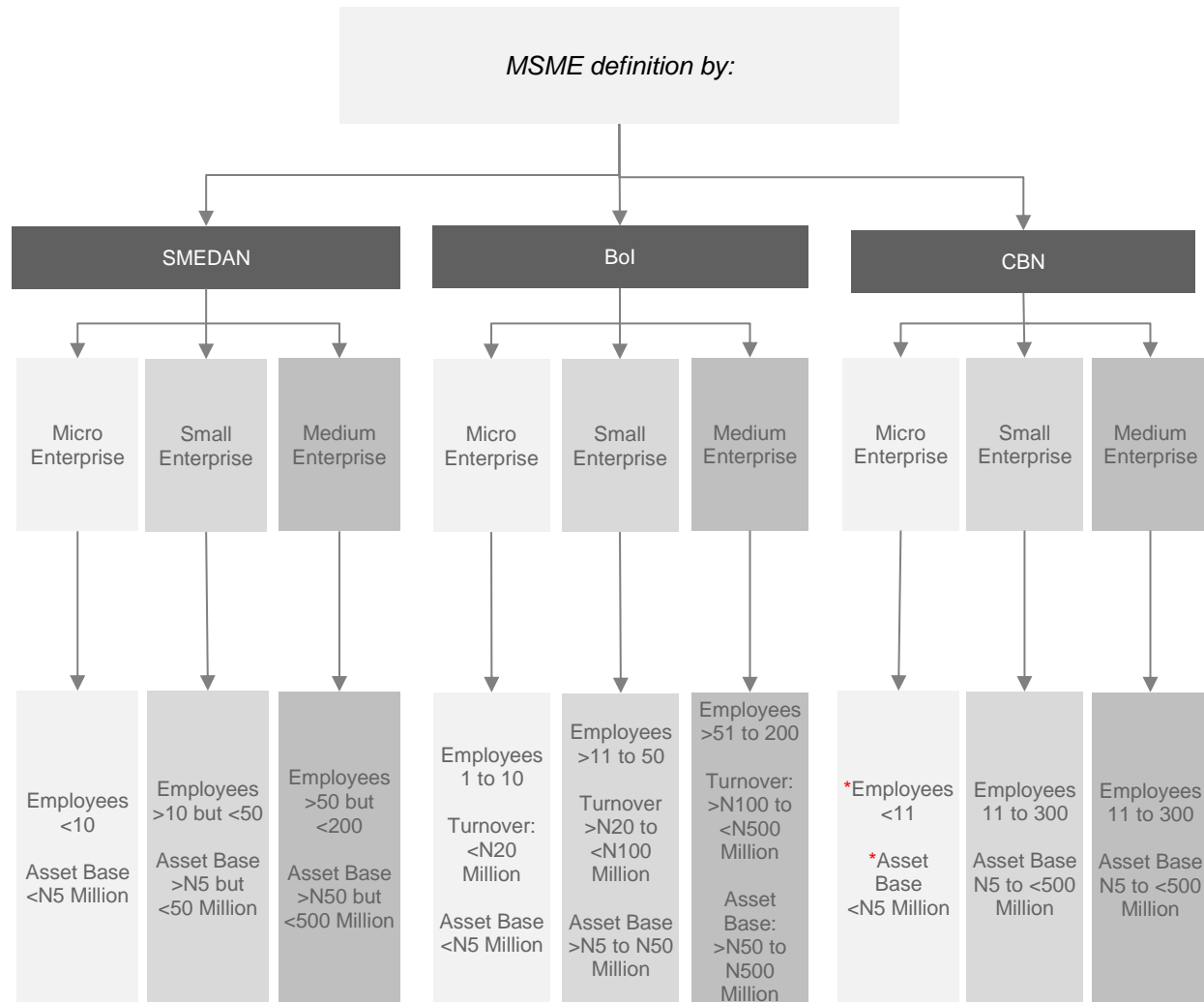
- *MSMEs contribute c.84% of total employment.*
- *MSMEs are characterized by high levels of informality and low scale businesses*
- *Poor information dissemination and weak implementation by sponsoring government agencies results in low awareness of intervention funds*
- *Despite the availability of numerous intervention funds targeted at MSMEs, access is limited due to stringent compliance standards.*
- *The high level of formality within the medium enterprise confers a disproportionate advantage in accessing government intervention as against the small and micro enterprises.*



# MSMEs in Nigeria

## Overview

In Nigeria, multiple bodies have attempted to define MSMEs along the parameters obtainable internationally, as shown below:



Source: CBN, BOI, SMEDAN

\* Default category

Based on the various definitions above, MSMEs are broadly defined as enterprises with a labour force between 1-300 people, annual turnover less than N500 million and an asset base no more than N500 million.

## Review of National Policy on MSME

The first National Policy on Micro, Small and Medium Enterprises (MSMEs) was developed in 2007 by the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN), with an aim to forge synergy amongst stakeholders and provide a roadmap to the development of the MSME space.

The implementation of the 2007 policy on MSMEs was affected by several challenges which include:

- Low levels of stakeholders (public and private sectors) participation
- Weak institutional synergy and approach
- Ineffective funding of MSME development
- Lack of strong commitment to MSME development by all tiers of government
- Limited capacity of MSMEs

The policy was subsequently revised in 2015, incorporating feedback and lessons learned in the implementation of the initial policy. The emphasis of the revised policy is to create flourishing MSMEs that would spread the benefits of economic growth more evenly.

### *Revised policy, similar implementation challenges...*

#### **Strengths of the revised policy**

- The overall objective of the policy is to create and promote the necessary conditions for the growth and development of MSMEs via the adoption of close partnership and cooperation between the various levels of government, the community organisations and organised private sector.
- The revised National Policy better articulates the general parameters, benchmarks and direction within which MSME programmes, interventions and initiatives will be designed, implemented, monitored and evaluated.
- The policy was also built on international classification standard for MSMEs, based on the dual criteria of employment and assets (excluding land and buildings).
- The policy promotes a cluster approach for the development of MSMEs. This approach was believed to be a more effective and efficient way of reaching MSMEs globally as clusters provide an ecosystem for small businesses.
- The revised policy also attempts to leverage the use of ICT in improving Government's efficiency, effectiveness and service delivery to MSMEs.
- The policy incorporates themes relating to social inclusion taking into account the increasing youth population in Nigeria, the high rates of youth unemployment and the need for women empowerment.

**Table 2.1: Classification of MSMEs**

Category	Staff count	Assets (N'million)
Micro enterprises	Less than 10	Less than 10
Small enterprises	10 - 49	10 - 99
Medium enterprises	50 - 199	100 - 1,000

Source: National Policy on MSMEs

## **Key barriers to implementation and effectiveness of the National Policy:**

*Highs levels of informality, lack of coordination among agencies and absence of a concerted awareness program inhibits the implementation of the National Policy on MSME. Rigor and institutional discipline around implementation should be considered*

The MSME National Policy was reviewed in the context of a market analysis that was conducted to understand the current state of play in the MSME sector with the purpose of developing recommendations and strategies for growing the involvement of MSMEs in government procurement.

Observations and results of surveys conducted as part of the market analysis highlighted these key barriers to implementation and effectiveness of the National Policy:

- **Informal nature of MSME operations:** MSMEs report low level of formality as 70% of all enterprises are unregistered. The high level of informality is a constraint on the anticipated outcome constraint due to difficulty in targeting implementation at the intended recipients.
- **Regulatory environment:** Strong regulatory framework and institutional discipline is required to drive the development of linkages between the various MSME strata, as well as the synchronisation and harmonisation of various government actions.
- **Information dissemination:** The survey reveals poor awareness among MSMEs of government intervention programs as c.66% of MSMEs surveyed are unaware of such programmes. The information dissemination system is limited in its outreach and better communication strategies need to be developed.
- **Capacity development:** Across all the sectors that MSMEs generally operate, there are significant skill gaps and a general lack of knowledge required for market competitiveness. Targeted capacity programs that link skill acquisition to specific industry opportunities should be developed. Institutional capacity of the Industrial development centres, entrepreneurship development centres and other training programmes initiated by these institutions should be enhanced.
- **National monitoring and evaluation system:** Each of the three key agencies: SMEDAN, CBN and BOI, all run separate MSME enhancement programmes. To ensure congruency with the National Policy on MSME, development of a robust and measurable key performance indicator is required for tracking and assessing the impact of these varied efforts. A central database platform can be established to track these KPIs and will provide national planners with a bird's eye view of the performance and tracking of these programmes.

## **Characteristics and performance of MSMEs**

Based on our survey sample of 1,017 respondents, we have summarized the results and analysis of the primary research conducted on Nigerian MSMEs by the respective categories (Micro, Small and Medium businesses) using the following parameters:

**Ownership structure:** This shows the means of control over a business enterprise. It is considered a significant factor as it highlights the level of complexity and sophistication of an enterprise. There is a strong correlation between type of business formation and level of formality.

**Employee number:** The employee number is a globally accepted criteria used to classify MSMEs. This criterion is further analysed to ascertain if the employee number in its current definition is in any way a disadvantage to MSMEs in government procurement process.

In Nigeria, the perception of the MSMEs on what is an appropriate size categorisation for government procurement purpose is not clear. We have seen businesses that are defined as micro enterprises with staff strength of 3 and turnover of NGN50m per annum. These businesses consider themselves as medium sized.

However, our report concentrates on the most appropriate MSME categorisation from the viewpoint of inclusion in public procurement.

**Turnover:** This is a residual criterion used to classify the MSMEs. This criterion has been further analysed to show the average turnover by the MSMEs and ascertain if it is a relevant metric for the purposes of classification for government procurement process.

**Financial records:** This is one of the main requirements used by government procurement agents to assess the capacity of the contractors.

**Business registration:** Business registration here, refers to the registration of the business either with the government or a trade association. This is a key requirement used by the government in its procurement process and is an indicator of the potential to participate in the formal economy.

Our findings are shown on the next page.

## The Typical Nigerian Micro Business

Micro enterprises are broadly defined in Nigeria as enterprises with less than 10 employees and an asset base (excluding land and building) below N5 million. Micro enterprises make up over 96% of the MSME sector in Nigeria with c.90% of this category currently unregistered<sup>1</sup>.

Micro enterprises have an average of 4 employees, with an average estimated annual turnover of N5.5 million.



### Ownership

**92%** of micro enterprises are organized as a sole proprietor; **6%** as partnership and **2%** as a limited liability company (LLC). Capital is typically self-funded, with **62%** of respondents claiming that business financing is from their personal savings.



### Employment

Survey findings revealed that micro enterprises employ about **4 people** including family members and support staff. **75%** of respondents revealed that they do not have any formal training program for their staff and employees.



### Turnover

Respondents across this category recorded an annual average estimated revenue of about **N5.5 million**.



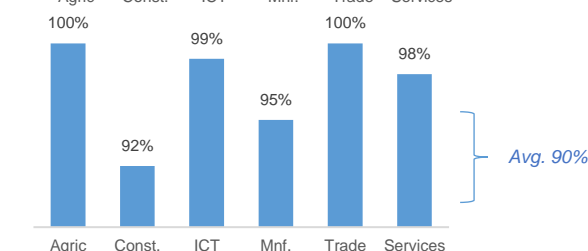
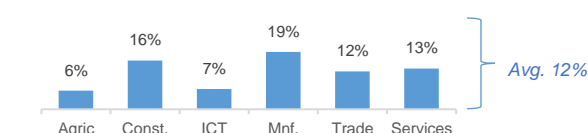
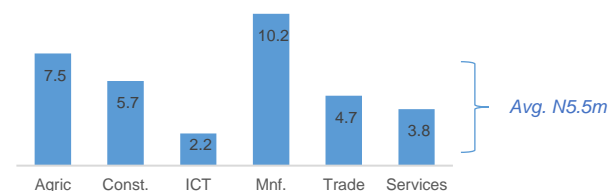
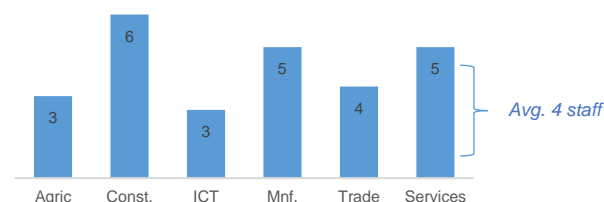
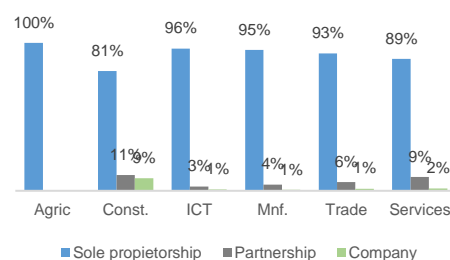
### Financial records

**17%** of micro enterprise respondents do not have a bank account and are unlikely to have access to any formal form of financial services. Only **12%** of respondents maintain financial records



### Regulatory compliance and trade associations

**90%** of micro enterprises surveyed were not registered with the CAC, with respondents indicating that business within the sector is carried out informally. Low business registration is a factor that constrains the ability of micro enterprises to access government intervention programs.



**This category of MSMEs is highly informal with a low rate of business registration, financial record keeping and access to financial services.** These factors constrain the ability of micro enterprises to access government intervention programs, thereby inhibiting their growth prospects.

<sup>1</sup> Decision Support Consulting

## The Typical Nigerian Small Business

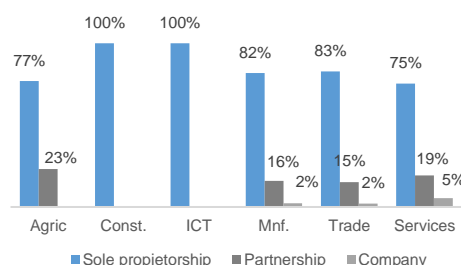
Small enterprises are enterprises with 10-50 employees and an asset base (excluding land and building) between N5 million and N50 million.

Small enterprises have an average annual turnover of c.N59.3million and an average employee number of 23 people<sup>2</sup>.



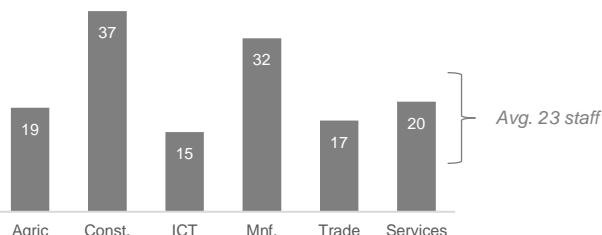
### Ownership

Sole proprietorship is also the prevalent ownership structure for small enterprises with **81%** owned and controlled by a sole proprietor, 17% are partnerships while 2% were registered as a company. This sector is financed by personal savings (50%) and borrowings (from friends, family and banks)



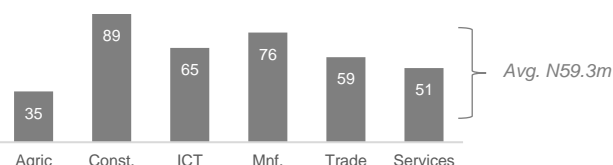
### Employment

Small enterprises employ about **23 people** including family members and support staff with about 13 full time staff. About 50% of respondent alluded to having some form of formal training for their staff both on and off the job.



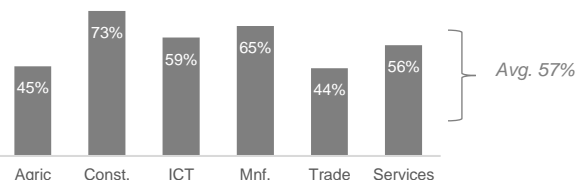
### Turnover

Respondents across this category record an estimated annual revenue of about **N59.3 million**.



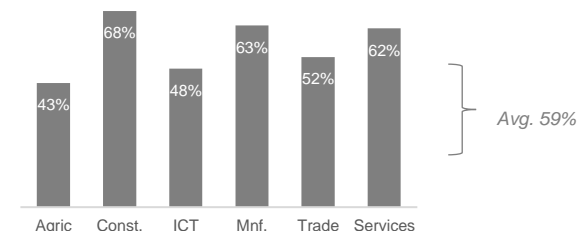
### Financial records

**64%** of small businesses maintain a corporate bank account while **57%** prepare financial statements annually indicating relatively better bookkeeping than micro enterprises.



### Regulatory compliance and trade associations

**59%** of small enterprises covered were registered with the CAC while **68%** of this category were members of local trade associations.



There is relatively better record keeping within this category as **57%** of respondents prepare annual financial statements. However, the absence of a contract value restriction tied to each category of MSME means that the small business category is often crowded out by the Medium enterprises.

<sup>2</sup> Decision Support Consulting

## The Typical Nigerian Medium Enterprise

Medium enterprises are defined as having 51-200 employees and an asset base (excluding land and building) between N50 million and N500 million.

Medium enterprises have the least population within the MSME sector. Most respondents (90%) within this category have registered businesses, prepare annual financial statements these businesses report an average annual turnover of N263 million; individually employing c.148 people<sup>3</sup>.



### Ownership

56% of medium enterprises surveyed are owned by sole proprietors, with 24% partnership agreements and 20% registered companies. Financed largely by borrowings, medium businesses report just 40% of their finance raised from personal sources.



### Employment

A typical medium enterprise employs about **148 people** with about 25% of staff being casual workers and support staff. About 50% of respondents alluded to having some form of formal training for their staff both on and off the job.



### Turnover

Respondents across the sectors within this category record an annual turnover of about **N263 million**.



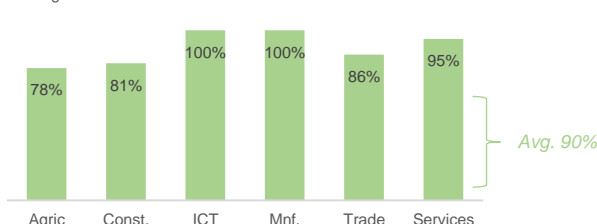
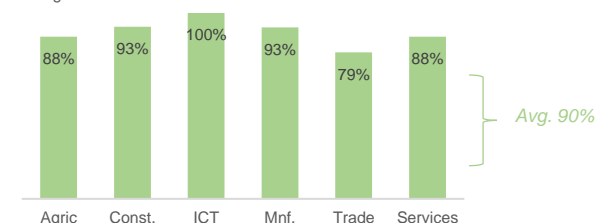
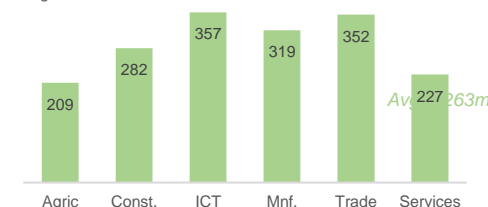
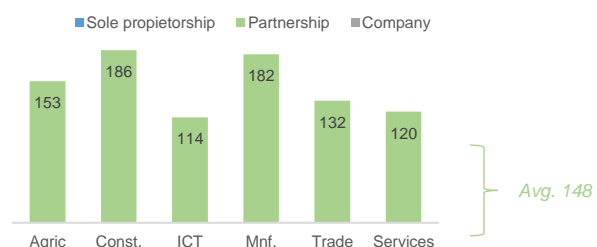
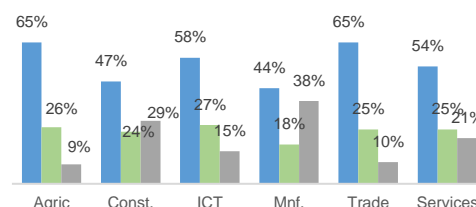
### Financial records

Proper accounting is carried out by medium enterprises with **90%** of respondents preparing annual financial statements.



### Regulatory compliance & trade associations

**90%** of medium enterprises covered were registered with the CAC while 72% of the category are members of local trade associations. Business registration is a key requirement for government procurement.



The largely formal nature of medium enterprises confers a competitive advantage in accessing and benefiting from government programmes in contrast to other segments. The high rate of business registration makes for easier targeting for government policies, while the record keeping and access to financial services provides the adequate credentials to meet most government tender requirements.

