THE ROLE OF THE LAW IN INDUSTRIALIZATION: THE CASE OF THE LEGAL FRAMEWORK FOR SMALL AND MEDIUM SCALE ENTERPRISES (SMEs) IN NIGERIA

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Abstract:
This paper appraises the legal framework for the regulation of small and medium scale enterprises (SMEs) in Africa with particular reference to Nigeria. The paper examines the legal environment for the operation of SMEs in Africa by appraising the laws enacted for the promotion of SMEs in Nigeria. The paper further examines the laws in order to discover whether they adequately provide for the extant needs of SMEs in Africa in the areas of technology acquisition, access to micro-credit, infrastructure, energy-supply and access to the market for finished products. The paper finds that the laws providing for the needs of SMEs are scanty and still in their embryonic stages. Apart from this, they do not cover most areas of need of the SMEs. Moreover, the enforcement of available laws is still far from satisfactory in Nigeria. There is a need for adequate legal protection for SMEs in Africa in order to stem the growing unemployment and poverty rates across the continent.

Introduction:
Industrialization is the act or process of industrializing, the widespread development of industries in a region, country, culture and so on. (Merriam-Webster). Traditionally non-industrial sectors (such as agriculture, education, health) of an economy become increasingly similar to the manufacturing sector of the economy by the process of industrialization. The process assures sustained economic development based on factory production, division of labour, concentration of industries and population in certain geographical areas, and urbanization. (Business Dictionary). Industrialization is a veritable channel of attaining the lofty and desirable conception and goals of improved quality of life for the populace (Okafor, 2008). This is because; industrial development involves extensive technology-based development of the productive or manufacturing sector of the economy. In other words, it includes a sustained application and combination of suitable technology, management techniques and other resources to improve the economy from the traditional low level of production to a more automated and efficient system of mass production of goods and services (Ayodele and Falokun, 2003). Ayodele and Falokun examined the structure of the Nigerian industrial sector with emphasis on the manufacturing subsector. In their analysis, it was observed that industrialization is central to economic growth and development. This is because the excess labour resources in the country can be absorbed by the desired positive developments in the process of industrialization.

Industrialization is central to a nation’s economic growth and development. This therefore explains the reason why successive governments in developing countries such as Nigeria emphasize industrialization as a way of transforming their economies. In the past five decades, Nigeria has pursued industrialization with the hope of transforming the economy from a monolithic, inefficient and import-dependent economy to a more dynamic and export-oriented economy, especially the export of industrial goods.
Small and Medium Scale Enterprises (SMEs) are believed to be the engine room for the development of any economy because they form the bulk of business activities in a growing economy like that of Nigeria and they contribute to the GDP and employment generation capacity. Small and medium scale enterprises are a veritable means of improving trade and industrialization in Africa. They are the bedrock of industrialization hence they possess extensive knowledge of resources, demand and supply trends and so constitute the chief suppliers of inputs to larger firms. They help in economic development through industrial disposal and addition and constitute important sources of local supply and service provision to larger corporations. They are an indispensable component of national development in African economies. They are acknowledged globally, as having the ability to contribute substantially to enhancing employment creation, or generation, poverty alleviation, equitable distribution of resources and income redistribution as well as encouraging rapid industrialization (Agboduwa and Oisamoje, 2013). SMEs are seabed to innovations, inventions and employment. The significance of this subsector in an economy is overwhelming, yet it is being relegated to the background in most developing African countries like Nigeria and South Africa. The way out of this stagnation is the existence of an adequate legal framework to assure a viable small and medium scale enterprise sector in Africa.

The Meaning of SME:
Defining the SME is not an easy task. The concept has been subjected to different interpretations hence the definition varies in different jurisdictions. Agboduwa and Oisamoje, defined the SME as an enterprise that has an asset base (excluding land) of between N5Million-N500 Million and a labour force of between 11 and 300. CBN Guidelines have also defined the SME as any enterprise employing less than 250 employees and further broke it into micro (0-10 employees), small (11-49) and medium (50-249 employees). The above definition was adopted by the European Union in 1995. These definitions are based on criteria like turnover, number of employees, profit, capital employed, available finance, market share and relative size within the industry. These indices are quantitative in nature, are thus susceptible to periodic changes (like inflation etc.), and to this extent are not helpful. The notion of the SME posited in this work is such that will accommodate every aspect of individual business activity irrespective of number, size or any other considerations.

The Role of the SME in the Development of the African Economy:
Small and Medium Enterprises (SMEs) are the bedrock of the Nigerian economy. They serve as important sources of employment generation, economic dynamism, competition and innovation; thus, contributing to national growth and poverty eradication. (A. D Ogechukwu, S. Oboreh, I.Umukoro and V. Ayozie, 2013). The development of an economy is dependent on small and medium enterprises that create jobs from the grass roots to the urban areas, thereby reducing the unemployment rate and its attendant social vices. It encourages entrepreneurship with the attendant increase in the Gross National Product (GNP). This will guarantee a more even distribution of wealth among the citizens. It will also assure the exportation of more qualitative and competitive products and the repatriation of profits to Nigeria. This will no doubt improve or raise the standards of living of consumers. It has contributed heavily to the empowerment of labour by creating jobs for the teeming youths. This will invariably upgrade the social status of such youths and provide the platform for turning them into successful entrepreneurs and operators of SMEs. People derive joy in working for themselves and these businesses may eventually grow into conglomerates.
The Statutory Framework for Regulation of SMEs in Nigeria:
A conducive legal environment is a sine qua non for a viable SME in Nigeria. There exists an array of laws in Nigeria aimed at enhancing the promotion of small and medium scale enterprises in Nigeria.

(a) Small and Medium Enterprises Development Agency of Nigeria Act 2003:
This Act established the Small Medium Enterprises Development Agency as a body corporate and with perpetual succession and common seal, capable of suing and being sued in its corporate name. (Small and Medium Enterprises Development Agency of Nigeria Act, 2003). The Functions of the agency include the initiation and articulation of ideas for small and medium scale industries policy thrust, serving as a vanguard agency and focal point for rural industrialization, technology acquisition and adaptation, job creation and sustainable livelihood. The Agency is empowered to oversee, co-ordinate and monitor development in the small and medium industries sub-sector. (Section 8 (e) ibid) The SMEDA has the responsibility of linking the SMEs to sources of assistance, finance, technology and skill development. The agency is conferred with powers to demand and obtain information/data in relation to the promotion and development of SMEs. It can enter into a joint venture arrangement and draw up a memorandum of understanding with relevant institutions and organizations for the promotion and development of small and medium scale industries. It is also empowered to do all such other things as are necessary for the successful performance of its functions under the Act.

The task of the agency is no doubt onerous. Considering the specialized nature of some specific functions of the agency (for example, in relation to financial assistance, technology and skill development), it is necessary that the membership of the agency constitute experts from all fields relevant to the SMEs. It is highly regrettable that there are no legal personnel in the membership of the governing board. This is a grave legislative oversight capable of undermining the full implementation of the Act. Legal representation on the Board of the Council will ensure that appropriate legal frameworks and policies are put in place for effective and viable implementation of the Act. SMEs cannot be viable in an ineffective legal environment. A more effective legal framework is therefore a pre-condition for the development of more viable SMEs. The Agency is also empowered pursuant to the Act to make regulations as are necessary and/or expedient to giving full effect to the provisions of the Act and for the due administration of its provisions. There is also likely to be a conflict of roles and functions between the Small and Medium Enterprises Development Agency and other agencies like Corporate Affairs Commission, Nigerian Export Promotion Council, and the Nigerian Investment Promotion Commission.