<sup>3</sup> Decision Support Consulting

## Impact of MSME Intervention Programmes and Support Institutions

*While there are many MSME focused intervention funds, awareness and access continues to be a challenge*

The Government, over the years, has adopted the intervention funds model to stimulate the impact of MSMEs especially in recognition of the capacity of small businesses to create jobs and serve as engine of innovation. Thus, the federal and state government in collaboration with other organisations such as the Central Bank of Nigeria have introduced a number of intervention funds worth over N1 trillion aimed at MSMEs<sup>4</sup>. The table below shows a brief description of some of the intervention programmes (See Annex 3 for more details)

**Table 2.2: MSME intervention programmes**

Programme & objective	Year of establishment	Project sponsor	Program coverage	Fund size	Source of fund	Success parameters
<b>Small and Medium Enterprises Equity Investment Scheme</b> - The SMEEIS was created in response to the Federal Government's concerns and policy measures for the promotion of SMEs as vehicles for rapid industrialisation, sustainable economic development, poverty alleviation and employment generation.	1999 (Stopped 2008)	All banks under the supervision of the CBN	"Every legal business activity with the exception of trading/merchandising and financial services"	n/a	10% of PAT of Banks in Nigeria	MSME equity investments  MSME growth
<b>Small and Medium Credit Guarantee scheme:</b> The SMECGS was set up to aid development of the SME manufacturing segment by providing credit guarantee from banks to SMEs and manufacturers.	2010	CBN	Nationwide	N235 billion	CBN	MSME growth and development  Number of MSME financed  Number of jobs created
<b>Micro Small and Medium Enterprises Development Fund</b> - The objective of the MSME Development Fund is to channel low interest funds to the MSME sub-sector of the Nigerian economy using Participating Financial Institutions.	2013	CBN	All MSMEs in the country	N220 billion	CBN	Number of MSMEs financed  Number of jobs created
<b>CBN - Entrepreneurship Development Centre</b> - The CBN-EDC was set up to develop young entrepreneurs that will become net-contributors to the national economy. The project is designed to provide training, strategies and certification programmes that will assist young Nigerians to embrace micro, small, and medium scale enterprises as an alternative employment option.	Pilot phase - 2008 Second phase - 2013	CBN	Nationwide	n/a	CBN	Training of entrepreneurs  MSME created  Number of jobs created
<b>YouWiN! Programme</b> – YouWiN! which represents youth enterprise with innovation in Nigeria was established in April 2012 as a business plan competition with the main aim of creating jobs and supporting entrepreneurial youths.	2012	Ministry of Finance, Ministry of Communication Technology Ministry of Youth	Nationwide	n/a	Ministry of Finance	Provision of one-off grant to MSMEs  Generate 80,000 to 110,000 new jobs

<sup>4</sup> Agosto & Co research



		Development Ministry of Women Affairs				
<b>Real Sector Support Facility</b> - The RSSF was set up to fast track the development of SMEs in the manufacturing, agricultural value chain and services sub-sectors in a bid to increase local production, generate employment, diversify the revenue base, increase foreign exchange income and provide input for the industrial sector on a sustainable basis	2014	CBN	Nationwide	N300 billion	CBN	Increase MSME contribution to GDP  Number of jobs created  Number of MSMEs financed
<b>National Enterprise Development Programme</b> - The National Enterprise development programme was set up for the development of MSMEs in the country by directly addressing the critical factors that have inhibited the growth of the sector. The programme is a holistic plan that cuts across all tiers of enterprise and provides the tools to assist enterprises grow from micro to small, small to medium and medium to large.	2014	SMEDAN, ITF and BOI	Nationwide	N5 billion	BOI	1 million new jobs target every year  Increase MSME contribution to GDP  Increase MSME export by 100%  Reduce formal/informal gap by 50%  Improve access to finance
<b>Graduate Entrepreneurship Fund</b> - The Graduate Entrepreneurship Fund was set up to support the establishment and/or expansion of an estimated 1,000 enterprises promoted by NYSC members across the country yearly. The scheme was expanded in 2017 to support 3,000 enterprises.	2015	BOI	Nationwide	N2 billion	BOI	Develop and train youth entrepreneurs  Create 5,000 direct jobs and 25,000 indirect jobs annually.
<b>Lagos State Employment Trust Fund</b> - LSETF was established by the Lagos State government in 2016 to provide financial and technical support to residents of Lagos State, to tackle unemployment and create wealth	2016	Lagos state	Lagos	N25 billion	Lagos State, Sterling Bank, FCMB, Stanbic IBTC	Number of MSME financed and trained
<b>Youth Entrepreneurship Development Programme</b> - The program was set up to build capacity, fund start-ups and create employment for youth owned SMEs.	2016	CBN	Sectorial coverage: Agriculture, ICT, Mining and solid minerals, Creative industry	n/a	CBN	Number of MSMEs created  Number of MSMEs financed  Number of jobs created
<b>Youth Entrepreneurship Support programme</b> - The YES programme focuses on capacity building and enterprise funding.	2016	BOI	Select SME clusters	N10 billion	BOI	Number of jobs created  Number of MSMEs financed

Source: CBN, BOI, LSETF

Although the interventions funds are theoretically available, the conditions for accessing the funds have been overly bureaucratic for both the financial institutions aiming to participate in disbursement and the MSMEs who require the funds. For example, five years after its launch by the CBN, the impact of the N220 billion Micro, Small and Medium Scale Enterprises Development Fund (MSMEDF), is yet to be felt across the sector as much of the fund has remained largely inaccessible, and a majority of the MSMEs seem unaware of its existence.

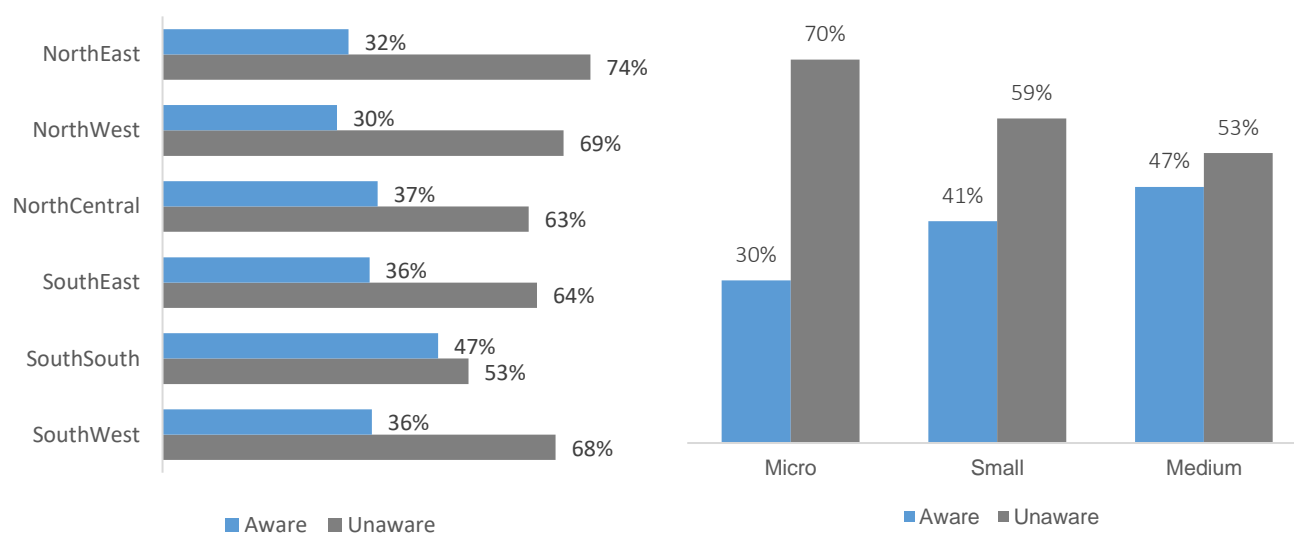
**Table 2.3: Average Amount Disbursed Per Annum**

	AGSF	RRF	ACSS	SMECGS	MSMEDF	RSSF	LSETF
Total amount disbursed (billions)	94.4	378.9	0.9	4.2	52.3	3.5	5.5
Number of years the fund has been active*	40 yrs	15 yrs	12 yrs	8 yrs	5 yrs	4 yrs	3 yrs
Average amount disbursed per annum (billions)	2.36	25.3	0.1	0.5	10.5	0.9	1.8

Source: CBN, Agosto & Co research, LSETF

## Results of our Survey on Intervention Funds

**Chart 2.1: Respondents' awareness of MSME policies and intervention programmes**



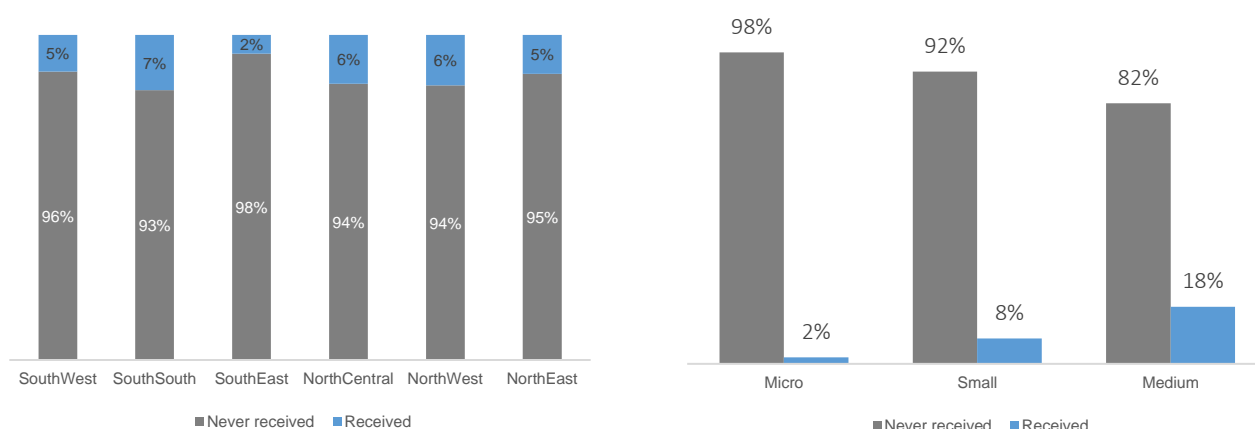
Source: Decision Support Consulting, EY

Our MSME survey revealed that 66% of respondents are unaware that the CBN has funds aimed at MSMEs. Following from our survey findings, the general perception among the MSMEs is that the Government intervention funds and procurement process is quite bureaucratic and encourages favouritism in most instances. Based on our desktop review and meetings with the government procurement agencies, there is no information about MSME participation in government procurement. To mitigate the negative perception of favouritism in government

procurement among the MSMEs, the government should on regular basis publish list of successive MSMEs who have participated in government procurement.

Among the geopolitical regions, the South-South region indicated the highest level of awareness at 47%, while the North West region reported the least awareness at 30%. There was no specific underlying reason noted for the disparity in regional awareness level based on the market survey; however, heightened efforts at addressing social grievances in the South-South region may be a factor in the relatively high level of awareness of the intervention programmes.

**Chart 2.2: Respondents' receipt of government loans/grants**

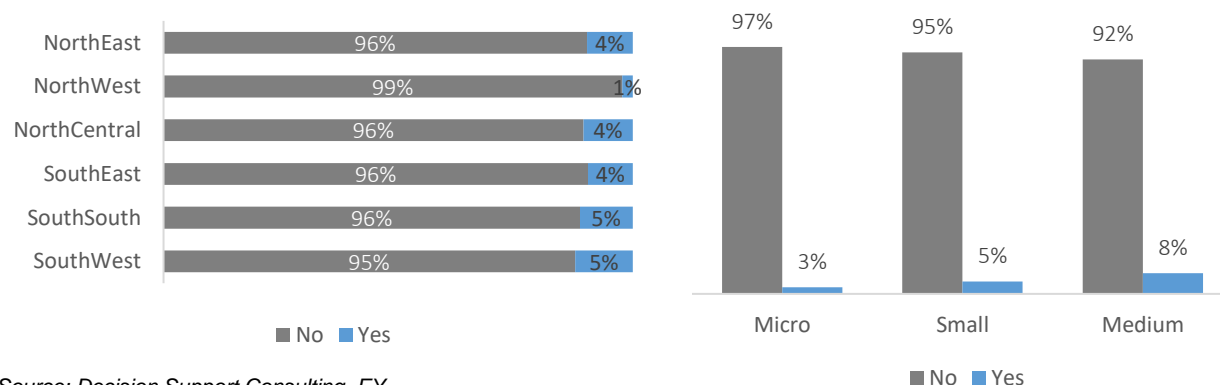


Source: Decision Support Consulting, EY

Our survey also indicated that less than 2.3% of MSMEs in the South Eastern part of Nigeria have received any government loans related to MSMEs, while the South-South region of Nigeria received the highest percentage of government loans/grants.

Although this corroborates findings that the South-South region is the most aware of government intervention programmes related to MSMEs, we could not identify any other reason for the disparity in regional access to MSME loans and grants.

**Chart 2.3: Participants' response to whether they have benefitted from government sponsored trainings**



Source: Decision Support Consulting, EY

## Key considerations for measuring the progress of intervention funds

The market analysis revealed a perception among stakeholders of political interference limiting the success of past MSME intervention funds, on the basis that disbursing agency heads are often political appointees and are susceptible to political exigencies.

Additionally, the access requirements of the funds apportion a heavy compliance burden on MSMEs in requesting for business registration, financial records, etc. Given the largely informal nature of MSMEs, these requirements are often impossible for the MSMEs to meet and therefore limiting access. Consideration should be given to reducing compliance burden and costs.

These considerations should be taken into view in reforming or designing intervention fund programmes:

1. **Accountability targets:** Our survey shows that many MSMEs, who are the primary target beneficiaries are relatively ignorant of the existence of these intervention funds and other modalities for disbursement. We therefore recommend that stakeholders set benchmarks outlining information on disbursement of the funds to the target market through the use of monthly, quarterly and annual disbursement targets. Sensitization plans should also accompany each phase of disbursement to ensure that target participants are informed.
2. **Targeting MSME category:** Due to size, structure and the formal nature of their operations, medium enterprises tend to crowd out the micro and small enterprises in receiving support in form of grants, loans and technical trainings. We recommend that intervention programmes should be targeted at specific categories of MSMEs in order to adequately measure the impact at the three levels.
3. **Impact on MSMEs:** We recommend the use of benchmarks like revenue and output (volume) to measure the impact of the intervention funds on the MSMEs. Successful growth stories, like Omatek Ventures Plc, should be made the target for each fund. This will determine if the businesses have been able to grow their top line and output on the back of the government's intervention.
4. **Impact on the economy:** The impact of these intervention funds on the economy can be measured using primary metrics like jobs created and tax revenue generated by the government.

**N.B:** Omatek Ventures Plc, a computer assembling company, was the highlight beneficiary of the SMEEIS programme. In 2003, the small company received equity investment from Zenith Bank and Guaranty Trust Bank, subsequently increasing its working capital and purchase required raw materials. The company grew and was listed on the Nigerian stock exchange in 2008

## Review of MSME regulatory environment

### *Absence of policy harmonization and implementation coordination among MSME focused agencies results in an inconsistent and incoherent regulatory environment*

Nigeria's current rating on the World Bank's ease of doing business index increased by almost 4 points, raising the country from 179<sup>th</sup> in 2016 to 145<sup>th</sup> in 2017's doing business ranking<sup>5</sup>. This results from government reforms in Nigeria's tax, licensing, ease of getting credit and international trade amongst other reforms.

MSMEs, generally, complain of the multiple taxation costs which the sector has to bear ranging from local government levies to state government licenses and personal income tax and federal government's company income tax. These costs add to a harsh business climate and are detrimental to MSMEs. According to the World Bank Enterprise Survey, firms in countries that rank better on the ease of paying taxes tend to perceive both tax rates and tax administration as less of an obstacle to their businesses.

**Table 2.4: Regulatory charges and their impact on MSMEs**

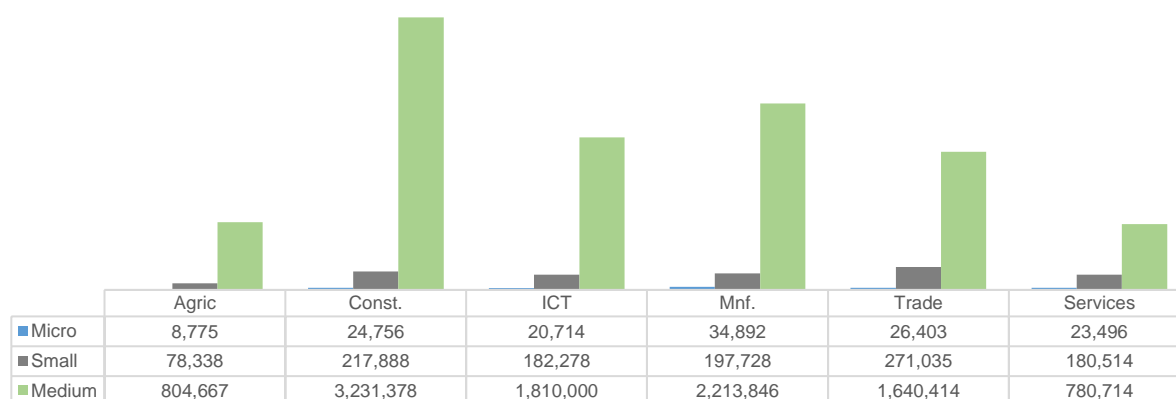
Operators	Customs	NAFDAC	SON	Police	State tax authority	Local govt. Tax authority
Importers (Drug)	H	H	H	L	M	L
Importers (Non-Drug)	H	M	H	L	M	L
Local Manufacturers	L	H	H	L	M	H
Wholesale and Retail Traders	L	L	M	H	L	H
Distributors	L	L	L	H	L	M

Source: Agosto & Co research

Legend: H=High negative impact M=Medium negative impact L=Low negative impact

Survey findings show that micro, small and medium-scale enterprises pay an annual average of N23,500, N188,500 and N1.9 million respectively in taxes and levies, with 60.5% of respondents surveyed across all categories, describing it as cases of multiple taxation<sup>6</sup>

### **Estimated annual tax expense (N)**



<sup>5</sup> World Bank – Doing Business Report

<sup>6</sup> Decision Support consulting

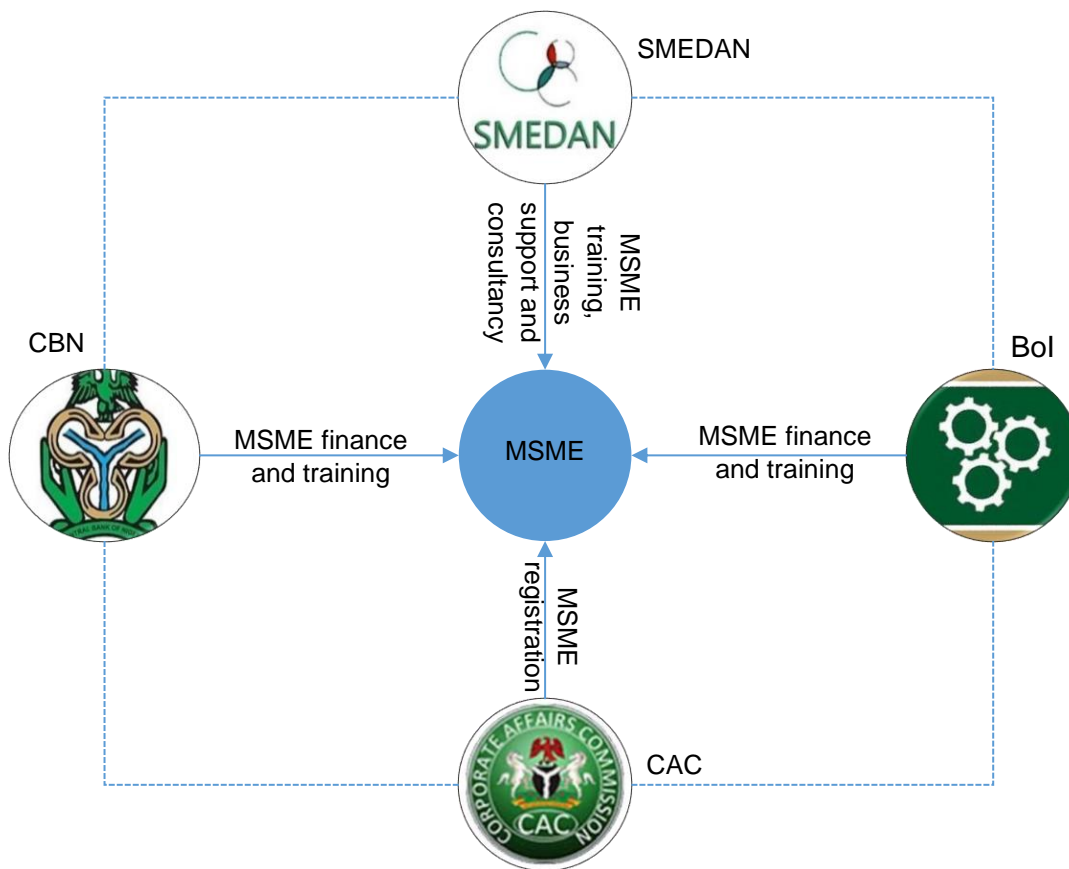
Significant levels of tax evasion thrive in Nigeria (particularly operating within the agricultural and services sectors) as many MSMEs remain unregistered. The Federal Government's drive to increase compliance in tax payments can only be carried out effectively if the Nigerian Government can create a database for the over 37 million micro, small and medium scale enterprises in Nigeria. In addition, there is also a need to simplify tax filing procedures as these MSMEs become registered in the database.

### Regulatory institutions

The regulatory environment for MSMEs is quite weak, highlighted by the fact that most MSMEs are not registered with the Corporate Affairs Commission and SMEDAN, hence, creating a huge informal sector with an adverse implication on government policies and programmes.

The following are some of the reasons for the weak regulatory environment of the MSME in Nigeria:

- MSMEs negative perception of regulatory bodies as they see most bodies as cost centres which add little or no benefit to their business.
- Weak collaborative efforts of the regulatory institutions which leads to unnecessary duplication of roles, multiple sets of data, additional costs to MSMEs amongst others.
- Lack of adequate sensitization and information dissemination channels.



The regulatory environment of MSMEs in Nigeria includes the following institutions:

### **1. Small and Medium Enterprises Development Agency of Nigeria**

The Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) was established by the SMEDAN Act of 2003 to promote the development of micro, small and medium enterprises (MSMEs) in the Nigerian Economy.

Functions of the agency include:

- a) Stimulating, monitoring and coordinating the development of the MSME sector
- b) Initiating and articulating policy ideas for MSMEs' growth and development
- c) Promoting and facilitating development programmes, instruments and support services to accelerate the development and modernization of MSME operation
- d) Linking SMEs to internal and external sources of finance, appropriate technology and technical skills as well as to large enterprises
- e) Working in concert with other institutions in both public and private sectors to create an enabling environment for businesses in general, and MSME activities in particular
- f) Intermediating between MSMEs and the Government. SMEDAN is the voice of the MSMEs.

### **2. Corporate Affairs Commission**

The Corporate Affairs Commission (CAC) has a mandate to regulate the formation and management of companies in Nigeria. MSMEs currently account for more than 90% of all registered businesses in Nigeria<sup>7</sup> however according to SMEDAN, most MSMEs in Nigeria are unregistered and operate within the informal space with less than 5% of the sector registered with the CAC.

The Federal Government, in 2016, inaugurated the Presidential Enabling Business Environment Council (PEBEC) with a mandate to ease the business environment of MSMEs by addressing critical regulatory bottlenecks and impediments to movement of goods and service as well as a seamless registration process.

### **3. Central Bank of Nigeria**

The CBN is the apex monetary authority in Nigeria. The major regulatory objectives of the bank as stated in the CBN Act are to: maintain the country's external reserves, promote monetary stability, act as financial adviser to the federal government and create a sound financial environment.

The bank has over the years performed major developmental functions, which directly impact MSMEs across the various sectors of the Nigerian economy particularly the agricultural, financial and manufacturing sectors.

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<sup>4</sup>PEBEC-Making business work report 2018

#### **4. Bank of Industry**

The Bank of Industry is the Federal Government's development financial institution with the core mandate of providing financial assistance for the establishment of large, medium and small projects; as well as expansion, diversification and modernization of existing enterprises; and rehabilitation of ailing industries.

The Bank introduced the bottom of the pyramid scheme whereby Bol lends to partner micro finance banks to on-lend to MSMEs at the grassroots level across the country at single digit interest rates per annum.

#### **5. Development Bank of Nigeria**

The Development Bank of Nigeria (DBN) was conceived by the Federal Government of Nigeria (FGN) in collaboration with global development partners to address the major financing challenges facing Micro, Small and Medium Scale Enterprises (MSMEs) in Nigeria.

The objective of the DBN is to alleviate financing constraints faced by MSMEs and small Corporates in Nigeria through the provision of financing and partial credit guarantees to eligible financial intermediaries on a market-conforming and fully financially sustainable basis.

DBN objective and mission is to contribute to alleviating specific financing constraints that inhibits the growth of the MSMEs and small corporates in achieving the desired economic potentials of the MSME segment.



## **Major challenges of the MSME sector**

MSMEs have generally lagged behind in benefitting from government policies and programmes due to the informal nature of the sector. The major challenges facing MSMEs include:

### **1. Shortage of easy finance and credit instruments**

Easy credit access and quick finance is arguably the most critical growth driver for any MSME. Most Nigerian MSMEs start out with minimal capital, which eventually limits growth potential. The lack of easy credit tends to stagnate MSME growth, which in turn affects GDP growth, employment and other social objectives of the government like poverty alleviation. Typical issues MSMEs face in accessing credit assistance include:

- a. Lack of required collateral to obtain loans
- b. High interest rates on commercial bank loans
- c. Bureaucratic procedures and delay in government MSME-support fund disbursement
- d. Lack of Private Equity funding for MSMEs due to size

The commercial banks have not been an effective avenue for MSMEs to raise capital. The business model of commercial banks supports commercial lending to credit worthy businesses and individuals at market rates. Borrowers need to demonstrate an ability to repay, a track record of repayment and/or tangible collateral in the case of default. Commercial banks would readily extend credit and financial support to capacity built MSMEs who are able to repay the loans. To this end, it is highly unlikely that the governance framework of commercial banks will allow/promote MSME on-lending given the small scale and high-risk profile of these businesses

Currently, the commercial banks play the role of financial intermediation as an on-lenders for the various intervention funds operated by the MDAs. We recognize this role is limited and should be expanded beyond financial intermediation to include outright targeting of MSMEs for commercial lending. Risk mitigation tools such as risk pooling, government procurement financing, and MSME credit insurance schemes backstopped by government guarantees are examples of tools that can be used to incentivize Commercial Banks to lend to MSMEs.

### **2. Lack of basic infrastructure facilities**

Nigeria's lack of adequate and modern infrastructure limits the growth potential of her economy. Infrastructural gaps pose serious concerns to an enterprise's daily business operations of production, consumption and distribution of goods and services. Poor infrastructure affects businesses at every level and ends up being a deterrent to economic growth. While the biggest challenge continues to be the lack of reliable and steady electricity supply, other gaps such as insufficient transportation options, bad roads and no rail service adversely impact distribution channels.

### **3. Competition from multinational companies**

Nigeria, being a net-importer of goods and services, provides a viable market for large foreign multinationals to export and trade fast moving goods. This results in MSMEs having to compete directly with larger companies with relatively infinite resources. Consequently, MSMEs lose a sizable portion of the market as they do not have required resources to expend on marketing and branding, compared to the multinationals who enjoy such economies of scale.

#### **4. Lack of training and skill development program**

The training and development programs in respect of MSMEs development is very low, thus resulting in limited availability of skilled manpower for MSMEs. MSME owners are either unaware of the innovative methods of production or cannot finance required investment for training and development. According to the SMEDAN survey conducted in 2013, only 15% of MSMEs were aware of the Small and Medium Enterprises Agency of Nigeria (SMEDAN) while only 4% of those aware had enjoyed benefits of some sort from the agency.<sup>8</sup>

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<sup>5</sup>SMEDAN/NBS MSME survey



# Government Procurement

## ***Key highlights***

- *Government procurement - a tool used for MSME growth & development.*
- *MSMEs are currently disadvantaged in the government procurement process mainly due to their informality, size and perceived technical capability*
- *Government procurement opportunities below a value threshold can be reserved to provide a captive pipeline of procurement opportunities for MSMEs*

## Government procurement

### *Public procurement contributes c.28% of GDP in developing countries like Nigeria*

Public procurement accounts for at least 15 percent of global GDP, and is the largest share of government spending besides wages<sup>9</sup>. Public procurement accounts for an average of 15% of GDP in OECD countries and 25-30% of GDP in developing and emerging market economies<sup>10</sup>. In 2011, it accounted for 12% of GDP in the United States and 17% in the EU<sup>11</sup>. Public procurement accounts for as much as 70% of government budgets across Africa<sup>12</sup>.

Public procurement is the use of public funds by the government through its ministries, departments and agencies, for the acquisition of goods, services and works in line with laid down rules and regulations. Public procurement covers the federal, state and local government requirements. The government can use public procurement as a tool to stimulate economic growth, reduce income inequality and promote healthy competition and innovation among enterprises.

In Nigeria, the Federal Government procurement is regulated by the Public Procurement Act (PPA) of 2007, under the administration of the Bureau of Public Procurement (BPP). 26 states of the federation currently have a public procurement act that guides the procurement activities of such states (e.g. Lagos state Public Procurement Act of 2011). The local governments have established procurement departments that are reliant on the Procurement Acts and Regulation of their various states for procurement laws, methodologies and processes.

The Bureau of Public Procurement and the Public Procurement Agencies of the various states are authorised to formulate general policies and guidelines relating to the public procurement of goods and services, including monitoring the price of tendered items and keeping a database of registered contractors and standard prices to prevent fraudulent procurement.

The objectives of the BPP are codified within the BPP act and they include:

- a) The harmonization of existing government policies and practices on public procurement and ensure probity, accountability and transparency in the procurement process
- b) The establishment of pricing standards and benchmarks
- c) Ensuring the application of fair, competitive, transparent, value-for-money standards and practices for the procurement and disposal of public assets
- d) The attainment of transparency, competitiveness, cost effectiveness and professionalism in the public sector procurement system

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<sup>9</sup> European Network on Debt and Development, EUODAD (2012)

<sup>10</sup> Roos, 2012

<sup>11</sup> Moerenhout and Roe, 2012

<sup>12</sup> African Development Bank (2009)

The objectives of the Lagos State Public Procurement Agency include:

- a. To ensure probity, accountability and transparency in the state's public procurement;
- b. Establish fair pricing standards and benchmarks for the state's procurement of good and services;
- c. Ensure the application of fair, competitive value-for-money standards and practices for the procurement and disposal of public assets and services;
- d. Create ample opportunities for the citizenry particularly, small and medium scale enterprises to participate in the economic opportunities and benefits of public procurement;
- e. Create a cost and time efficient, and effective, adjudicatory mechanism for the resolution of complaints arising from public procurement process in the State and its Local Governments filed by procuring entities, bidders and the general public; and
- f. Attain transparency, competitiveness and professionalism and guarantee integrity and public trust in the public procurement procedure.

### **Fundamental principles of government procurement in Nigeria**

These are principles that guide the government in its procurement of goods and services and ensure that no procurement is made without any budgetary approvals. The following are the stated fundamental principles of government procurement in Nigeria.

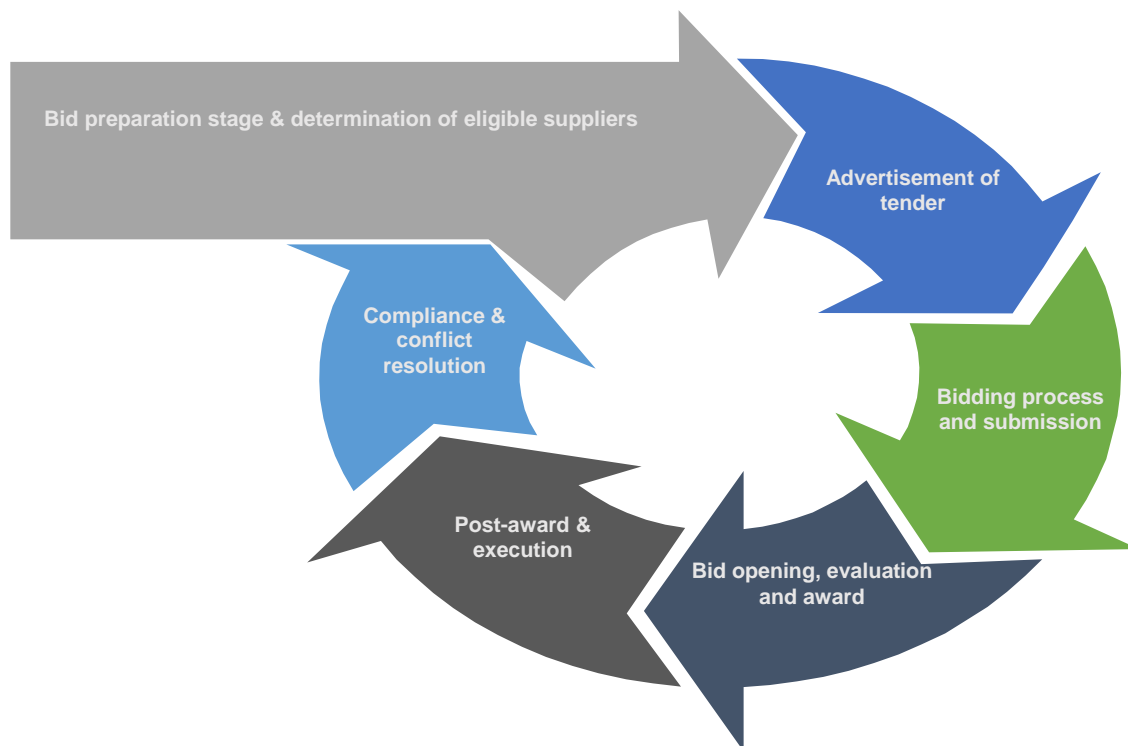
- a. All procurement above the national shopping window must be approved by the government procurement regulators.
- b. The national shopping window for the federal government has been pegged at N2.5 million, while that of the states and local government have been pegged at N500,000.
- c. Governments procurement would be based only on procurement plans supported by prior budgetary appropriations and no procurement proceedings shall be formalized until the procuring entity has ensured that funds are available to meet the obligations and subject to the threshold in the regulations made by the Bureau, and has obtained a "Certificate of 'No Objection' to Contract Award" from the Bureau;
- d. All procurement proceedings must be by open competitive biddings;
- e. All procurement must be in a manner which is transparent, timely, equitable for ensuring accountability and conformity with both the BPP Act and the Acts of the various states;
- f. All procurement must be carried out with the aim of achieving value for money and fitness for purpose;
- g. All procurement must be done in a manner which promotes competition, economy and efficiency; and
- h. In accordance with the procedures and timeline laid down in the BPP Act for the federal government and the PPA, of the states and as may be specified by the Bureau from time to time.

## The Procurement Lifecycle

The procurement process is a cycle with a series of steps that a business and procuring entity must complete. The procurement policy of the government has a lifecycle which is adhered to by the government agencies when initiating procurement for goods and services which are above the national shopping windows threshold.

The diagram below illustrates the government procurement lifecycle for public procurement in Nigeria.

**Chart 3.1: Procurement cycle**



## **The nature and characteristics of government procurement in Nigeria**

### ***Government procurement is broadly categorized into goods, works and services***

The nature of government procurement in Nigeria is diverse, huge in value and encompasses all goods, services and products which are useful to the government and the citizens alike. The government procurement involves purchases of goods such as toiletries, writing paper, computers for the ministries, departments and agencies to the procurement of very large and sophisticated equipment such as power plants for rural and urban electrification, to construction of roads and rail way, building of airports, and other infrastructural projects.

The Government's procurement of goods, services and works is usually captured within the budgets of the various ministries, agencies and departments for the federal, state and local governments and subsequently consolidated into the budget for the fiscal year and is usually presented to the legislature for approval before disbursement and implementation.

The following are characteristics of government procurement in Nigeria:

1. All government procurement must be captured in the budget;
2. All Federal Government procurement above two million five hundred thousand must get a certificate of no objection from the BPP before it can be procured;
3. All State Government procurement above five hundred thousand naira must get the certificate of no objection of the state's public procurement agencies
4. All procurement must pass through the required bidding process;
5. All procurement must be advertised in at least two national newspapers.

The timeline for government procurement is not fixed and can range from daily procurement such as procurement of water and catering products, to weekly or yearly procurement. Government procurement in Nigeria is based on the need and requirements of the procuring agency and the policy drive of the government in respect of construction, services and provision of social amenities.

Issuance of the certificate of no objection by the regulatory agencies such as the BPP for the federal, the procurement agencies of the states and the local government is a necessity for every government procurement above the national shopping limits.

Government procurement in Nigeria has been categorised into three namely:

1. Goods;
2. Services; and
3. Works;

**Table 3.1: Frequent government procurement in Nigeria**

Products	Services	Works
Air conditioning and electronic equipment	Management consultancy services	Buildings, including housing, offices and public amenities
Office IT	Software and electronics	Roads
Vehicles	Servers and data centres	Airports
Outdoor lighting	Couriers and postal	Railways
Paper	Fleet and vehicles	Hospitals
Office supplies	Waste handling	Schools
Fuel	Catering: food and beverage	Correction facilities

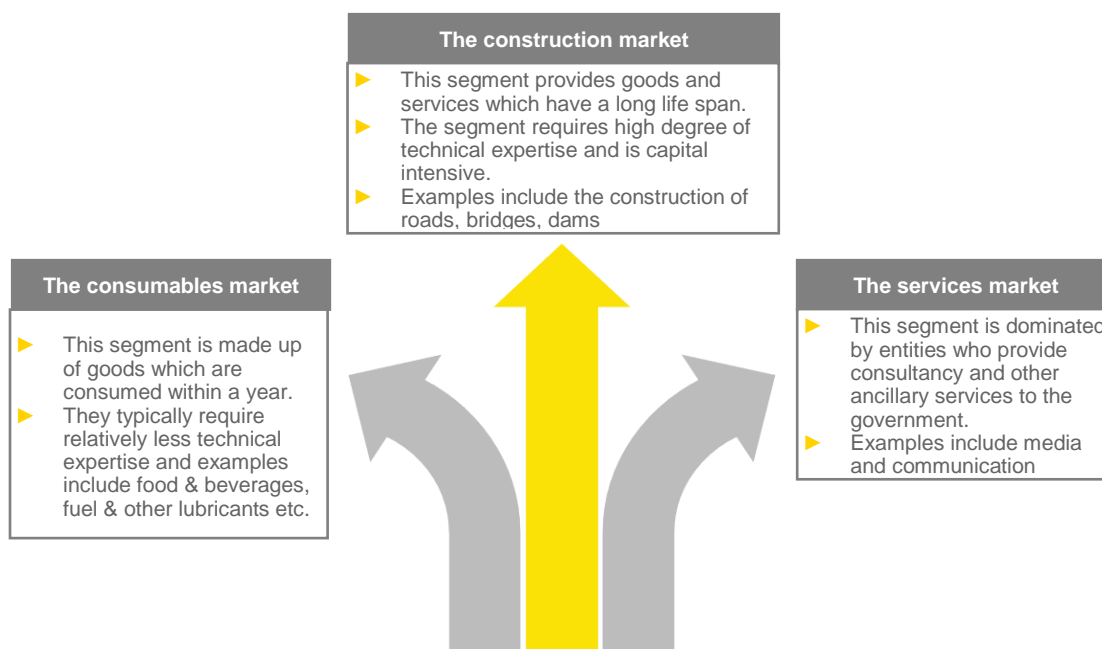
Source: EY survey

## Segmentation of government procurement

Based on the categorisation of the government procurement of goods and services above, the following segmentations can be derived from the products and services which the government buys:

- Segmentation based on market type
- Segmentation based on contractor profile
- Segmentation based on nature of goods

**Segmentation based on market type:** Represents segmentation into market classes based on the nature and characteristics of the products and services within the market and into three major market classes, which include:





1. **The consumables market:** This market caters for all government procurement that is expected to be used, utilised or replaced within one year. This market does not require any high level specialization or technical expertise among the participating enterprises or entities, as most products here are basic necessities within easy reach of most enterprises.