(b) The Companies and Allied Matters Act:
The legal regulation of SMEs requires that such SMEs be registered by NIPC pursuant to CAMA, Cap C20, Laws of the Federation of Nigeria, 2004 as amended. Unfortunately, most SMEs are not registered. This is because of high registration costs and company tax following such registration. The Companies Act should be amended to simplify business registration processes. It is also desirable that such processes be made cheaper, simpler and speedier.

(c) The Nigerian Investment Promotion Commission Act:
This Act established the Nigerian Investment Promotion Commission, a body corporate, capable of suing or being sued in its corporate name. (No. 16 of 1995; now Cap N117 LFN 2004). The Commission is mandated pursuant to the Act to simplify administrative procedures
for the incorporation of companies, issuance of business approvals, permits and licenses, and is to encourage, promote and co-ordinate investment in the Nigerian economy. (NIPC Act Section 4). The Commission is empowered pursuant to the Act to register enterprises, provide support services and information, and maintain a liaison between investors and ministries, agencies, government departments and other agencies for investors. The Commission pursuant to its powers to make regulations, released the pioneer status incentives regulations of 2014. (NIPC Act Section 30). The grant of pioneer status to a company in Nigeria enables it to operate within the pioneer industry and make significant capital expenditures and a reasonable level of return on profit within its formative years, without having to pay the company tax.

(d) The Nigerian Enterprises Promotion Act:
This Act established the Nigerian Enterprises Promotion Council. (No 3 of 1977 as amended by the Nigerian Enterprises Promotion Act No. 4 of 1988, section 1). It has some definite unambiguous provisions in relation to the regulation and control/ownership structure of Nigerian businesses. The Act sets out, amongst others, to encourage Nigerian indigenous participation in business through appropriate delineation of those areas that are exclusively reserved for Nigerians alone, and the development and growth of business in Nigeria.

The functions of the Council pursuant to the Act include the development and diversification of export related industries in Nigeria, creation of appropriate export incentives to monitor export promotion activities in Nigeria amongst others. (NIPC Act Section 4). The Council is mandated pursuant to the Act to spearhead the creation of necessary export incentives. (section 4(1). This is likely to create jurisdictional conflict of roles between the Council and the NIPC. The Act centres on export related industries most of which are SMEs. The fact remains that export promotion may not be attained in Nigeria without viable SMEs.

(e) The Industrial Development Tax Act:
This is the enabling law for the grant of pioneer status to a Nigerian company (No 2 of 1971 amended by the) Industrial Development Tax Act (Income Tax Relief) Act (Amendment) Bill). The status is granted where the Nigerian Government is of the opinion that any sector or industry in the economy is not being undertaken on a scale suitable to the economic advancement of Nigeria or that it is in the public interest to encourage the further development or establishment or advancement of trade in such a sector or industry, (Section 1 (1), Industrial Development Tax Act). The Pioneer Status Regulation 2014 increased the capital expenditure threshold required to enable a company apply for pioneer status from N150, 000.00 (one hundred and fifty thousand naira to N10, 000,000 (ten million naira only). This ten million naira is for both the indigenous and foreign companies. This provision appears to have done away with the distinction between foreign and Nigerian companies. The implication of the provision is that both local and foreign companies eligible for pioneer status would need to meet the same criteria in relation to capital expenditure.

Some SMEs who may deserve the pioneer status may not meet the ten-million-naira threshold. They may thus be potentially cut off from the pioneer status. A service charge of 2% of the estimated savings from tax exemption will be paid by the applicant company. (Section 5 of the Regulations). Where the applicant company records negative pre-tax earnings in its projections, the service charge shall be calculated on the higher of either 0.5 of its net assets or 0.25 % of its turnover. This provision on service charge is tantamount to granting an incentive with one hand and removing same with another hand. It makes a mockery of the tax holiday and will discourage Nigerian investors.
The Regulations also provide that the application fee for pioneer status be increased to N200,000.00 from N100,000.00. The regulation made pursuant to the Industrial Development Tax Act, which aims at promoting investment in Nigeria, has no doubt increased the cost for the grant of pioneer status.

The Amendment Bill that has been before the legislature since April 2018 seeks to, amongst others, provide for additional incentives for some investors by allowing companies in the process of expanding their operations to cover pioneer industries or products to be eligible for the pioneer certificate. The proposed bill also seeks to enable companies whose applications were previously denied on the grounds of expansion to re-apply for fresh consideration. However, the Bill proposes to increase the estimated cost of qualifying minimum capital expenditure required for companies applying for pioneer certificate to N100 million for indigenous companies and N120 million naira for other companies. The proposed amendments will have varying impacts on new and existing businesses. The implication is that most SMEs may not be able to take advantage of the scheme because of the proposed increment of the (QCE) to N100 Million Naira. Even companies that have been granted pioneer certificates for an initial period of 3 years pursuant to the existing threshold may not be able to re-apply as allowed by the law if they fail to meet the proposed capital threshold.

(f) Business Protection and Intellectual Property Laws:
These laws aim at the protection of the business interests of an entrepreneur. A business with a name, logo or any means of identification is required under the law to meet some established standards set by the law. The names or logo or whatever means of identification should not infringe on the rights of others or other businesses. Any business engaged in an act or special work or an intellectual creation should protect their rights over such creations by ensuring such rights are protected. (The following laws protect the intellectual property rights: Trade Marks Act Cap T13 Laws of the Federation of Nigeria 2004, Copyright Act Cap C28 Laws of the Federation of Nigeria 2004, Patent and Designs Act Cap P2 Laws of the Federation of Nigeria 2004). These laws cover patent and design, trademarks, and copyrights.

(g) Tax Laws:
SMEs like any other businesses in Nigeria are not exempted from payment of taxes. Businesses in Nigeria are required to remit one form of tax or another to the relevant statutory bodies upon registration as a company with the Corporate Affairs Commission (CAC). Some taxes are payable to the Federal Government, some are payable to the states, and local governments already in existence. The Federal Inland Revenue Service administers all taxes paid to the Federal Government. Those paid to the state and local governments are administered by the relevant state or local government agencies. Some of the taxes payable by small businesses in Nigeria include:

(i) The Company Income Tax: This is a tax on the profits made by the business and is calculated at 30% per annum. This assumes that tax is charged on profits for the accounting year ending in the preceding year of assessment. A company already in existence should file its returns within six months of its accounting year. New Companies are required to file their returns within eighteen months from the date of incorporation or six months after its first accounting period whichever is earlier. Education Tax is payable on the assessed income of the company at the rate of 2%.
Value Added Taxes: This is payable at 5 five percent on all goods and services that are subject to VAT. VAT payment is expected to be filed on the 21st day of the month following the transaction. Under VAT, companies are required to remit gross or net input where applicable.

Withholding Tax (WHT): This is an advance tax. In the case of individuals and unincorporated bodies or entities, remittance is due to the State Internal Revenue Service (SIRS) within thirty days after the duty to deduct arose.

Personal Income Tax (PITA): This is payable on the incomes of individuals including employees, partnerships and unincorporated trusts. They are all liable to personal Income Tax under the PIT Act.

SMEs in Nigeria are subjected to multiple taxes by different tiers of government, each with its own rigorous processes and significant compliant costs. Many SMEs have failed in the remittance of their taxes thereby incurring tax penalties and interest in addition to taxes unpaid, which can be avoided through adequate tax planning. The new National Tax Policy (NTP) aims at establishing a robust and efficient tax system in Nigeria by reducing tax burdens. The NTP proposes a reduction of the corporate tax registration thresholds as an incentive to encourage compliance and protect SMEs.