**Table 3.2: Products and services in the consumables market segment**

Foods and beverage
Fuel and lubricants
Educational equipment and supplies e.g. library books, drugs and medical supplies
Materials and other supplies e.g. kitchen/catering supplies etc.

The consumables market is highly suited to MSMEs as the services and products within this class are not technical in nature and fall within the basic commodities that are within the production and supply capacity of most micro and small enterprises.

2. **The construction market:** This market caters for government procurement that involves the provision of goods and services which are long term in nature, are highly specialised and technical in delivery and require huge capital outlay from the government.

**Table 3.3: Products and services in the construction market**

Construction of buildings, roads, dams
Construction of power generating plants, power transmission and distribution facilities
Extraction and processing of solid minerals
Telecommunications and broadcasting facilities

This market class may also be suited to the MSMEs especially the medium enterprises who have the workforce capacity, technical expertise and experience to engage the government to deliver these types of contracts.

3. **The services market:** This market caters for government procurement relating to the provision of consulting and technical services.

**Table 3.4: Select services within the services market**

Consultancy and professional services e.g. legal services, training and education, research and development, public relations and media;
Communications services e.g. express courier services, internet/data services;
Financial services e.g. insurance services, investment services;
Media & communications services e.g. outdoor/billboards, radio /TV, print etc.
Security services e.g. VIP protection, private investigative services etc.

This class of market may not be immediately favourable to the MSMEs as the services within this class would involve a high level of technicality and professional competency which most MSMEs may not readily have. The government can encourage MSME participation within this class by encouraging large firms to include the MSMEs as partners when bidding for any government contracts in this class.

However, for certain professional services, this may not hold true, given that lawyers, accountants, engineers and other professionals often operate as small businesses.

**Segmentation based on contractor's profile:** The segmentation of government procurement by customer profile shows the types of goods, works and services registered contractors are able to provide to the government.

The BPP uses four specific criteria in segmenting and categorizing contractors into five different classes. The specific classes of contractors and criteria used in classifying them are listed below

**Table 3.5: Classification of contractors based on Equipment owned**

S/n	Criteria - Equipment	Class				
		A	B	C	D	E
1	Bulldozers	10	8	4	2	-
2	Graders	10	8	4	2	-
3	Scrappers	5	4	2	1	-
4	Asphalt plant	1	1	-	-	-
5	Asphalt Pavers	3	2	1	1	-
6	Hoisting(Tower) Crane	10	8	4	1	-
7	Mobile Concrete mixers	10	8	4	1	-
8	Concrete Batching plant	1	1	-	-	-
9	Concrete Pumping machines	5	4	2	1	-
10	20, 30 Tons Tipping Trucks	30	20	10	5	-
11	Roller Compactors	15	12	6	3	-
12	Excavators	10	8	4	2	-
13	Pay loaders	15	10	5	2	-

**Table 3.6: Classification of contractors based on number of professional personnel and years of experience**

SN	Criteria- Personnel	Class					Years of industry experience
		A	B	C	D	E	
1	Civil/Structural Engineers	10	6	4	2	-	5
2	Accountants	1	0	0	0	-	5
3	Construction Manager	4	4	2	1	-	10

4	Land Surveyors	1	1	0	0	-	5
5	Mechanical Engineers	3	2	1	1	-	5

**Table 3.7: Classification of contractors based on experience and financial strength**

SN	Class	Sum of similar jobs completed in the last 5 years (x = No of jobs done)	Financial strength (Capacity) Mean of last 3 years Audited Turnover (x = Turnover)	
			Works	Goods/Services
1	A	Greater than 12	N10b or more	N1b or more
2	B	10 – 11	N1 - N10b	N300m - N1b
3	C	8 – 9	N300m - N1b	N100m - N300m
4	D	5 – 7	N100m - 300m	N50m - N300m
5	E	3 – 4	<N100m	<N50m

**Table 3.8: Classification of contractors based on range of procurement value**

SN	Class	Range of procurement values		
		Works	Goods	Services
1	A	Greater than 10b	Greater than N500m	Greater than N500m
2	B	N1b - N10b	N200m - N500m	N200m - N500m
3	C	N500m - N1b	N75m - N200m	N75m - 200m
4	D	N100m - N500m	N25m - N75m	N25m - N75m
5	E	< N100m	< N25m	< N25m

The Lagos state public procurement agency uses the following classification criteria to classify contractors or enterprises into different classes.

**Table 3.9: Classification of contractors for Lagos state procurement processes**

Class	Contract value/threshold	Registration fees	Annual renewal fees
A	Up to N10 million	N50,000	N25,000
B	Above N10 million - N100 million	N150,000	N50,000
C	Above N100 million -N250 million	N250,000	N75,000
D	Above N250 million - N1 billion	N500,000	N200,000
E	Above N1 billion	N2,000,000	N500,000

## Segments of government procurement MSMEs currently operate

Discussions with procurement agencies revealed that MSME currently operate majorly within the following classes:

Federal government procurement	State government procurement
<b>Class E:</b> Works: N2.5 million – N100 million Goods: N2.5 million – N25 million Services: N2.5 million – N25 million	<b>Class A:</b> N500,000 – N10 million

However, procurement agencies do not maintain records of MSME contribution to total procurement owing to the fact that they do not classify their contractors by business size and type.

## MSMEs suitable for government procurement

***Registration as an entity and a contractor prerequisite for procurement precludes majority of MSMEs from participating in government procurement***

Government procurement cuts across every sector and industry. Government procurement is highly regulated and usually follows a regimented process with established criteria for contractor participation.

Majority of MSMEs may not be suitable for government procurement because they operate outside the formal sector of the economy. MSMEs that would be suitable for government procurement are the MSMEs that are willing to meet the government requirements for contracting.

The following MSMEs are suitable for the Federal and State Government Procurement process:

**Table 3.10: Suitability for government procurement**

Federal government suitability	State government suitability
MSMES registered with the CAC	MSMEs registered with CAC
MSMEs registered within the BPP database of contractors	MSMEs registered with state board of procurement
Tax compliant or tax clearance received from the government	Tax compliant or tax clearance from the state
MSMEs that have an audited account	MSMEs who may or may not have an audited account

## Opportunities available to MSMEs in Government Procurement

MSMEs role as an economic development agent is crucial given the contribution to the economy in terms of employment creation (>50%); fostering innovation and driver of made in Nigeria goods. Given the magnitude of the MSMEs share of the economy, the potential opportunities of including MSMEs in public procurement are:

1. **Capacity development:** Involvement in government procurement can lead the drive for improved resources, knowledge and skills among the MSMEs. This would significantly improve the quality of their outputs.
2. **Encourages collaboration:** Government procurement provides MSMEs the opportunity to collaborate. Multiple competing and complementary enterprises can pool financial and human resources towards the execution of a government project.
3. **Increased competitive base:** Developing a strong MSME base may increase competition in public procurement, which may provide government with better value for money and increased efficiency in public procurement.
4. **Income re-distribution:** Including MSMEs in government procurement can be a veritable tool for addressing the income disparity in Nigeria. The inclusion of the sector would improve the standard of living for the middle-class and lower-class population in Nigeria.

## Review of Local content policy (Executive order 003)

### *Government leading the promotion of “made-in-Nigeria” products by demand*

In May 2017, the Federal government issued an executive order requiring all Federal ministries, departments and agencies to grant preference to local manufacturers of goods and service providers in their procurement of goods and services. The objective was to localise a portion of government expenditure on goods and services to stimulate local production and in turn increase employment and economic growth.

Further to the issuance of the Executive Order 003 (EO-003), all MDAs were to grant preference (with a minimum requirement of 40% of total procurement) to local providers in the procurement of uniforms and footwear, food and beverages, motor vehicles, pharmaceuticals, construction materials, ICT services, furniture & fittings and stationery.

### **Rationale for the Policy**

The need for the Local content policy was borne out of the drive to diversify government’s reliance on oil revenues, and improve the balance of foreign trade in Nigeria by first reducing the country’s imports and subsequently increasing its exports.

The policy is also expected to help align the country’s industrial revolution plan (NIRP) by providing available demand for the expected increase in supply. The plan which was developed in 2013 had also highlighted the following areas of comparative advantage for Nigeria.

**Table 3.11: Areas of comparative advantage**

Industry Groups	Sub-Sectors
Agribusiness & Agro-Allied	Food processing (particularly beverages and packaged food products); sugar, palm oil processing, cocoa processing, leather and leather products, rubber products, textiles and garments.
Solid Minerals & Metals	Cement, auto-assembly, basic metals, aluminium, chemicals.
Oil & Gas and Related Industry	Petrochemicals, fertilizers, methanol, plastics, refineries.
Construction, Light Manufacturing and Services	Housing stock, consumer goods, home goods, haulage services.

Source: NIRP

The policy is expected to have significant impact on employment and economic growth with a focus on the MSMEs.

### **Implementation**

The implementation of the EO-003 was anticipated for August 2017, but has been delayed by the ambiguity over what constitutes “Local content” with most MDAs claiming the need for clarification.

Subsequently a technical committee was set up to define what constitutes local content and a “made-in-Nigeria” product. The committee was also charged with the development of a monitoring and evaluation framework for the policy.

The Mandatory Conformity Assessment Programme (MANCAP) developed by the Standard Organisation of Nigeria was selected for the definition of Local content. It requires that for any product to be certified as “made-in-Nigeria”, a minimum 35% of its input (staff, management and raw materials) must be locally sourced.

### **Challenges and limitations of the Local content procurement policy**

Although the Federal Government of Nigeria desires an increase in Local content in procurement, both in the public and private sectors of the economy, the following serve as key deterrents:

- **Existing procurement law:** Existing procurement laws guiding public procurement such as the Public Procurement Act and other states' procurement laws contain inadequate provisions to support the local content policy.  
The Act neither has clear directives on the margin of preference nor compelling considerations for the bidding and procurement of goods and services from MSMEs existing in Nigeria.
- **Monitoring and evaluation:** There is a lack of adequate monitoring and evaluation mechanisms on existing local patronage. Procuring agencies and regulators rarely keep adequate data for past procurement which can serve as a reference for key focus and improvement areas.
- **Infrastructural deficit:** The huge infrastructural gaps which exists in vital sectors of the country such as power and transportation results in additional overhead costs for local producers which subsequently make them less competitive in pricing relative to foreign producers.
- **Technical capabilities of local producers:** Based on our survey, procuring agencies highlighted the significant gap in the quality of locally produced goods compared to the foreign products. This makes the implementation of a "margin of preference" for local goods difficult as there is significantly less value-for-money.
- **Weak private sector buy-in:** Many large companies in Nigeria do not have internal policies/responsibilities to increase local content by incorporating smaller producers in their supply chain. This is partly as a result of the profit-making objective (which make cheaper imported products more favourable) and a lack of regulation requiring the inclusion of locally produced goods.

### **Barriers to effective MSME participation**

The following are potential barriers to effective MSME participation in public procurement:

- **Existing nature of MSMEs:** Currently, most MSMEs operate informally and this has an adverse implication on possible Government policies and processes. As Government procurement is done formally, as required by PPA 2007, for transparency and efficiency purposes, MSMEs are disadvantaged in participating in procurement process.
- **Bidding cost and other related costs:** A typical government bidding process requires enterprises to incur additional administrative expenses not associated with production costs of goods or services. This has a relatively significant impact on MSMEs whose resources are quite limited, compared to larger firms.  
Costs such as supplier/contractor registration costs, bid information and documentary requirements, inspection requirements and other onerous requirements of the procurement process could serve as a deterrent to MSME participation.
- **The requirement for performance guarantee bonds:** The requirement of the Procurement Act of the government for contractors to submit a guarantee bond for some types or classes of contracts is a limitation on the MSMEs participating in government procurement.
- **The requirement for tax clearance certificates:** The requirement by the government that a tax clearance certificate is needed for contractors to bid for government procurement is a limiting factor to most MSMEs who currently do not pay any formal tax to the government.

- **Government bias for large firms:** There exists the general tendency of government procuring bodies to be risk averse when dealing with bids. Procuring agencies tend to prefer larger companies to MSMEs due to past credentials and demonstrated quality as opposed to small enterprises seeking an opportunity.
- **Low awareness levels:** Although procurement opportunities are published in major newspapers, MSMEs tend to be unaware of opportunities which are available to the sector. This is largely due to the informal and unorganised structure of the sector which makes information dissemination difficult for government ministries, departments and agencies.



A photograph of a man in a light-colored trench coat, white shirt, and striped tie, walking on a city street. He is holding a green coffee cup in his right hand and a smartphone in his left hand, looking down at the phone. The background shows a busy urban street with traffic lights and buildings.

## International Landscape

- *This section briefly looks at the international definition of MSMEs and their contribution to GDP.*
- *The section also draws other MSME initiatives from other African countries.*

### **Key highlights**

- *MSMEs contributes 62%, 68% and 63% of GDP in low-income, middle-income and high-income countries respectively.*
- *Backward integration, grassroots penetration and cluster development drives the MSME development approaches in South Africa, Ethiopia and India respectively.*

## Cross- country comparison

### *MSMEs have an average contribution of 65% to global employment*

The interconnectivity of the global economy has continued to transform what is traded, how it is traded and most importantly who is trading. Although large companies maintain their dominance of international trade, because they have the economies of scale and relevant technologies necessary to access and supply foreign markets, many MSMEs have maximized the emergence of new business platforms via the internet and now have the potential to become successful and important global traders as well.

Due to MSMEs' increasing contribution to total employment in many countries (particularly developing countries), and the opportunity MSMEs provide for social inclusion and poverty alleviation, many countries and international organizations (such as the United Nations, World Bank, The IFC) have continued to undertake proactive measures and increase initiatives to stimulate the growth of MSMEs around the world.

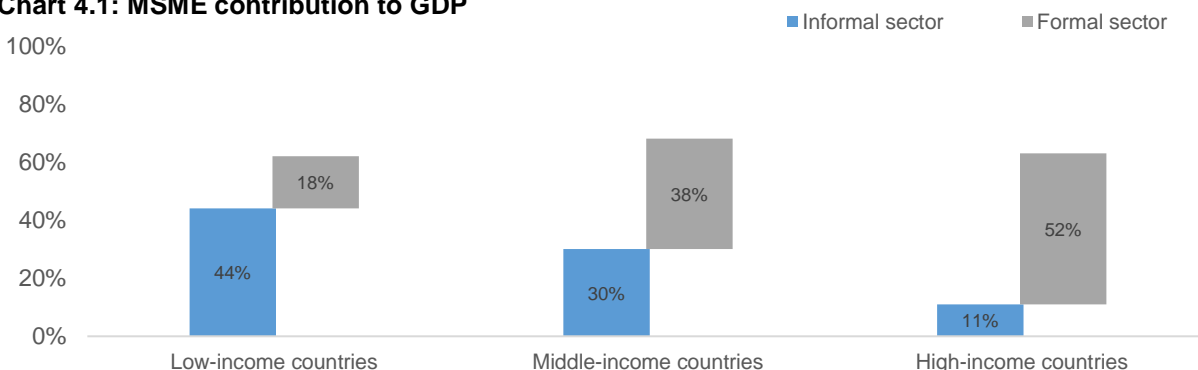
The International Finance Corporation's (IFC) MSME survey<sup>13</sup> defines (based on selected countries' definitions) MSMEs as follows;

- Micro enterprises are firms with less than 10 employees.
- Small enterprises are firms with 10-49 employees.
- Medium-sized enterprises are firms with 50-299 employees.

MSME's contribution to employment ranges between 63% and 67% according to various surveys and can well be above 70% in Sub-Saharan Africa when unregistered MSMEs are considered<sup>14</sup>. MSMEs also contribute a median of 45% (55% in developed countries and 35% in developing countries) to average country GDP<sup>15</sup>.

However, MSMEs are plagued with low productivity and a high mortality rate when compared to large companies. This is largely attributable to difficulties in accessing investment and/or credit, inability to capitalize on possible economies of scale, limited access to skilled labour and relatively large levels of informality in business transactions.

**Chart 4.1: MSME contribution to GDP**



Source: Edinburgh Group, South African Institute of Public Accountants

<sup>13</sup> IFC- MSME country indicators

<sup>14</sup> World Trade Report 2016

<sup>15</sup> Ayyagari et al 2007

## Insights from other economies with thriving MSME policies

**Backward integration, grassroots network and MSME cluster development drives the MSME development approaches for South Africa, Ethiopia and India respectively.**

This section seeks to highlight MSME development policies that have been implemented in some countries namely South Africa, Ethiopia and India. South Africa was selected because it is the most developed economy in the sub-Saharan region while Ethiopia was chosen due to the rapid economic growth experienced over the last decade with the country's GDP almost double in size. India was selected due to its similarities with Nigeria in terms of massive population and poverty levels. This section will also draw out recommendations that can be implemented by the Nigerian Government to accelerate the growth of MSMEs.

Generally, these countries are fraught with similar challenges confronting the Nigerian economy. These challenges include corruption, an inefficient public sector and significant poverty levels.

**Table 4.1: Key indicators**

Indicator	Nigeria	South Africa	Ethiopia	India
Population	192 million	55 million	105 million	1.28 billion
GDP per capita	\$2,412	\$7,524	\$549	\$1,936
Regional economic power	Yes	Yes	Yes	Yes
Ethnic groups	>250	>50	>10	>10
Life expectancy	53.8 years	63.8 years	62.6 years	68.8 years
Literacy level	59.6%	94.4%	49.1%	71.2%
Corruption perception index	148 <sup>th</sup>	71 <sup>st</sup>	107 <sup>th</sup>	81 <sup>st</sup>
Unemployment rate	16.5%	27.2%	5.2%	3.52%

Source: World Bank, NBS, CIA World Fact Book

### South Africa

Similar to Nigeria, MSMEs account for 91% of businesses in South Africa and provide about 61% to the Country's total employment<sup>16</sup>. In a bid to enhance the sector the South African government initiated a Supplier Development program - a policy actively promoted by the Government and adopted by all major stakeholders.

The Supplier Development Program was initiated in response to the need to improve the capacity, capability and competitiveness of local manufacturers to meet the import requirements of large enterprises. Prior to the commencement of the program, it was estimated that the country's import requirements for companies in some sectors such as the automotive and infrastructure investment space stood as high as 40%.

Consequently, the Government of South Africa (through the Department of Public Enterprises and State Owned Enterprises) set up the Competitive Supplier Development Programme (CSDP) to achieve the following objectives:

- Improve the competitiveness of the services rendered by State Owned Enterprises (SOE) through savings obtained from using more competitive suppliers.

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<sup>16</sup> Agosto & Co research

- Provide the economy with other potential benefits such as:
  - Removal of exposure to foreign currency fluctuations
  - Ease of communication
  - Creation of industrial clusters
  - Increased potential for collaborative partnerships and innovation for local conditions.

The United Nations Development Programme (UNDP) assisted the Government in realising its objective of SME development in South Africa. The Supplier Development Programme (SDP) provides SMEs with technical assistance over a period of 9-10 months. The objective of the SDP was to mentor selected SMEs or agribusiness cooperatives which will in turn become suppliers of larger organisations and government agencies.

To achieve this mandate, UNDP provided technical assistance to help selected SMEs enlarge the volume, quality and punctuality of sales. In addition, UNDP specialists provided technical assistance and collaboration structures for the smooth integration of SME suppliers with the large firms and government agencies.

### **Recommendations for Nigeria**

Most large enterprises operating in manufacturing and general commerce depend on imported raw materials, however, many of these products can be locally produced. Backward integration will help large manufacturing firms source some of these imported raw materials locally, thereby reducing foreign exchange exposures for the companies and the country as a whole.

Providing a channel for incorporating MSMEs in large corporations and government entities' value chain could create a synergy that is mutually beneficial to both stakeholders and the larger economy. The CBN's Anchor Borrowers Programme is a prominent example of this backward integration channel currently operating in the Agricultural sector.