It is regrettable that multiple taxation still persists in Nigeria. This has been hampering the growth of businesses in Nigeria. Many SMEs fail within the first few years of business as a result of the tax burden. A good number of SMEs are not able to benefit from tax incentives as a result of their not being duly registered under the law. This work recommends a moiré effective tax regime that will encourage some exemptions. Such a regime should ensure that the taxes collected are reflected in the provision of basic public services like healthcare and infrastructure by the various governments. The tax regime should also encourage voluntary tax compliance and the expansion of business interests in Nigeria. The Nigerian tax system is plagued by high cost of collection/administration. The policies should be designed to motivate SMEs growth.

(h) CBN Guidelines:
These guidelines established the Small and Medium Enterprises (SME) Credit Guarantee Scheme (SMECGS) 2012. (CBN Guideline Section 1). In 2012, the Federal Government of Nigeria approved the sum of N200 billion Naira for the operation of the Small and Medium Enterprises Credit Guarantee Scheme (SMECGS) fund. (See the 2010 CBN Guidelines on Small and Medium Enterprises Credit Guarantee Scheme (SMECGS)Section 2). The Guidelines set out to facilitate the development of the manufacturing SME sector of the Nigerian economy by providing credit from the banks to the manufacturing SMEs, thereby facilitating industrialization of the Nigerian economy. (Section 3 ibid). SMEs may only benefit from this fund if they are viable and satisfy the expected eligibility conditions. Qualifications for borrowing pursuant to the guidelines are:

(i) any entity falling within the definition of an SME
(ii) a wholly owned and managed Nigerian private limited company registered under the Companies and Allied Matters Act
(iii) A legal business operated as a sole proprietorship
A start-up company with satisfactory cash flows indicating a fixed asset cover ratio of 100:50.

A franchise. (section 7).

All banks are required to set aside ten percent of their profit before tax annually for equity investment in the SMEs in return and as incomes for this investment, the following tax reforms and incentives have been proposed:

(i) The corporate tax for the SMEs under the Companies Income Tax (CITA) is reduced to 10%
(ii) The Bank’s contribution to the SME to enjoy 100% investment allowance
(iii) Exemption of divested funds under the SMEs from payment of the capital gains tax.
(iv) Five years tax holiday for the SMEs

Securing loans from the banks and other financial institutions takes time and in most cases only exist on paper. Some difficult conditions are to be satisfied before an enterprise may be considered for a loan facility. The lending Acts should be amended to reflect and actualize the ideal objectives of a viable SMEs scheme.

The Challenges:

(a) Funding:
Personal savings form the major source of funding. Most new, small business enterprises are not attractive for banks because of the high-risk profile associated with them. (C M Anyanwu, 2012). Most of the financial institutions in Nigeria are reluctant to fund SMEs. Thus, loans to SMEs when given, are given with high interest rates and short pay-back times. (R.U Etuk, G.R Etuk; M Baghebo, 2014). SMES and Nigeria’s Economic Development do not extend medium- and long-term credit facilities to the SMEs in Nigeria. This will obviously lead to death of the SMEs. Most SMEs die within their first five years of existence, another small percentage goes into extinction between the sixth and tenth year. (T Alawe, 2002). There is no adequate credit collateral security by the SMEs to back such facilities. There is no titled balance between the promotion of SMEs and the banks interest in granting a redeemable loan. This has created a gap in the promotion of the scheme. Even where they advance such funds, they subject the SMEs to unfavourable and impracticable conditions that do not encourage productivity in business. According to Mr. Jide Mike the Acting Director General of the Manufacturing Association “the debris of dilapidated manufacturing concerns across the country is the outcome of years of harsh operating conditions. He averred that in spite of the small and medium industries equity investment scheme, funding has posed a serious threat to the SMEs. As a result of this challenge thirty percent of SMEs have closed down, about sixty percent are ailing and only ten percent operate at a sustainable level. (https://punchng.com 22 Aug, 2015).