By providing MSMEs with technical and financial support, production quantity and quality can be significantly improved. Successful implementation of supplier development programs and backward integration channels would also have positive effects by increasing the contribution of MSMEs to Nigeria in terms of employment, higher GDP and GDP per capita.

## Ethiopia

Ethiopia is currently the fastest growing economy in African with an annual growth forecast of 8.5%<sup>17</sup>. The growth has been driven by an increase in industrial activity with investments directed at the development of several industrial parks.

Similar to the case in Nigeria, the major constraint to the growth potential of MSMEs in the country is the limited access to finance. To address this challenge and support the overall development of the MSMEs in the country, the government has set in place an institutional structure at the federal, regional, and town levels.

The Federal MSE development agency formulates the overall support framework while regional bodies, including one-stop shop facilities set up at town levels for this purpose ensure proper implementation of the development of the strategy. Currently there are 1,097 one-stop shop service centres throughout Ethiopia providing all-encompassing support services to MSMEs, Technical and Vocational Education and Training (TVET) centres and a public-private machine leasing program to facilitate the government's Partial Credit Guarantee (PCG) Scheme<sup>18</sup>.

### Recommendations for Nigeria

Considering the vast spread of MSME activity within the 36 states of the country, SMEDAN (which serves as the development agency in charge of MSMEs) should have cut across all tiers of the government and have a similar wide spread of contact centres.

While SMEDAN is currently operating across the states, reaching MSMEs across grassroots networks like local government areas can further provide support to the development of MSMEs in the following ways;

- Better contact and service provision for MSMEs
- Ease of data gathering and information dissemination
- Quicker and easier sensitization of MSMEs of government policies and initiatives

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<sup>17</sup> World Economic Forum

<sup>18</sup> World Bank – Addressing the middle challenge

## India

Micro, Small and Medium Enterprises (MSMEs) play a very important role in the Indian economy and constitute more than 98% of all firms<sup>19</sup> providing employment for a vast number of the population and accounting for development of value added products through knowledge creation and innovation.

To aid the growth of the sector, some Indian states have tax exemption policies exempting MSMEs from VAT, Central Sales Tax and Goods and Services Tax for five (5) years. In addition to this, the Government of India developed policies to aid select sectors. This includes the removal of production quota in the textile sector and the deregulation of the financial sector.

Indian banks have been allowed to set the targets for funding MSMEs and are required to achieve a 20% y-o-y growth in credit to micro and small enterprises and a 10% annual growth in the number of micro enterprise accounts which has improved the ability of SMEs to access much needed funds<sup>20</sup>.

UNIDO worked with the Indian Government to identify 388 clusters spread over 21 states in the country. The Indian Government (through the Small Industries Development Bank of India (SIDBI)) thus advised banks to treat cluster based approach to financing as a key policy and increasingly adopt its use for funding SMEs.

Furthermore, the Ministry of Micro, Small and Medium Enterprises has approved a list of clusters under the Scheme of Fund for Regeneration of Traditional Industries (SFURTI) and Micro and Small Enterprises Cluster Development Programme (MSE-CDP). These clusters are located in 121 Minority Concentration Districts. Banks have also been given flexibility to identify new clusters.

### Recommendations for Nigeria

Across Nigeria, there are major and minor cluster segments within each state, the identification of these clusters like the Aba manufacturing market cluster, the ICT cluster in Lagos, Agricultural clusters in the Northern part of the country could lead to the development of industrial parks and economic zones.

SMEDAN is currently undertaking a study for the conversion of industrial centres in Nigeria to industrial parks. We believe that these industrial parks and economic zones would result in a more focused and directed intervention programmes at MSMEs. Clusters also help foster collaboration and competitiveness amongst MSMEs as innovative ideas and overhead costs are shared.

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<sup>19</sup> National institute for Micro Small and Medium Enterprises (NISME) India

<sup>20</sup> Augusto & Co research



## MSME Reclassification Recommendation

### **Key highlights**

- *This section covers the proposed reclassification recommendation and the justification based on the market survey and secondary research conducted*
- *Recommends government procurement below a value threshold can be reserved to provide a captive pipeline of procurement opportunities for MSMES*
- *The recommendation suggests an additional “Nano-business” category, to SMEDAN’s small, micro and medium enterprises. In addition, recommendations have been made to the classification to recognise sectoral differences.*

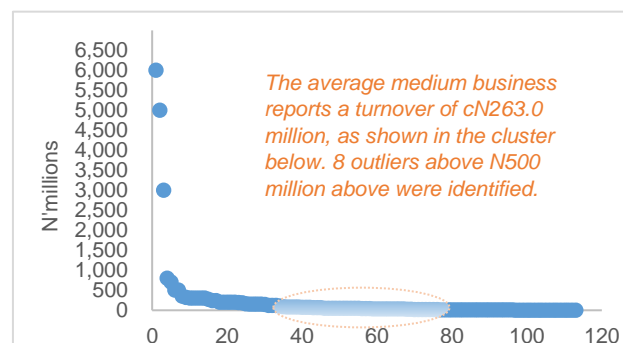
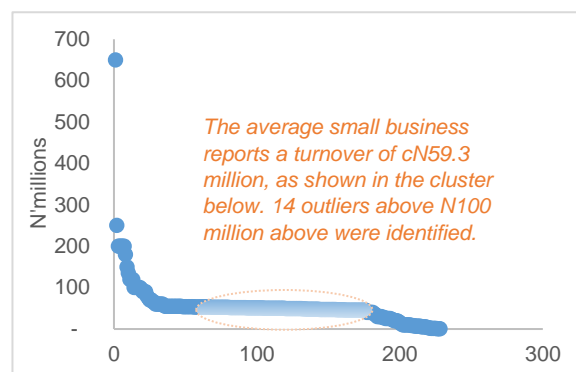
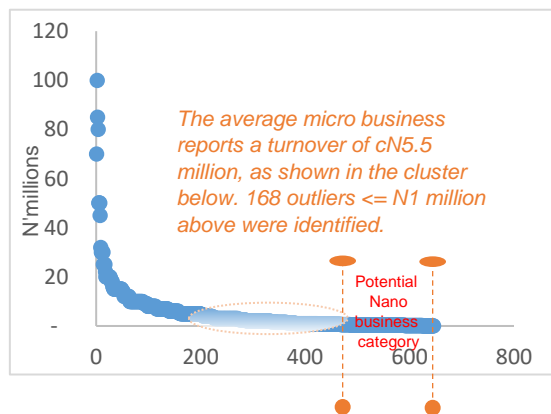


## MSMEs Reclassification Recommendation

Certain category of businesses within the Micro Enterprise grouping exhibit characteristics that are distinct from the broader group and as such may require a separate classification.

Labour force, turnover amount and asset base underpins the current MSME categorization, with labor force being the key classification criterion when the three criteria are in conflict. To understand the impact, if any, of the categorization criteria on MSME participation in government procurement, each criterion was analysed separately. Key observations noted include:

- **Employment:** This is the single most used and generally accepted classification criteria for MSME segmentation. Broadly, the number of employees provides a credible measure for capacity, and in our view did not readily present any procurement disadvantages to the MSMEs, except some evidence of many non-employer businesses within the Micro Enterprise category, indicating the need for potential consideration of a “Nano business” category.
- **Turnover:** Evaluation was based on whether Turnover represents a proper definitional criterion, as well as whether the value parameter (i.e. turnover level) used for category segmentation is appropriate. However, unlike labour force, it is challenging to objectively determine MSME turnover, as most enterprises do not adequately keep financial records and do not have audited financial accounts to provide a verifiable basis for the reported turnover. Furthermore, analysis of respondent turnover data indicated no significant outliers, except some evidence of many businesses in the  $\leq N1$  million turnover category of the micro businesses, indicating the need for potential consideration of a “Nano business” category.





- **Asset base:** This criterion is less weighty when compared with the employee and turnover based classification as it presents challenges to objective validation, as well as being highly susceptible to management manipulations. Furthermore, the cash based business of most MSMEs and the evolving business models oriented towards "asset light" commercial structures undermines this criterion's credibility as a measurement of the capacity of an enterprise. Consequently, we do not consider this classification criteria as necessary for MSME categorization purposes for government procurement.

## Re-categorization considerations

### *Consideration of a potential new category of Nano businesses, which can be effectively targeted for government procurement opportunities outside of the Micro-business ambit*

Analysis of the individual MSME categories indicated the Micro classification exhibited less homogenous characteristics as a group in comparison to the Small and Medium enterprises.

Our findings indicated two separate characteristics of businesses that can be grouped into employer and non-employer businesses. The employer-businesses represents the staple definition of the Micro Enterprise category (i.e. revenue >N1m, employees >1, but less than 10), while non-employer businesses are a distinct sub-group that are defined by the following common markers:

1. Revenue size <=N1 million
2. Family owned, with pseudo employees (typically owner managed with owner & or one additional family member/spouse doubling as the only employees)
3. Primarily service oriented businesses like plumbing, wood-work, auto-engineering, etc.
4. Increasingly digital & social media driven, as a cost-efficient, scalable platform for projecting business offering/services

High unemployment due to the recession have driven many individuals to seek self-sufficiency through self-employment and with the availability of social media platforms, opportunities have opened up for these non-employer businesses to thrive. However, given the staple definition of Micro Enterprises as primarily employer-businesses, the procurement opportunities being targeted for this group (e.g. national shopping window bids) may overwhelming give preference to employer businesses and crowd out the non-employer sub group due to these opportunities often being suitable for firms with capacity and leverage to perform the work.

This sub-group have peculiar needs, separate from the larger Micro business pool. The typical business profile is quick-start, minimal initial investment and low overhead base. These businesses may be targeted for the following potential public procurement opportunities:

- Temporary/contract staffing for short term government projects e.g. data entry exercise in government parastatals looking to digitalize their operations
- Stand-alone routine maintenance services like plumbing, electrical work, etc. in select local government offices

For categorization purposes, the MSME classifications are re-categorized as follows

	Staff count	Assets (N'million)
Nano enterprises	1 (self-employed)	Less than 1
Micro enterprises	Less than 10	Less than 10
Small enterprises	10 – 49	10 - 99
Medium enterprises	50 – 199	100 - 1,000

The categorization of Nano businesses and targeting of government procurement and intervention programs towards them provides an opportunity for self-employed individuals to use the Nano-business model as a starting point towards building capacity and entrepreneurial experience to potentially grow into a micro, small or medium businesses and beyond.

### ***Categorization of the Nano enterprises provides a vehicle for the implementation of youth and gender differentiated policies targeting the MSME sector.***

The youthful demographics of Nigeria's population, as well as the gender based policies intended to increase women participation in the economy provides the impetus for targeting procurement and intervention program towards the Nano category, as it provides an opportunity to directly address the issues hindering the growth of these two constituencies. The recommended actions are grouped into sector-level and firm-level steps

#### **Sector level**

Sector level interventions should be designed to address multilateral issues that thread across the Nano business landscape.

##### **Youth differentiated ICT policy**

- The critical role ICT plays in the development of the Nano category and the youth oriented nature of the enterprises provides an anchor for implementation of programs designed to support this category. As previously noted, the rise in non-employee firms was driven largely by high unemployment, as a result of the recession and use of social media as a commercial platform for trading of goods and services. However, these activities are largely occurring in silos and are in a fragmented state, with little cumulative impact on the economy. This raises the need for tailoring of government programs to harness the disparate capacities of these ICT based Nano businesses to drive a stronger economic contribution.
- Among other things, identifying emerging hubs and developing supporting eco-systems in the form of access to finance, capacity building, infrastructure support, etc, will enhance the development and competitiveness of this category by lowering their cost of operation through economies of scale and increased competence through technical assistance schemes.

##### **Gender differentiated policy**

- The CBN, BOI and other government agencies have intervention funds targeted exclusively for women owned businesses. However, the access rate for these funds is low because the qualifying criteria are designed for businesses with capacities that fall within the micro (upper echelon), small and medium categories. Recognition of Nano businesses as a class will drive more access to these funds because women account for a significant portion of the Nano business sector.
- Furthermore, we recommend a calibration of the qualifying criteria for the gender intervention funds that takes into consideration the typical profile of woman-owned business, which are largely non-employer, one-person endeavours.

## Firm level intervention

Nano businesses are at the bottom of the pyramid. These businesses largely operate as self-employed contractors and therefore are suitable for bid opportunities that can be performed by a single individual. Accordingly, we recommend such opportunities to be reserved for the Nano category, as well as percentage (20%) of the small sized procurement needs within the “national shopping” window up to N500,000.

MSME category	Sector	Contract value	Justification for reclassification
Nano enterprises	Professional and consulting services	20% of bid opportunities up to the N500,000 national shopping window	<p>Professional and Consulting Services are usually customized services that are based on intellectual or creative expertise an individual (s) or company that are provided for a fee.</p> <p>Based on our survey findings, we identified a bias for targeting professional firms for government procurement as against individual providers.</p> <p>Given the number of qualified and experienced professionals that are out of work or under-employed due to the economic downturn, the Nano Class is suitably positioned to render certain classes of professional services such as legal contract review, accounting bookkeeping, architectural design, real estate valuation etc.</p>
	Construction		Certain maintenance services that are routinely provided and do not require specialised or customized work orders such as repair services, paint work, small equipment rental, etc are suitable and can be easily performed by an independent contractor and do not require a firm.
	ICT		Nano businesses in this sector are involved in web design, installation of computers systems and networks, repair and maintenance of computers and other software development and installations.
	Trade		Nano business traders supply household items, electronic products and other consumer staples.
	Other Services		Self-employed contractors can provide data entry services, janitorial, security (small offices) and other labour based services.

## **Complementary categorization criteria required to assure a market of procurement opportunities**

MSMEs have low participation rates in government procurement and this is despite the preponderance of intervention funds created to enhance MSME capacity, as well as specific policies designed to grow their involvement in government procurement. Based on feedback from market surveys, the stringent criteria for qualification has been identified as a key obstacle. Procurement requirements such as business registration, tax compliance (payment or waiver) and financial records, for a sector that largely operates informally places a compliance burden most MSMEs are unable to overcome, resulting in their being crowded out by larger and more formal enterprises.

To correct this imbalance, a complementary categorizing criterion that will assure a pipeline of procurement opportunities for MSMEs and a shield against unfair competition from larger enterprises is recommended. A restricted tendering procurement process is a mechanism often used by governments to improve the competitiveness of a focus sector, and in this context a value based restricted tendering is recommended.

A value based restricted tendering for MSMEs follows along the same themes of existing government programs, such as the local content policy, designed to enhance the capacity and participation of indigenous businesses on key sector opportunities. To include a value based restricted tendering process for MSMEs, key policy provisions should be carefully considered; notably:

### **Key considerations in our approach to recommending inclusion of restricted tendering in MSME classification for government procurement**

1. **Sectoral consideration** – We conducted a pre-sample of prevalent MSME businesses by sectorial representation; and identified clustering around the following sectors. This is a more focused categorization, compared to the 2013 SMEDAN study as shown in table below.

**Table 5.1: MSME Sectoral classification**

SMEDAN Survey	EY Survey
Agriculture	Agriculture
Mining and Quarrying	Construction
Manufacturing	ICT
Sewage, Waste Management and Remediation	Manufacturing
Construction	Trade
Wholesale and Retail trade	Services
Transportation and storage	
Accommodation and food services	
Information and communication	
Administration and support services	
Education	
Arts, Entertainment and recreation	
Hotel and restaurants	

In taking a sectoral approach to applying a value based restricted tendering for MSMEs, we understand the contract value parameters, as well as other classification criteria will be determined by the peculiarities of each sector and have made specific classification recommendations in consideration of these sector peculiarities.

2. **National shopping window** - Government procurement patterns have also been carefully considered. Our findings indicate the "BPP approval free" government shopping windows for local/state and federal governments are N500 thousand and N2.5 million respectively. Beyond this, government buying is summarized below:

**Table 5.2: Federal government procurement**

SN	Class	Range of procurement values		
		Works	Goods	Services
1	A	Greater than 10b	Greater than N500m	Greater than N500m
2	B	N1b - N10b	N200m - N500m	N200m - N500m
3	C	N500m - N1b	N75m - N200m	N75m - 200m
4	D	N100m - N500m	N25m - N75m	N25m - N75m
5	E	N2.5m - N100m	N2.5m - N25m	N2.5m - N25m

**Table 5.3 State government procurement**

Class	Contract value/threshold
A	Up to N10million
B	Above N10million - N100million
C	Above N100million - N250million
D	Above N250million - N1billion
E	Above N1billion

In recommending a Value based Restricted Tendering as a complementary category driver for MSME procurement purposes, we recognize that most government buying is driven by size of the contract - and this is an easier way to estimate the potential capacity of the contractor for each respective opportunity. Accordingly, we recommend procurement within the national shopping window, which is pegged at N2.5 million at federal level and N500,000 at state, should be reserved for the micro and small enterprises. The specific procurement value parameters recommended are indicative; a focused market analysis of the appropriate parameter value and the broader market implication should be conducted.

### **Modification of the regulatory compliance requirements -**

The respective regulatory acts for federal and state government procurement requires all contracting entities to meet the minimum requirements of;

- a) Registration with the CAC or with the public procurement agency of the state governments and
- b) Tax complaint (either by actual payment of taxes or tax waivers by respective tax authorities)

However, these minimum requirements are the major deterrents for MSME participation in public procurement as majority are unregistered and level of tax evasion is high. Initiatives to incentivize the registration of these enterprises is key to their participation in government procurement. Cost reduction initiatives (e.g. the 50% registration cost slash for a 90-day window recently initiated by the Federal government), ease of registration initiatives (e.g. the development of a simplified registration app accessible by the CAC, BPP and other relevant stakeholder) need to be explored.

While the need for a disciplined regulatory environment is noted; however, to increase MSME participation in public procurement, consideration should be given to waiving the tax compliance requirements, particularly for certain procurement bands – especially micro enterprises. The overall aim is to focus on aiding the growth of these enterprises rather than inhibiting their growth with tax burden and adding to the already high mortality rate experience in the sector. Subsequently, the growth would benefit both the enterprises and the government – through tax returns of an established enterprise.

Based on the above and relying on our survey findings and understanding of government procurement, the following recommendations were made:

## Micro enterprises

Micro enterprises are at the bottom of the MSME pyramid and typically suffer the highest levels of mortality and are the least equipped to participate in government procurement. Consequently, across all sectors, **Micro enterprises need a captive market that excludes all non-micro enterprises from competing in the reserved procurement bands** in order to provide a stream of opportunities to build capability and capacity **enterprises from competing in the reserved procurement bands** in order to provide a stream of opportunities to build capability and capacity.

MSME category	Sector	Number of employees	Contract value	Justification for reclassification
Micro enterprises	Agriculture	1-10	Less than N500,000	Enterprises in this sector are involved in agriculture and farming activities such as poultry, fishery, animal rearing etc. for a scale a bit higher than subsistence farming.  Enterprises in this sector can provide agriculture produce such as chickens, turkeys, eggs, yams etc. during festive periods.
	Construction			Enterprises in this class of MSMEs are mostly involved in renovation of buildings, fitting of street lights, beautification of gardens etc.  We suggest the reservation of construction works within the “national shopping” up to N500,000 be reserved for this category of enterprises.
	ICT	1-5		Our survey findings show that micro enterprises in this sector are engaged in web site design, repairs of computer and other ICT equipment. This category typically employs less people than other micro enterprises with an average staff strength of 3 people  We recommend the reservation of ICT related procurement of the government below the N500 thousand “national shopping” window for this category of enterprises.
	Manufacturing	1-10		Our survey revealed that micro manufacturing enterprises that would be suitable for government procurement are involved in the production of polythene and paper bags, manufacture of slippers and low-cost shoes etc. and other items which feature regularly within the procurement needs of the government.  We recommend state governments reserve its manufacturing procurement less than N500,000 for micro-manufacturing enterprises.
	Trade			Micro traders currently employ an average 5 people and record annual turnover of N4 million trading electronics, household and office utensils, spare parts and other products which are required by the government.  We recommend government reserve its small sized goods procurement needs within the “national shopping” window up to N500,000 to this sector
	Services			Our survey result shows that majority of enterprises within this sector are registered, and provide services such as catering, legal, consulting and management advisory. Services worth less than N500,000 across Federal and state MDAs can be reserved exclusively for the micro service providers.



## Small enterprises

With relatively higher levels of formality than the Micro category, small enterprises are poised to be targets for procurement within the Federal “national shopping” window (i.e. **procurement less than N2.5 million**). Due to variances in size, some small enterprises can also provide government needs higher than N2.5 million as shown in the table below:

MSME category	Sector	Number of employees	Contract value	Justification for reclassification
Small enterprises	Agriculture	11 - 50	N500,000 – N2.5 million	<p>Based on our survey findings, the small agricultural enterprises that are suitable for government procurement have an average staff strength of 20 employees. And record an average annual turnover of N35 million</p> <p>This class is favourably positioned to supply government schools’ feeding requirements, particularly with the ongoing school feeding programme. We recommend that agricultural procurement needs between N500,000 and N2.5 million be reserved for small agriculture enterprises across State and Federal government levels.</p>
	Construction			<p>Our survey showed that the small construction firms that are suitable for government procurement under this sector have an employee base of about 37 people.</p> <p>The firms in this sector are mostly involved in minor road construction, building of shopping complexes and low-cost houses, construction of road side drainage system etc.</p> <p>While we recommend that construction project worth between N500,000 and N2.5 million be exclusively reserved for the small construction enterprises, we also note that they can be involved in construction works worth up to N25 million (Federal procurement class E) as they currently record an average turnover of N89 million.</p>
	ICT	6 - 50		<p>The firms in this category typically install computers systems and networks, repair and maintenance of computers, building of websites and other software development and installations.</p> <p>They are well equipped to provide ICT trainings to local and state government employees and provide other related ancillary services with such services worth up to N2.5 million.</p>
	Manufacturing	11-50		<p>Our survey found that small manufacturing firms are mostly involved in the production of clothes and shoes, tissue papers, soaps &amp; detergent, bottled water etc and they record estimated annual turnover of N76 million.</p> <p>Related procurement opportunities such as uniforms and boots between N500,000 and N2.5 million can be reserved for this class of MSMEs. However, we note that they can also be targeted with opportunities worth up to N10 million.</p>
	Trade			<p>Our survey result shows that the small traders are registered and have outlets in more than one location. With an estimated annual turnover of N58 million</p>

				We recommend that procurement opportunities between N500,000 and N2.5 million can be exclusively reserved for this category. However, they can supply government procurement need up to N10 million naira.
	Services			<p>Firms in this sector provide the same services as the micro enterprises but on a relatively larger scale. Services includes hotel and accommodation, hall and event rentals, legal, accountancy and consulting, estate valuation services etc.</p> <p>We recommend that procurement opportunities between N500,000 and N2.5 million should be exclusively reserved for this category of MSMEs. However, some of these service providers can be targeted with procurement worth up to N10 million naira.</p>

In addition to the above, we also recommend that while the small enterprises procurement band remain exclusive to small (and micro) enterprises, these enterprises can also bid for procurement opportunities beyond their upper limits to ensure that enterprises build their way up the value chain and the financial gap is reduced as these firms develop.

## Medium enterprises

Medium enterprises are suitable for procurement opportunities in Class B and Class E of State and Federal government procurement respectively (particularly as the “National shopping” windows for state and federal procurement and most state government procurement Class A have been reserved for micro and small businesses). Broadly, Medium enterprises as a group do not generally suffer the same issues as the other MSME categories and typically are more sophisticated enterprises with higher participation in the formal economy, which translates to capacity to compete for large value procurement opportunities.

MSME category	Sector	Number of employees	Contract value	Justification for reclassification
Medium enterprises	Agriculture	51 – 200	>N2.5 million	<p>Based on our survey findings, the medium agriculture firms that are suitable for government procurement have an average employee base of 153.</p> <p>These enterprises are involved in agricultural and farming activities on a commercial scale and use modern farming machinery such as tractors, weeding machines, rice separating machines and a host of other equipment.</p>
	Construction			<p>Our survey indicates that the medium construction firms suitable for government procurement have an employee base of about 173 staff. They are mostly involved in road construction on a large scale, building minor bridges and pedestrian walkways etc.</p> <p>The firms in this sector have assets such as motor grades for creating flat surfaces for asphalts on the roads, asphalt mixing machines, forklift trucks etc. and are suitable for construction projects worth between N2.5 million and N100 million</p>
	ICT			Our survey findings indicate that the medium enterprises in this sector are well established companies with a well-coordinated

			<p>distribution network for ICT products and services such as networking, ERP management, personalised app development and robotics.</p> <p>Firms within this sector can help build and manage government database, synchronise multiple agencies networks amongst others. They are also well equipped for advanced ICT trainings and development programmes.</p>
	Manufacturing		<p>Our survey found that medium manufacturing firms are mostly involved in the production and design of clothes, pharmaceuticals, chemical manufacturing and other consumer products</p> <p>This class is suitable for the production of government uniforms &amp; boots, furniture etc. at the Federal level.</p>
	Trade		<p>Our survey results indicate that the medium traders are largely registered companies with locations across multiple states in Nigeria.</p> <p>These companies have an employee base of around 60 to about 120 staff and can supply government procurement between N10 million and N100 million</p>
	Services		<p>Our survey result shows that majority of enterprises within this sector are registered. Services provided includes legal, electrical, consulting and management advisory, estate valuation services etc.</p> <p>We recommend that related procurement opportunities worth between N10 million and N25 million should be targeted at these enterprises.</p>

The capacity of Medium enterprises to compete for large scale procurement opportunities, particularly at the top strata of the category spectrum, presents challenges in stipulating a contract value parameter. The size of the procurement opportunity at this level could have an unintended adverse effect, given that establishing a restricting tendering value parameter for Medium enterprises could result in crowding out large enterprises, who are also large employers and large source of tax revenue. Consequently, we do not recommend any value parameters or exclusive procurement range for medium enterprises. A focused market analysis should be conducted to determine the broader market implications of a captive public procurement market for Medium enterprises.

## Appendices

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## Annex 1

### Project Background

Micro, Small and Medium Enterprises (MSMEs) play a vital role in the economic development of countries in a number of ways including: increased competition, fostered innovation, employment generation and serving as an important source of goods and services.

Recognizing the crucial role MSMEs play in the development of any economy through the provision of goods & services for local use and global export as well as the employment of human capital, the Federal Government is looking to enhance the participation of this vital business segment in its local value chain and consequently drive global market competitiveness.

In order to achieve the above, the government seeks to understand how to better impact MSMEs through Federal Government procurement opportunities in line with the Local Content Policy. This project seeks to align government procurement and MSME classification (or re-classification) as a driving agent for improved employment and economic growth.

The table below illustrates the share of MSMEs participation in public procurement by country indicating that active MSME involvement in government procurement opportunities is a catalyst for economic growth and industrialisation, given that most countries profiled are first and second world economies.

Country	SME Percentage share of government procurement	Total Procurement \$b	GDP \$b
Austria	48%	57	417
Belgium	48%	70	493
Brazil	39%	n/a	2,056
Denmark	59%	46	325
France	51%	377	2,583
Germany	35%	553	3,677
Italy	65%	200	1,935
Spain	78%	137	1,311
Sweden	35%	86	538
United Kingdom	44%	359	2,622
United States	31%	n/a	19,390
Mexico	64%	n/a	1,150
Netherlands	15%	166.7	826
Poland	45%	63.9	525

Source: Business Environment Working Group, OECD

The study seeks to provide an understanding of the following:

- The market segments in which MSMEs currently operate;
- An assessment of constraints to MSME growth potential and access to support services;
- The nature of government procurement and identification of some MSME interventions/programmes and their impact on MSMEs;
- Identification of the current MSME policy and procurement opportunities available to the MSMEs;
- Identification of MSMEs suitable for participation in government procurement;
- Specific recommendations for possible re-classification of MSMEs;
- Review of best practice across similar developing nations.

## Our methodology

We conducted both primary and secondary research as an input to the MSME reclassification report. For the primary research, we defined a sample size of 1,017 respondents spread across 8 states of Nigeria which was pre-agreed with PDF II.

Respondents include micro, small and medium enterprises, as well as institutions involved in MSME capacity development such as the BPP, SMEDAN, CBN and BOI.

Our data and information was gathered from the above identified respondents through:

- Interviews;
- Survey questionnaires; and
- Secondary research

The table below shows the selected locations and respondent size for our survey:

Geo-Political Zones	States	Basis of selection	Respondent size
South West	Lagos	Lagos was selected based on its economic importance in Nigeria and the concentration of MSME activities in the state.	145
	Oyo	Oyo was selected to represent the views of MSMEs activities in a pure administrative environment in South West Nigeria.	122
South East	Anambra	Anambra was selected based on the predominance of trade and small manufacturing activities.	124
South South	Rivers	Rivers is an oil rich state with numerous MSME activities especially supporting the oil and gas sector.	149
North Central	Kwara	Kwara was selected based on the large concentration of small and medium enterprises especially manufacturing companies.	134
	Abuja	Abuja was selected to provide views of MSMEs that operate in a public sector focus.	124
North West	Kano	Kano was selected based on the large number of entrepreneurs in the North West.	120
North East	Bauchi	Bauchi was selected to represent MSMEs in a relatively peaceful state in the North East.	99
Total			1,017

## **Sampling strategy and method**

We have used a combination of the stratified sampling and the simple random sampling methods. Under the stratified sampling method, we segregated the Nigerian MSMEs into six different subgroups or sectors which was based on our studies of the Nigerian MSMEs sectoral analysis. In the six subgroups identified from the stratified random sampling, we then applied the simple random sampling method to select our respondents from the subgroups.

A simple random sampling method is a sampling method in which the entire population in the sample has an equal chance of being selected for the survey.

Based on a population of 37m MSMEs in Nigeria and using a 5% margin of error and 95% confidence level, a representative sample size of 1,040 was selected. Based on our sample size, and the analysis of the responses of the respondents we have being able to draw up inferences and conclusions which formed the basis of this report. We have used both the primary and secondary research methods to obtain information from the respondents.

## **Survey and interview objectives**

The main objectives of the survey and interviews include:

1. Determination of the level of awareness of government procurement opportunities among MSMEs.
2. Understand the level of MSME participation in government procurement and ascertain whether certain MSME categories are disproportionately advantaged or disadvantaged in government procurement selection.
3. Ascertain the key challenges facing MSMEs in Nigeria; which preclude them from participating in government procurement opportunities.
4. Determine the major government policies that affect MSMEs and explore how these policies aid or hinder MSME participation in government procurement.
5. Determine the impact of existing MSME intervention funds developed to support MSMEs.
6. Determine the Impact of other government policies on MSMEs operations.
7. Propose a reclassification recommendation for MSMEs to enhance participation in procurement opportunities.

## **Survey sample size**

The questionnaires were administered to 1,017 respondents in seven states of the six geopolitical zones of Nigeria that are operating in the following sectors:

- Agriculture
- Construction and allied services
- Information and communication technology
- Manufacturing
- Trade
- Services

## Survey administration

Our goal was to ensure that the respondents of our survey are MSMEs operating in Nigeria. To ensure the randomness of the survey, we considered the following:

- **Diversity:** To identify our respondents, we started with two primary information sources:
  - The NACCIMA listing of registered companies, which provides a database for commercial entities within each state
  - Membership listing from various trade networks in our sectors of interest such as the Manufacturing Association of Nigeria, National Association of Nigerian Traders and other local trade unions.

Working with the above, we developed a sampling framework to randomly select businesses with at least one employee.

- **Economic sectors:** The selected sample included MSMEs across various industries from retail trade and supplies, construction and allied services, manufacturing, hotels, conferences and events services, transportation/logistics etc. across the six geopolitical zones.

## Data processing and analysis

Data collation, processing and analysis was completed in Lagos, following the successful completion of the nationwide interviews and data gathering exercises. The process involved data collection, data cleaning, data processing/analysis, data interpretation (report writing and review)

Data processing was conducted through the use of Microsoft Excel to develop charts and tables for analysis. The results of the processed data are communicated using Microsoft Word in this report.



## Annex 2

### Characteristics and performance of MSMEs

In Nigeria, MSME operations cut across almost all sectors of the economy and sustain a sizable number of households. MSMEs account for more than 90% of all registered businesses in Nigeria, 84% of jobs and contribute c.50% to the GDP of Nigeria<sup>21</sup>. Surveys suggest that MSMEs are active in agriculture, wholesale and retail trade, information and communication services, and manufacturing sectors amongst others.

Although a large portion of the micro and small enterprises are informal, they account for majority of new jobs created. According to the SMEDAN, about 58 million jobs are provided by MSMEs. This is largely driven by the increasing entrepreneurial drive of the Nigerian youths due to the unemployment level in the country and the recent economic recession which resulted in an increased demand for local products, in a bid to diversify the heavily oil-reliant economy.

Based on our survey sample of 1,017 respondents, we have summarized the results and analysis of the primary research conducted on Nigerian MSMEs by;

- Category (Micro, Small and Medium businesses)
- Sector (Agriculture, Construction, ICT, Manufacturing, Trade and Services)
- Location (South West, South East, South South, North Central, North West and North East)

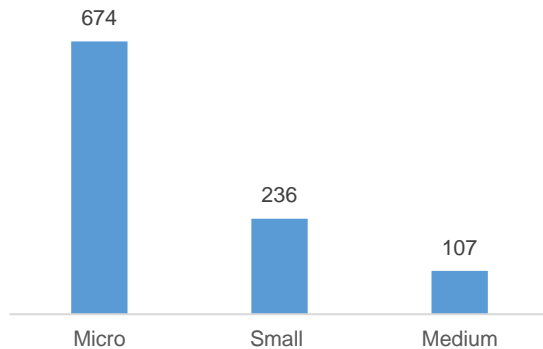
Our findings are shown on the next page.

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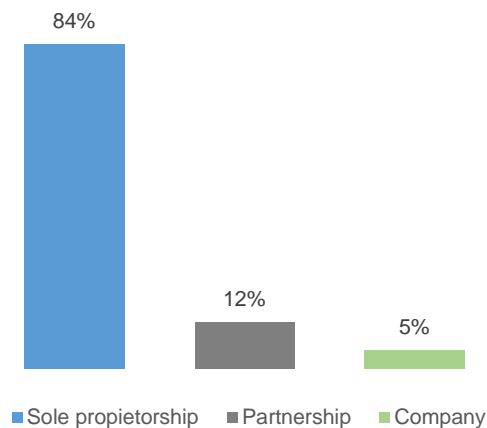
<sup>4</sup> PEBEC Annual Report 2018

## MSME by category

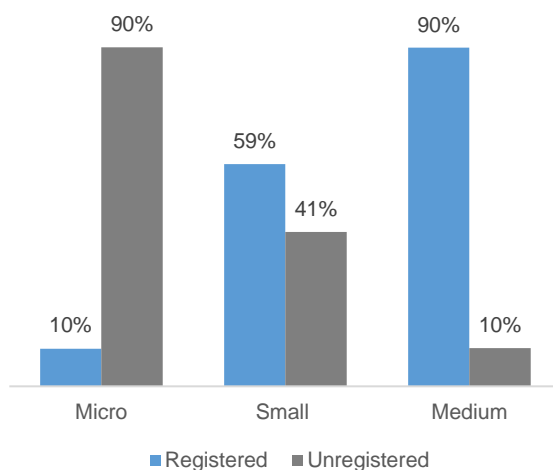
### Respondents



### Ownership structure



### MSME Registration



Our survey covered 1,017 micro, small and medium enterprises in 8 states across the six geopolitical regions of Nigeria.

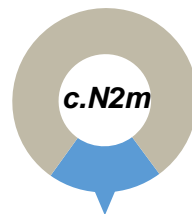
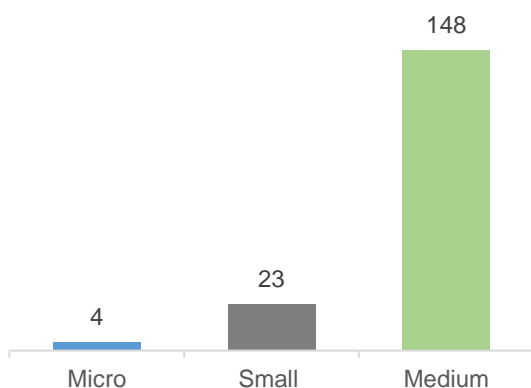
About 84% of the MSMEs surveyed were owned and controlled by a sole proprietor. This was particularly due to respondents' fear of dilution in ownership and control of the enterprise. Many micro business owners also cited a lack of trust as the reason for their ownership structure

There is a larger representation of partnership and limited liability company models within small and medium enterprises due to increased amount of capital required to operate at such sizes.

Based on our survey, micro enterprises account for the largest number of unregistered MSMEs with c.90%, indicating that they were not registered with the CAC. Respondents cited reasons such as a perceived lack of value and a generally negative perception of the registration process as major reasons for operating informally. Some respondent also cited that their businesses were relatively new as reason for not being registered.

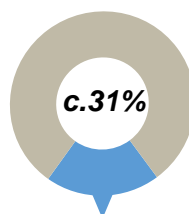
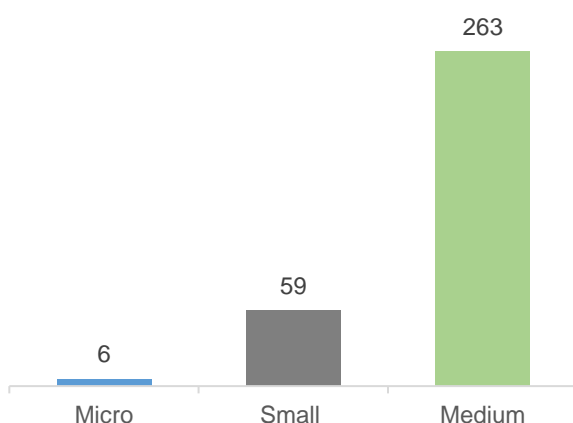
On the other hand 56% of Small & 90% of medium enterprises are registered Again MSMEs generally perceive the need to register with the CAC as their businesses expand and grows as against registering from the onset.

## Staff strength



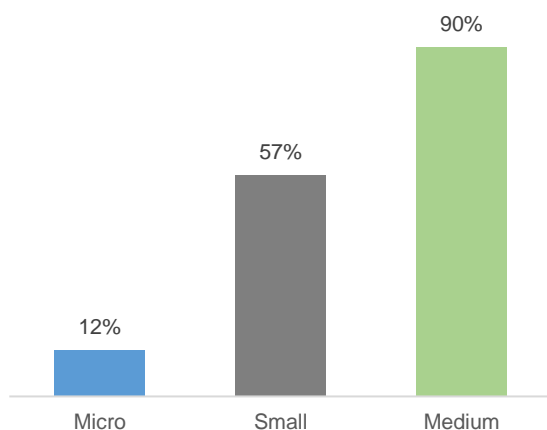
*An average MSME employee generates N2million annually*

## Average turnover (N'm)



*Only 31% of MSMEs surveyed kept annual financial records*

## Financial record

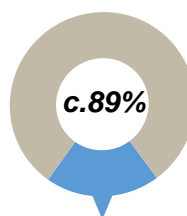
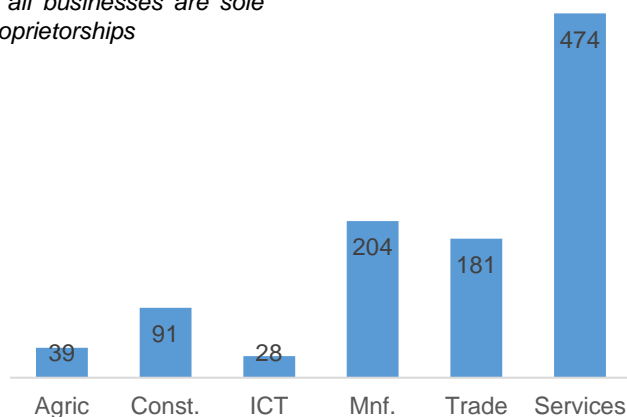


Only 31% of all MSME surveyed kept formal financial records. While 90% of medium enterprises prepared annual financial statements, only 12% of micro business kept formal financial records.