The World Bank in 2001 reported that almost fifty percent of micro, thirty-nine and thirty-seven percent of the small and medium scale firms respectively, are financially constrained in Nigeria, as opposed to twenty-five percent of the very large firms. (World Bank, 2001). The implication of this is that small and medium scale enterprises are either
discriminated against or cannot access funds at the credit market. In addition to this, the stringent conditions attached to loans and credits also discourage industries from accessing credit from the banks. This factor has largely undermined the capacity of small and medium scale enterprises in Nigeria. Even where the SMEs can access loans, it is usually a short-term loan whereas what the SMEs require in building capacity are long-term loans which can be rolled over many years.

The enforcement regime against beneficiaries of SME soft loans as provided in the Act or regulations is not sufficient to enable various agencies meet the objectives of the schemes where the beneficiaries are unable to repay their loan. Most loans in the Nigerian market are short term based. The unique nature of the SMEs requires long-term loans to nurture them. Long-term capital has been established to be pro small business growth. (C. Golis ,1998).

The Central Bank of Nigeria and the Banker’s Committee established the Small and Medium Enterprises Equity Investments Scheme (SMEEIS). It is part of the requirements of the Investment Scheme that all banks in Nigeria must set aside 10% of their annual profits before tax in support of SMEs. The Bank of Industry (BOI) is expected to provide credit to SMEs but not on soft lending rates. It is only the Nigerian Export Import Bank (NEXIM) that provides soft loans to export oriented SMEs.

(iii) Inadequate infrastructure:
Infrastructural facilities promote the growth of SMEs. These infrastructures enhance investment in and growth of the SMEs. They include provision of good access roads, effective power supply, provision of portable water, establishment and maintenance of an export-processing zone. (Ayodele, A. S. (2004):15).

Adequate provision of these facilities enables business expansion and movement of goods and services, the expansion of markets for products and promotion of investments. Many studies have established the existence of links between power as a form of energy and economic outcomes such as productivity, industrial development, the growth of SMEs, employment generation, economic growth and development amongst others. (Okafor (2008), Alam (2006) Regrettably, various taxes imposed on citizens are aimed at providing these infrastructures but they are not provided and the poor citizens may not enforce them hence they are not justiciable. The right to infrastructural facilities is captured under ECOSOC rights in Nigeria. ECOSOC rights are not unjusticiable in Nigeria. A world Bank study in 1989 estimated that the cost of providing infrastructural facilities by SMEs in the absence of those facilities is about 15-20 percent of the cost of establishing manufacturing enterprises in Nigeria.

(iv)Technological Acquisition:
Innovations rely heavily on research and development. SMEs especially in the manufacturing sector cannot carry out extensive research and development. They are at a great risk of falling behind competition in innovations and technology. This calls for the building up of their research and development capacities. Some of the business ideas in some of the SMEs are not scientific in nature. Hence, they cannot be accessed easily and may die with their originators. Technological backwardness in African nations does not encourage entrepreneurship culture and education. Some SMEs breakthrough may require re-engineering of products and services to meet with market demands. A viable research and development capacity is needed.
**Recommendations:**

Government should put in place measures to create an investor friendly environment. Government should provide access to financial services because SMEs require great access to financial services and investment capital.

SMEs should be excluded from the application of the provisions of the Companies Income Tax Act (CITA) for a minimum of five years and thereafter should be subjected to CITA at a rate not more than ten percent per annum.

Nigeria should urgently address the power needs of the industrial sector by revisiting the generation and distribution sub sectors of the electricity sector so as to ensure uninterrupted and affordable electricity supply to the SMEs.

The legal provisions for eligibility for the grant of the pioneer status as it relates to the provision of a minimum capital for an SME is unreasonable. The increase of the minimum capital from one hundred and fifty thousand naira to one hundred million naira hinders the participation of most SMEs whose minimum capital is far less than one hundred million naira. It is therefore suggested that the minimum capital for eligibility to participate should be reduced to five million naira.

There should be a reduction in the cost of registration of SMEs with the Corporate Affairs Commission so as to encourage SMEs to register and benefit from available incentives.

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²³