Due to the informal nature of its operations, micro respondents did not perceive value in maintaining formal records focusing majorly on tracking its revenue daily or monthly. On the other hand, Medium enterprises acknowledged the need to maintain records in order to track growth, attract financial investors and access loans and grants.

## MSMEs by sector

of all businesses are sole proprietorships



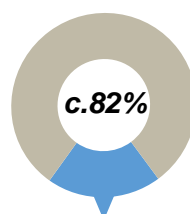
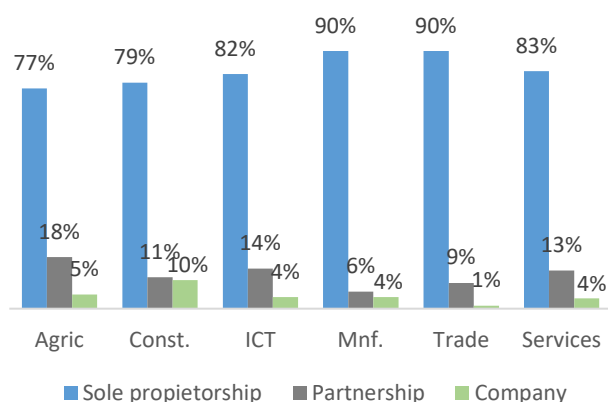
Respondents were categorized into the six sectors based on their core business operation.

47% of the respondents were service providers, 18% traders and 20% were engaged in some form of manufacturing.

Sole proprietorship is the most prevalent ownership structure for MSMEs across all sectors of the Nigerian economy.

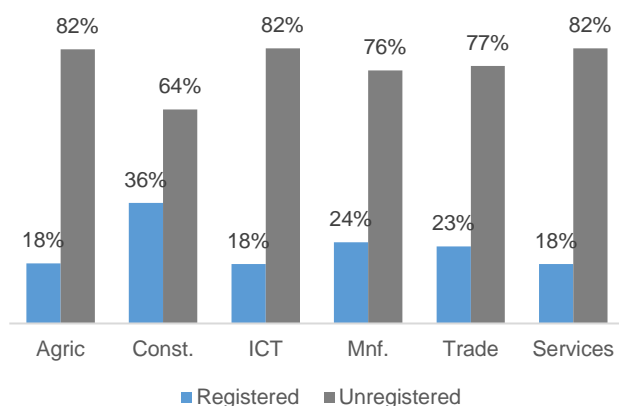
Partnership is common within the Agriculture, ICT and services sectors due to an increasing need to pool resources.

## Ownership structure



of agricultural businesses are unregistered

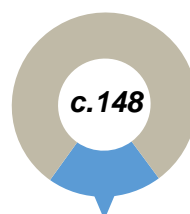
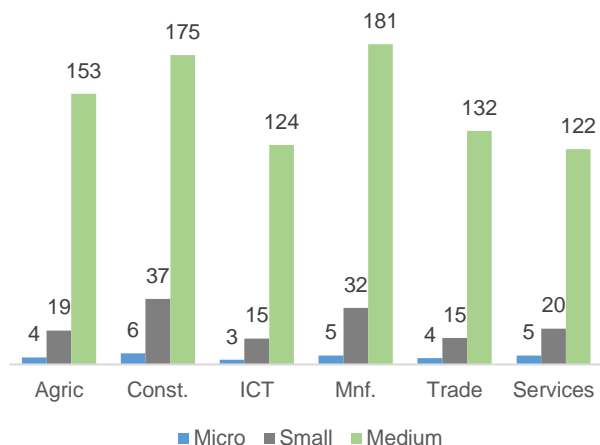
## Registration status



The agricultural sector had the highest level of informal business with 82% of MSMEs in this sector currently unregistered with the CAC.

The Construction sector reported the highest level of regulatory compliance as 36% of MSMEs were registered within the sector.

## Employment



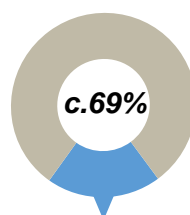
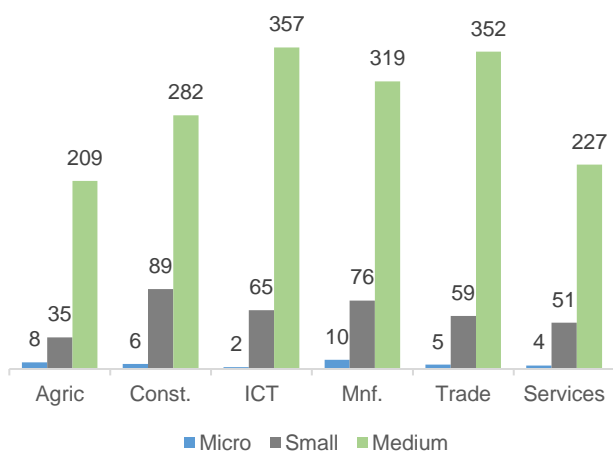
people are employed by a typical medium construction enterprise.

The sectoral analysis of the MSMEs employment data indicates that medium enterprises in the manufacturing and construction sectors have the largest number of employees due to the availability of casual workers.

The manufacturing, construction and ICT sector lead all other sectors in annual turnover at the micro, small and medium enterprise levels respectively with annual averages of N10 million, N89 million and N357 million.

Agriculture and Manufacturing micro businesses generated the highest revenue per employee at the micro level with N2.1 million while the average ICT small enterprise generated about N4.3 million per employee and the medium Service provider generated about N1.8 million per employee

## Average turnover (N'm)

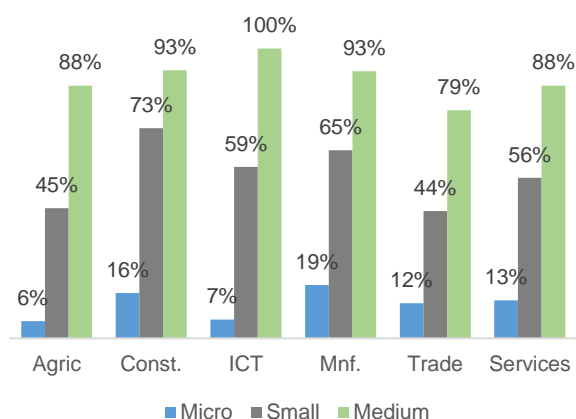


of all surveyed MSMEs failed to keep formal records

Significant number of MSMEs in the agricultural sector failed to keep formal financial records.

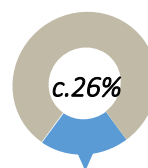
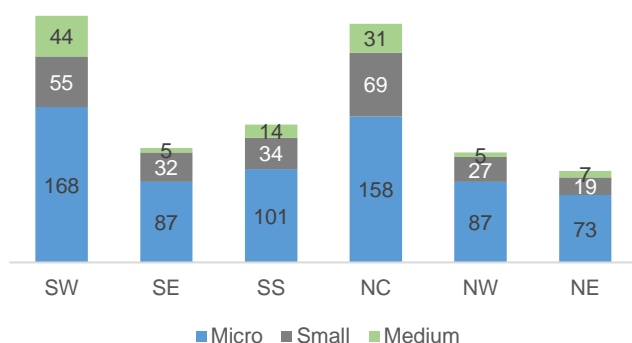
Respondents within the highly formal sectors like Construction and Manufacturing formally recorded financial transactions and prepared annual statements

## Financial records



## MSMEs by Geopolitical zones

### Respondents

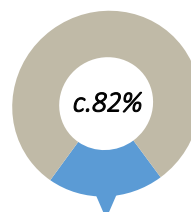
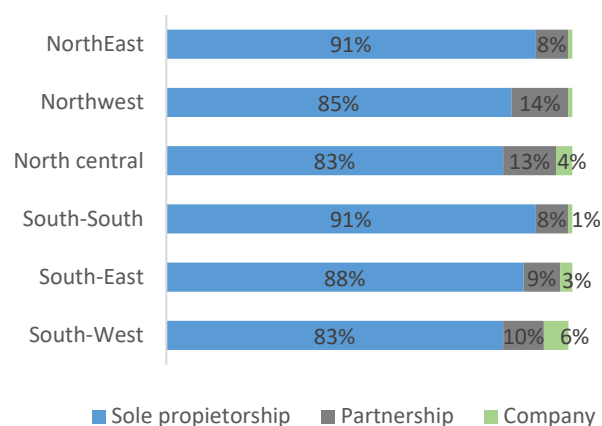


of all businesses surveyed were located in the South West

Our survey across the six geopolitical zones covered 8 states. The South West and North central regions had additional state representation in addition to Lagos and FCT which are regarded as the commercial and official capital states of Nigeria.

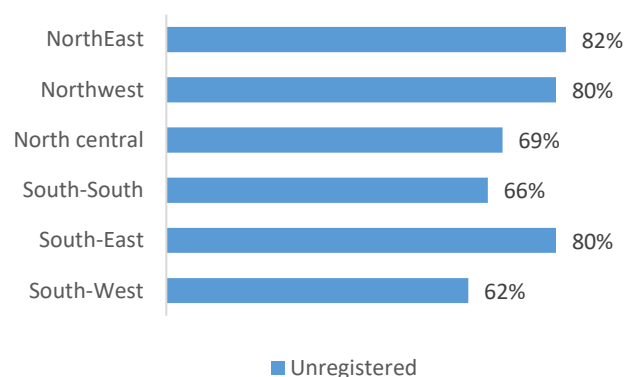
83% of all surveyed MSMEs were owned and controlled by a sole proprietor. Partnerships are more popular in the South-West and South-South region of the country while the North East had no MSME registered as a limited liability company.

### Ownership structure

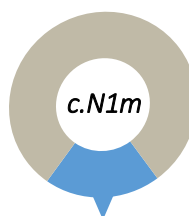
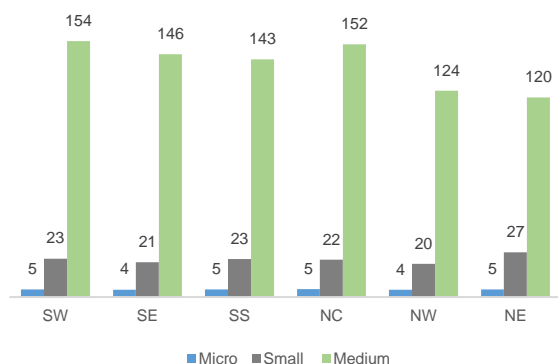


82% of respondents in the North East had unregistered businesses, while the South West had reported just over 62% of MSMEs unregistered. The relatively higher business registration levels in the South West is due to the concentration of CAC offices and publications, as well as the relatively higher literacy level in the region.

### Registration Compliance (% Unregistered MSMEs)



## Employees ('People)



The average Medium enterprise in the North Central makes c.N1m per employee

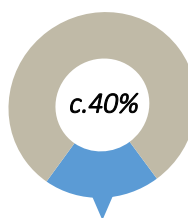
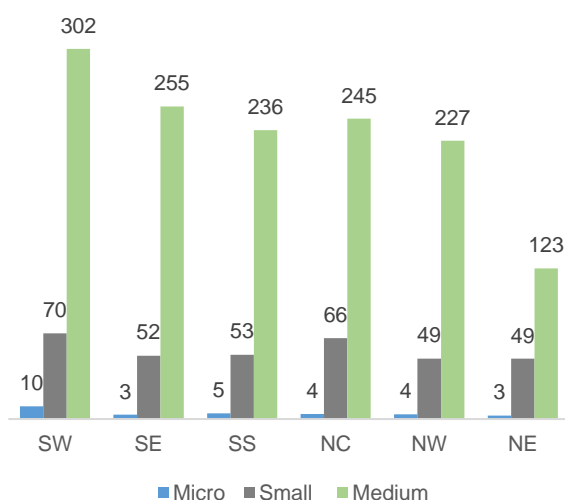
Medium enterprises in the South West employ the highest average number of staff at 154 people while Micro enterprises in the North central region tend to employ more people with an average of 5 employees.

Small businesses in the South eastern part of the country employ about 27 people.

MSMEs in the South West generate the highest revenue with an average of N10 million, N70 million and N302 million for micro, small and medium respectively.

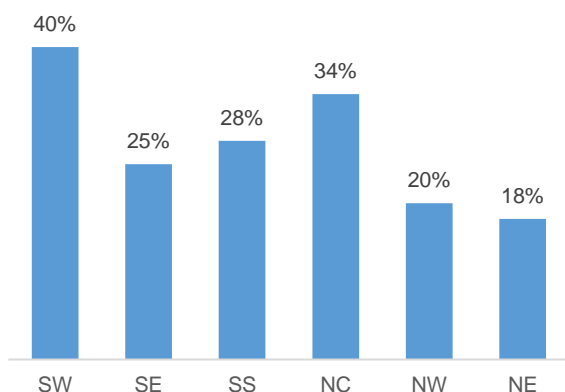
On the other hand, the North East region is the least productive state with respondents generating an average revenue of about N3 million, N49 million and N123 million for micro, small and medium businesses respectively. We believe this is due to the general unrest and safety concerns in the region.

## Turnover (N'm)



Of MSMEs in the South West keep financial records

## Financial records



Record keeping was predominantly high in the South West of Nigeria 40% of the respondents keeping annual financial records and statements.

Relatively lower literacy level meant that North East enterprises had the lowest level of financial recording across all the geopolitical zones

## Annex 3

Government ministries and agencies have collaborated with financial institutions to disburse funds encouraging MSME development including:

Name	Agricultural Credit Guarantee Scheme Fund (ACGSF)
<b>Fund size</b>	<ul style="list-style-type: none"> <li>• N3billion</li> </ul>
<b>Date of fund inception</b>	<ul style="list-style-type: none"> <li>• 1978</li> </ul>
<b>Interest rate</b>	<ul style="list-style-type: none"> <li>• Varies per project</li> </ul>
<b>Target market</b>	<ul style="list-style-type: none"> <li>• Livestock and Crop producers</li> </ul>
<b>Fund objectives</b>	<ul style="list-style-type: none"> <li>• The purpose of the fund is to provide guarantee for loans granted for agricultural purposes.</li> </ul>
<b>Description</b>	<ul style="list-style-type: none"> <li>• The ACGSF was established in June 1988.</li> <li>• Initially, the fund size was ₦100m, contributed by the Federal Government (60%) and the Central Bank of Nigeria (40%).</li> <li>• The fund was subsequently increased to ₦3bn in March 2001.</li> </ul>
<b>Strengths</b>	<ul style="list-style-type: none"> <li>• The fund required no tangible collateral for loans below ₦20,000.</li> <li>• The rural communities were the major target of the funds indicating an inclusive industrialisation plan.</li> <li>• The CBN provides quarterly updates on the disbursements of the ACGSF.</li> </ul>
<b>Weaknesses</b>	<ul style="list-style-type: none"> <li>• The fund has been running since 1978 and so far, has been unsuccessful in reviving the agricultural sector.</li> <li>• Two Banks (First Bank of Nigeria Limited and Union Bank of Nigeria Plc.) are the major participating financial institutions in the scheme. The withdrawal of either one could negatively impact the entire scheme</li> </ul>

Source: CBN, Augusto & Co research



Name	Small and Medium Enterprises Equity Investment Scheme (SMEEIS)
<b>Fund size</b>	The scheme requires all banks in Nigeria to set aside 10% of their profit after tax (PAT) for investment and promotion of small and medium enterprises.
<b>Date of fund inception</b>	1999
<b>Interest rate</b>	Maximum of 9%
<b>Target market</b>	<p>All legal businesses are covered with the exception of:</p> <ul style="list-style-type: none"> <li>• Trading/merchandise</li> <li>• Financial services</li> </ul>
<b>Fund objectives</b>	The fund aims to increase the banking sector's contribution to Federal Government efforts to stimulate growth, develop local technology and generate employment.
<b>Description</b>	<ul style="list-style-type: none"> <li>• Funds were provided in the form of loans, equity investments or both.</li> <li>• After the first five years of the scheme, banks contribution may reduce to 5%.</li> <li>• In 2009, the scheme became optional to banks.</li> </ul>
<b>Strengths</b>	<ul style="list-style-type: none"> <li>• Offers large institutional backing therefore increasing the MSME's chances of success.</li> <li>• Funding varies from asset financing to working capital financing.</li> <li>• Equity investments do not require interest repayments.</li> </ul>
<b>Weaknesses</b>	<ul style="list-style-type: none"> <li>• The programme became optional in 2009 and as such the level of participation has subsequently reduced.</li> <li>• Owing to gaps in the definition of MSMEs, deposit money banks were able to reclassify established large corporates as SMEs to qualify for the SMEEIS loans. This led to the overcrowding of the genuine MSMEs from the SMEEIS scheme thus constricting the impact of the scheme on small businesses.</li> <li>• Several small businesses were not able to benefit from the SMEEIS scheme owing to the high interest rates of bank credit.</li> </ul>

Source: CBN, Agosto & Co research

Name	CBN's N200 billion Refinancing and Rediscounting Scheme (RRF)
<b>Fund size</b>	N200 billion
<b>Date of fund inception</b>	2002
<b>Interest rate</b>	Eligible projects have a concessionary rate of 2% below minimum rediscounting rate (MRR).
<b>Target market</b>	<ul style="list-style-type: none"> <li>▪ Agricultural production</li> <li>▪ Manufacturing</li> <li>▪ Semi manufacturing</li> <li>▪ Exploration and exploitation of solid minerals</li> <li>▪ Information Technology (IT)</li> </ul>
<b>Fund objectives</b>	<ul style="list-style-type: none"> <li>• To encourage medium and long term lending in order to expand and diversify the country's production base.</li> <li>• To change the trend where short-term credits to general commerce and trade dominate domestic lending.</li> <li>• To encourage medium and long term loans to the real sector for growth and development.</li> </ul>
<b>Description</b>	<ul style="list-style-type: none"> <li>• In 2002, the CBN introduced RRF, a N200bn scheme to encourage banks to advance medium to long term loans to the agriculture and manufacturing sectors.</li> <li>• The RRF was discontinued in December 2014.</li> </ul>
<b>Maximum tenor</b>	<ul style="list-style-type: none"> <li>• Eligible projects have a tenor of five years and over.</li> </ul>
<b>Strengths</b>	<ul style="list-style-type: none"> <li>• The RRF scheme opened a window for MSMEs which were being restricted by high interest rates on existing credit to refinance their borrowings.</li> <li>• This refinancing window created new opportunities to use the extra cash flow to fund expansion plans.</li> </ul>
<b>Weaknesses</b>	<ul style="list-style-type: none"> <li>• The bank bears all the credit risk, significantly reducing the chances of bank participation.</li> <li>• It was a refinancing scheme and did not accommodate credit requests for green field opportunities and plans.</li> </ul>

Source: CBN, Augusto & Co research

<b>Name</b>	<b>Agricultural Credit Support Scheme (ACSS)</b>
<b>Fund size</b>	N50 billion
<b>Date of fund inception</b>	2006
<b>Interest rate</b>	14% interest rate (6% rebate after pay back of facilities on schedule)
<b>Target market</b>	<ul style="list-style-type: none"> <li>▪ Farmers and agro-allied entrepreneurs</li> </ul>
<b>Fund objectives</b>	<ul style="list-style-type: none"> <li>• Extend credit facilities to the agricultural sector at single digit interest rate.</li> <li>• Reduce the cost of agricultural production and increase output.</li> </ul>
<b>Description</b>	<ul style="list-style-type: none"> <li>• The Federal Government and the Central Bank of Nigeria, with support from the Bankers' Committee established the ACSS in April 2006.</li> <li>• The purpose of the fund is to lend to farmers at single digit interest rates.</li> <li>• The fund is managed by a Central Implementation Committee (CIC), which has members of key government ministries including the Federal Ministry of Finance, Federal Ministry of Agriculture and the Federal Ministry of Commerce.</li> </ul>
<b>Strengths</b>	<ul style="list-style-type: none"> <li>• The fund encourages timely payback through the interest rate rebate.</li> <li>• The fund allows for substitutes to collateral securities for short-term loans.</li> </ul>
<b>Weaknesses</b>	<ul style="list-style-type: none"> <li>• The interest rate at 14% defeats the objective of single digit interest rate as the rebate is only available after the business has shown an ability to make timely repayments.</li> <li>• Established and large agro-allied businesses have crowded out MSMEs from the ACSS as deposit money banks seek to minimise exposures to agriculture.</li> <li>• The high risk ratings and perception of the agricultural sector implies that banks will continue to seek ways of crowding out small hold farmers and other names in the agricultural space perceived as high risk.</li> </ul>

Source: CBN, Agosto & Co research

<b>Name</b>	<b>CBN's N235 billion Small and Medium Enterprises Credit Guarantee Scheme (SMECGS)</b>
<b>Fund size</b>	N235 billion
<b>Date of fund inception</b>	April 2010
<b>Interest rate</b>	The fund is administered at the prime lending rate of the participating bank.
<b>Target market</b>	<ul style="list-style-type: none"> <li>▪ Manufacturing</li> <li>▪ Agricultural value chain</li> <li>▪ Educational institutions</li> </ul>
<b>Fund objectives</b>	<ul style="list-style-type: none"> <li>• Accelerating the development of the SME manufacturing segment by providing credit guarantee from banks to SMEs and manufacturers.</li> <li>• Increasing output, generating employment, diversifying the revenue base increasing forex earnings and providing sustainable inputs for the industrial segment.</li> <li>• Increasing access to credit to SMEs and manufacturers.</li> </ul>
<b>Description</b>	<ul style="list-style-type: none"> <li>• In 2010, the Central Bank of Nigeria (CBN) sponsored SMECGS, a N235 billion funding scheme with the aim of promoting SME access to credit.</li> </ul>
<b>Strengths</b>	<ul style="list-style-type: none"> <li>• The SMECGS gives small businesses a unique long term funding opportunity given that MSMEs are largely considered as a high risk segment which ordinarily would not qualify for long term lending.</li> <li>• The two-year moratorium gives beneficiaries time to sufficiently invest cash flows ahead of repayment.</li> </ul>
<b>Weaknesses</b>	<ul style="list-style-type: none"> <li>• In comparison to other funds, the interest rate on the SMECGS can be considered high because the SMECGS is administered at the prime lending rate of the participating bank.</li> <li>• Despite the altruistic features of the SMECGS, product knowledge is quite weak. Our survey indicates that only 9% of MSME respondents had knowledge of the SMECGS.</li> <li>• The CBN records low stakeholder buy-in to the SMECGS scheme suggesting a nadir by borrowers.</li> </ul>

Source: CBN, Augusto & Co research

Name	CBN's N220 billion Micro, Small and Medium Enterprise Development Fund (MSMEDF)
Fund size	N220 billion
Date of fund inception	April 2013
Interest rate	9% per annum (all charges inclusive)
Target market	<p>Microenterprises:</p> <ul style="list-style-type: none"> <li>▪ Agricultural value chain activities</li> <li>▪ Cottage industries</li> <li>▪ Artisans</li> <li>▪ Services to hotels, schools, restaurants, laundry, etc.</li> <li>▪ Trade and general commerce</li> </ul> <p>Small and medium enterprises</p> <ul style="list-style-type: none"> <li>▪ Manufacturing</li> <li>▪ Agricultural value chain activities</li> <li>▪ Educational institutions</li> <li>▪ Renewable energy/energy efficient product and technologies</li> </ul>
Fund objectives	<ul style="list-style-type: none"> <li>• Providing better access to financial services</li> <li>• Increasing productivity and output of microenterprises</li> <li>• Achieving a higher rate of employment in Nigeria</li> <li>• Enhancing female inclusion in MSME growth</li> </ul>
Description	<ul style="list-style-type: none"> <li>• In 2013, the Central Bank of Nigeria launched a N220 billion fund- MSMEDF –to assist wholesale funding of microfinance institutions.</li> <li>• The fund aims to increase women's access to finance by about 15% annually to address gender disparity in entrepreneurship. Therefore, 60% of the fund is reserved for women.</li> <li>• Two per cent of the fund is also aimed at people with disabilities (excluding mental illness).</li> <li>• In 2014, the Lagos State Chamber of Commerce and Industry (LCCI) applied for the loan and was able to access and disburse N70bn within a space of three months.</li> </ul>
Strengths	<ul style="list-style-type: none"> <li>• The fund is not limited to the agricultural sector but extends to companies in trade and services.</li> </ul>
Weaknesses	<ul style="list-style-type: none"> <li>• Banks bear as much as 75%* of the risk which resulted in high interest rates</li> </ul>

Source: CBN, Agosto & Co research

Name	Real Sector Support Facility (RSSF)
<b>Fund size</b>	N300 billion
<b>Date of fund inception</b>	2014
<b>Interest rate</b>	9%
<b>Target market</b>	<ul style="list-style-type: none"> <li>• Manufacturing <ul style="list-style-type: none"> <li>▪ Producing and processing of tangible goods</li> <li>▪ Fabricating, deploying plants, machinery or equipment to deliver goods or providing infrastructure to facilitate economic activity in the real sector</li> </ul> </li> <li>• Agriculture</li> <li>• Services</li> </ul>
<b>Fund objectives</b>	<ul style="list-style-type: none"> <li>• To fast-track the development of SMEs in the manufacturing, agricultural value chain and services sub-sectors.</li> <li>• Small and Medium Scale Enterprise (SMEs) are defined as entities with an asset base (excluding land) of between N5 million and N500 million and with a labour force between 11 and 300.</li> <li>• Increase production, generate employment, diversify the revenue base, increase foreign exchange income and provide input for the industrial sector on a sustainable basis.</li> </ul>
<b>Description</b>	<ul style="list-style-type: none"> <li>• The CBN introduced the RSSF to unlock the potential of the real sector.</li> <li>• The fund is aimed at start-ups and expansion projects in the manufacturing, agriculture and services sectors.</li> <li>• The CBN and the deposit money banks share the 9% interest rate in the ratio of 3:6.</li> </ul>
<b>Strengths</b>	<ul style="list-style-type: none"> <li>• The RSSF provides long term lending to key sectors where MSMEs operate.</li> </ul>
<b>Weaknesses</b>	<ul style="list-style-type: none"> <li>• None recognised.</li> </ul>

Source: CBN, Agosto & Co research

Name	Lagos State Employment Trust Fund
Fund size	N25 billion
Date of fund inception	2016
Interest rate	5%
Target market	Lagos state
Fund objectives	<ul style="list-style-type: none"> <li>• LSETF was set up with a focus to promote entrepreneurship by improving access to finance, strengthening the institutional capacity of MSMEs and formulating policies designed to improve the business environment in Lagos State.</li> <li>• The scheme provides up to N250,000 start-up finance for micro enterprises while providing growth and expansion loans of up to N500,000 for micro enterprise owners</li> <li>• Small and Medium enterprises could access loans of up to N2.5million</li> </ul>
Description	<ul style="list-style-type: none"> <li>• The Lagos State Employment Trust Fund (LSETF) was established by The Lagos State Employment Trust Fund Law 2016 to provide financial support to residents of Lagos State, for job, wealth creation and to tackle unemployment.</li> </ul>
Strengths	<ul style="list-style-type: none"> <li>• While the LSETF is controlled by the Lagos state government, the scheme partners with private sector financiers like Primera Credit, Vineland micro-finance bank, FCMB, Sterling Bank, Stanbic IBTC amongst others.</li> <li>• The scheme also recognises the need for trainings and development of MSME owners and has technical training partners such as PwC, WFO Rödl &amp; Partner, Enterprise Lab Consulting, BDS consult, UNILAG Consult etc.</li> <li>• The scheme maintains an updated database of beneficiaries for monitoring &amp; evaluation and other consultancy purposes.</li> </ul>
Weaknesses	<ul style="list-style-type: none"> <li>• None recognised.</li> </ul>

Source: Lagos State Employment Trust Fund

## Annex 4

### MSME and Private sector procurement

While public procurement focuses on adding social value to the supply chain within an economy, private procurement has a centralized focus on efficiently driving company revenue. Private companies procure in an effort to increase shareholder returns. There is a larger pressure on procurement professionals in the private sector to procure with a financially driven mindset aimed at increasing margins, driving profitability and enhancing competitiveness.

Unlike public sector procurement which requires a bureaucratic process and a lot of regulation, private sector procurement in Nigeria typically operates in a less regulated and more efficient manner.

From our survey, large private companies typically require the following from potential vendors and contractors:

- **Registration with CAC:** Large companies typically ensure that transactions are conducted formally and as such would only do business with a registered company. This is also guided by the large companies' need to be tax compliant, as dealing with unregistered companies would result in untraceable withholding tax liabilities.
- **Registration with the company:** In building its database of contractors, large companies require that vendors be registered with them. The registration requirement varies per company ranging from product and service quality checks to anti-bribery and corruption compliance. They however do not typically require financial payments.
- **Capability check:** Some large companies require a "proof of concept/content" before enlisting a MSME as a list of potential suppliers. A "proof of concept/content" is a pro-bono service/good provided by the MSME to a larger company as evidence of its capability to meet the requirements of the large company.

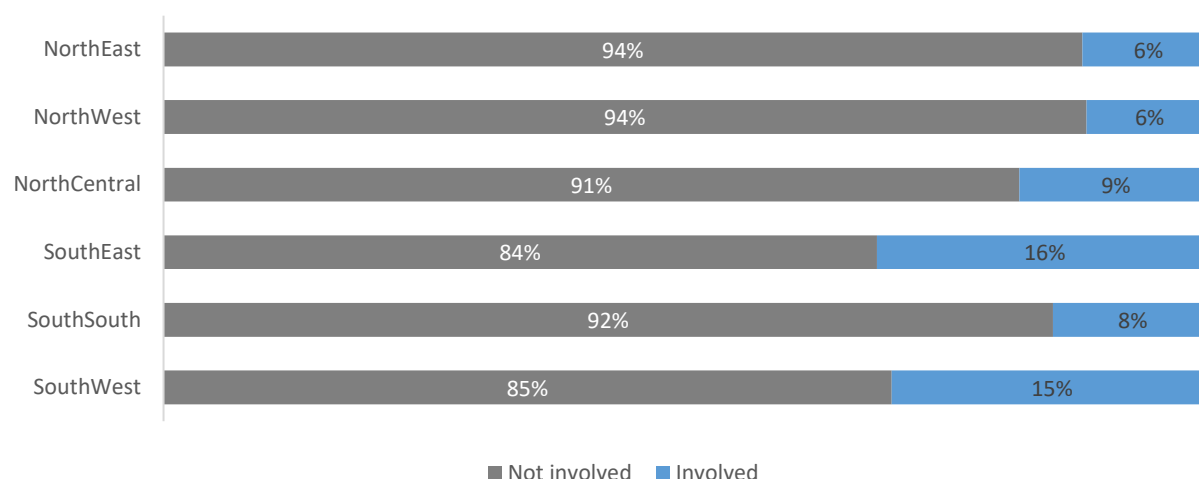
### How the supply chain works

Many private sector tenders are issued as part of the supply chain for larger projects. Opportunities for projects will be advertised by large private sector companies that require additional or specialist support or input typical scenario might involve a large private sector company or companies winning a large public-sector contract, but cannot themselves provide every aspect of the goods, works and services required. The private sector company therefore seeks subcontractors, and in doing so becomes a buyer for a private sector tendering opportunity. Sometimes the subcontractors then need further to subcontract for aspects of the contracts they have won thereby creating another supply chain.

Alternatively, a large private sector company might seek alternative cost options for its raw material input or other overheads resulting in a request for proposals from potential suppliers of such goods and services.



## Respondents' response to participation in private sector procurement



Source: Decision Support Consulting

## Incorporating MSMEs in Private sector procurement

Due to the flexible nature of MSMEs, decision making is faster, which is a critical success factor in working with large companies. However, several other factors will lead to MSME inclusion within the value chain of larger organisations.

- 1. Capacity building and development:** Private sector procurement requires goods and services of the highest quality at the lowest realistic price in order to meet their profitability objectives. MSMEs currently require regular technical training and skill development programmes in order to produce/deliver competitive goods and services that meet the standard required by large companies.
- 2. Fostering collaboration:** Owing to the current infrastructural deficit in Nigeria, MSMEs expend a lot on overhead expenses such as fuel cost, delivery charges, and communication costs which limits their competitiveness and growth potential. Development of collaborative networks such as industrial centres, and economic zones for clusters could help bring cost saving mechanisms and channels for MSMEs.
- 3. Establishing relationships:** In order to help connect MSMEs and large companies, SMEDAN could organise stakeholder programmes and meetings that help connect registered MSMEs with large companies who require their input either as a teaming agreement, sub-contracting larger contracts or direct supplier agreements.
- 4. Long term contracting:** Upon securing a procurement opportunity, MSMEs should seek to formalise a long-term business operation by contracting such large company, rather than approaching such opportunities as one-off transactions. SMEDAN could help provide required contractual dealing trainings and advisory services for MSMEs
- 5. Innovative service delivery:** Unlike the public sector, the private sector requires maximum value-for-money and ensures the monitoring and implementation of its procurement more efficiently. This would require MSMEs to continuously ensure they deliver goods and services of the highest quality with regular innovations as decline in quality might lead to loss of large companies as customers.

## Annex 5

Meeting and discussions with the Bureau of Public Procurement (BPP) on government procurement processes as a continuation of our studies on the **MSME Recategorisation and Enhanced Local Content Development and Implementation Strategy**

We had a meeting with the BPP on the 18<sup>th</sup> of October 2018 at the BPP's office, Presidential villa, CBD, Abuja. Our meeting commenced at about 1:27 pm and ended at about 2:33pm.

The attendees at the meeting include:

1. Mr. Aliyu – BPP (Director)
2. Mr. Adesina – BPP
3. Mr. Mansour – BPP
4. Chidiebere Chukwujindu – EY
5. Oreoluwa Porter - EY

The following is a list of discussion questions discussed between EY and BPP:

1. Kindly talk us through the typical government procurement process by stage

**BPP Response:**

The typical government procurement process is guided by the BPP act of 2007. The following steps indicate the typical procurement processes.

- 1) Starts with an expression of invitation to bid by the MDAs;
- 2) Submission of proposals by the contractors;
- 3) Evaluation and examination of submitted proposals by the MDAs;
- 4) Acceptance and award of contract by the MDAs to the successful contractor.

2. What products and services does the government buy?

**BPP Response:**

The government typical buys everything. The BPP categorises the government procurement into three areas. They include

- a) Goods such as office equipment, power equipment, food & beverage, fuel and lubricants etc.
- b) Consultancy and professional services such as sciences and investigations, town and regional planning, information technology, management services etc.
- c) Works such as oil and gas, power and utilities, solid minerals, telecommunications, buildings, civil works etc.

3. Are these government products classified by sector and/or sub-market? Please list the different sectors and/or sub-markets:

**BPP Response:**

Yes these products and services are classified by sectors. These sectors include the oil and gas, construction, telecommunication, and agricultural sectors etc.

4. How often do government MDAs make procurement?

**BPP Response:**

Government makes procurement based on needs and budgets. The timeline is not fixed and could range from daily to weekly, monthly or yearly depending on the type of goods/services.

5. What are the requirements for participating in a typical government procurement process?

**BPP Response:**

To participate in government procurement, the following is required:

- a) You need to be registered;
- b) You need to show evidence of tax compliance and payment; and
- c) You need to be captured within the government register for contractors.

6. Are some of these products/services produced/provided by MSMEs?

**BPP Response:**

- a) Yes, some of the products are provided by MSMEs.

7. Please provide a percentage estimate of MSME contribution to overall annual procurement:

**BPP Response:**

BPP does not have or keep statistics of government procurement carried out by MSMEs. However, they believe that the small and medium enterprises have a more significant participation rate in government procurement than micro enterprises.

8. For products/services not suited to MSMEs, why are they not suitable for MSME production?

**BPP Response:**

Only military procurement is not open to MSMEs and this is for national security purpose. All civilian procurement is open to the MSMEs.

9. [For those produced/provided by MSMEs] Which procurement opportunities are most suitable to the different categories of MSME?

**BPP Response:**

Procurement of works related products and services less than N100 million and procurement of provision of consultancy services and goods related services below N25 million are suitable to MSMEs

10. Are there any other possible reasons for low MSME participation in government procurement asides from size, track record & informal nature of business?

**BPP Response:**

Yes, and they include:

- a) Lack of networking among the MSMEs; and
- b) Lack of finance.

11. How do you think the government can drive MSMEs participation in government procurement?

**BPP Response:**

- a) MSMEs can be better incorporated into government procurement through the creation of a national policy that would require that government MDAs set aside certain items of procurement for MSMEs;
- b) Keeping a register of MSMEs at SMEDAN that can transact business with the government

12. Can unregistered micro and small enterprises be given a waiver of registration to a certain stage in the government procurement process?

**BPP Response:**

- a) Government would never transact business with any unregistered entity

13. Apart from registration of businesses and tax clearances, are there other conditions you consider in awarding government procurement contracts? (such as minimum number of employee, relevant experience & credentials, financial strength, net asset base etc. which may serve as a deterrent to MSMEs)

**BPP Response:**

Yes. Employee numbers, relevant experience, financial strength and asset types

14. In your past experience, does the government deal directly with individual MSMEs? Or are procurement opportunities passed through MSMEs trade unions?

**BPP Response:**

Government deals directly with individual MSMEs only.

15. Does the BPP have any gender based procurement rules?

**BPP Response:**

There are no gender based rules or programmes for social excluded persons

16. Do you require surety bonds or liability indemnity from MSMEs before awarding contracts to them?

**BPP Response:**

No, there are no requirements for surety bonds for MSMEs

17. Do you consider the location of MSMEs when considering their procurement bids?

**BPP Response:**

No location consideration is needed to get government procurement.

## Annex 6

Proposed assignment schedule and breakdown			
Task	Start date	End date	Status
Kick-off meeting <ul style="list-style-type: none"> <li>Project timelines</li> <li>Deliverables</li> </ul>	11 Sept	11 Sept	Completed
Work-plan, background analysis and current state assessment <ul style="list-style-type: none"> <li>Engagement planning meeting</li> <li>Initial desktop research on MSME classification</li> <li>Initial desktop research on nature of government's procurement (i.e. goods and services)</li> <li>Highlight the MSMEs contribution to Nigeria's economic growth and job creation</li> <li>Draft survey instrument for focus group sessions and interview</li> <li>Develop rationale for questionnaire</li> </ul>	12 Sept	21 Sept	Completed
Drafting of inception report	24 Sept	30 Sept	Completed
Conduct executive interviews with relevant stakeholders (BPP, FMIT, SMEDAN, CBN, Micro Finance & Commercial banks)	2 Oct	19 Oct	Completed
Data collection survey and interviews (1000 sample size)	24 Sept	19 Oct	Completed
<b>Analysis of focus group and survey findings/Validate collected data and confirm baseline</b> <ul style="list-style-type: none"> <li>Business &amp; policy factors affecting market development</li> <li>Market failures, opportunities and risks specific to the MSME segment</li> <li>Confirm findings of initial desktop research on MSME classification</li> <li>Assess the driving factors behind the regional spread of MSMEs in Nigeria</li> </ul>	22 Oct	25 Oct	Completed
Draft MSME reclassification recommendations report	22 Oct	26 Oct	Completed
<b>Checkpoint meeting</b> Agenda <ul style="list-style-type: none"> <li>Discussion on draft MSME reclassification report</li> <li>Discussion on strategic framework identified and suitable segments</li> </ul>	19 Nov	19 Nov	Yet to commence
PDF to revert on Draft MSME reclassification report	TBD	TBD	Yet to commence
Submission of final MSME reclassification report	TBD	TBD	Yet to commence
Strategy formulation and development of strategic framework <ul style="list-style-type: none"> <li>Development of implementation roadmap</li> <li>Development of MSME M&amp;E framework</li> <li>Draft strategic framework and implementation report</li> </ul>	1 Nov	29 Nov	In progress
Submission and presentation of final outputs	10 Dec	10 Dec	Yet to commence