Towards Improving Micro, Small and Medium Enterprise Credit Access through Movable Assets Registry in Nigeria

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Abstract

There is a visible dichotomy in the Nigerian economy, which breaks it into a large and growing informal sector, buoyed by an array of inadequacies that have reduced the ease of doing business, and a formal sector that is largely stagnant. As a result of many years of incongruent and mostly unstable political-social and economic policies, unemployment and poverty rates have run amok, driving large portions of the population to the informal sector. Economic exclusion has festered as more and more people get structured to the periphery of the economy. With a population estimated by McKinsey to hit 207 million by 2020, and a financial exclusion rate of over 50%, the job of poverty reduction has become even more challenging. One of the key handicaps of the informal sector is the lack of bankable assets among operators in a banking system that is predominantly formal. Indeed, the Nigerian financial superstructure is patently formal but sits squarely on a substructure of informality. This has hampered banks' effort to maximally finance the informal sector. However, the recent introduction of the Secured Transactions in Movable Assets Law, 2017, promises to unleash the hitherto unbankable informal sector assets to facilitate financial inclusion. This paper examined the existing principles of the Nigerian law of secured credit, vis-à-vis the potentials of the new law to boost access to credit by the informal sector. It identified its prospects and proposes that the implementation of the new law be accompanied by massive enlightenment and education of stakeholders, to avoid misconceptions and mistakes that may discourage lenders from fully embracing the new rules. It also suggested a combination of strategies for making the most out of the new law so as to facilitate responsible bank lending to the informal economy in Nigeria.

Keywords: Secured credit, collateral registry, economic exclusion
JEL Classification: E51, P42

Introduction

The ability of lenders to smoothly and cost-effectively enforce their contracts with borrowers is critical to an effective financing regime. The willingness of lenders to make loans is the result of many well-thought out factors. They include, but are not limited to, the viability of the business in which the loan is to be invested, the availability of alternative repayment sources and the probability of default on the part of the borrower. They also include the availability of funds with the lender and the level of commitment by the borrower, by way of equity in the transaction. A borrower, who

cannot show commitment to the repayment of a loan and, thereby, give confidence to the lender, might as well forget the idea of borrowing. Debt contracting and, by extension, the supply of credit have serious implications for economic activity and, in particular, poverty reduction and economic growth.

The Nigerian economy is heavily dependent on oil. The extent to which oil has dominated the economy can be seen from its influence in the revenues of the country. While oil represents a whopping 90 per cent of her exports and 60 per cent of revenue receipts, it is only 10 per cent of the national economy. The International Monetary Fund (IMF) is of the view that Nigeria is actually the biggest economy in sub-Saharan Africa (FATE, 2016). With a population of 188.7 million people (IMF, 2018) Nigeria has the largest collection of consumers in Africa. The economy has just exited a recession, which was caused by a combination of factors, including the collapse oil prices, the reduction in national oil output and some policy missteps. The recession heightened mass poverty that was already engulfing most households and a large portion of the population, especially in the rural areas. Worse still, most micro and small enterprises collapsed for lack of patronage and funding.

Access to finance has been a major challenge to operators in the informal sector, due to certain factors. The weak legal environment in most developing countries does not inspire lenders, as contracts are often unenforceable or observed in breach. There is very low creditors' rights index– the rate at which creditors are likely to get their money back. The micro and small enterprises in the informal sector lack bankable assets and are unable to meet the stringent conditions usually attached to bank loans. Most of their assets are mere chattels, which the banks do not regard as good security for loans. Debt contracting and, by extension, the supply of credit have serious implications for economic activity and, in particular, poverty reduction and economic growth. Movable assets, by which we mean all non-real estate assets, including plant, machinery and equipment, accounts receivable and inventory, have recently become the focus of the search for the much needed collateral for bank lending to micro, small and medium enterprises (MSMEs). According to Calomiris et al. (2016), this renewed search is partly due to the fact that the legal structures for the use of movable assets as collaterals are non-existent and, where they exist at all, have proved to be weak in a number of areas. For instance, they limit the scope of movable assets that can be used as collateral, lack centralized registration systems, which establish priority and permit monitoring of the security interests of lenders and do not promote the enforcement of rights, in the event of default is often possible only through long and winding courts processes. The informal sector is dominated by micro, small and medium enterprises (MSMEs) and has been recognized as an engine of growth in most economies.

The objective of the study was to examine the relevant elements of the Secured Transaction in Movable Assets Law 2017 (also called collateral registry law) and the status of financial inclusion in Nigeria, and propose strategies that would enhance the effectiveness of the new law in helping Nigeria achieve its goal of reducing financial exclusion to 20 per cent by 2020, through a greater democratization of financial services, especially to the MSMEs. The study was anchored on the work of Gonzalez-Vega (2003), which identifies three gaps that must be filled to deepen financial access. In particular, it was premised on the insufficiency gap theory, which separates current from potential supply of financial services, occasioned by the introduction of innovations such as the recent collateral registry law in Nigeria.

Access to finance has been one of the factors limiting the growth of MSMEs in Nigeria (KPMG, 2014). Efforts have been made to facilitate easy access to finance for the teeming operators in the sector, but much has not been achieved. Government recently passed laws that are set to promote the use of 'dead capital' in the form of chattels to secure loans. The laws are the Secured Transactions in Movable Assets Law (or collateral registry law) of 2017 and the Credit Reporting Law of 2017. The laws promise to accelerate the flow of credit to the informal sector if properly implemented. This study draws from the experiences of other countries that have implemented such a system of rules to propose critical success factors in the implementation of the collateral registry law to maximize MSME access to credit.

Overview of the Nigerian Economy

The Nigerian economy has certain striking features that have largely shaped its growth and development. Two of those features stand out and deserve special mention. First, the economy is very heavily dependent on the external sector. The petroleum sector has had an overwhelming influence on the economy. This influence is traced largely to the role of crude oil exports in the financial well-being of the country. The oil sector, an essentially enclave economy, is driven by forces mostly domiciled abroad. However, the flow of petrodollars has continued to exert increasing influence on the direction of the economy. Two categories of operators continue to dominate the Nigerian economic space. These are the large corporations, including government, its parastatals and agencies, and large limited liability companies, on the one hand, and small operators, on the other. In the first category are also medium corporations, employing substantial numbers of people, and also professionals. These all constitute the formal sector. The other segment is made up of artisans– bricklayers, mechanics, electricians, commercial bus drivers, commercial motor cycle operators, etc. These are members of the self-help community and the army of the self-employed. They constitute the informal sector and make up about 60 per cent of the country's economy (Phillips Consulting, 2014). The whole idea of movable assets as security for bank lending derives from the burning desire of government to canalize financial resources to the informal sector.

The informal sector encompasses the good, the bad, and the ugly parts of the economy. The bad and ugly parts are to be found in the operating environment of the sector, which manifests the absence of legal framework for operation, lack of credit and

savings opportunities, high cost of funds relative to the formal sector and lack of social and economic infrastructure. The good side of informality may be found in the make-up of the members of the sector. They are characterized by abundant energy and drive, youth and the desire for self-actualization. Members of the informal sector are skilled in survival strategies and have very creative minds. Their inventive genius and survival instincts subsume the very difficult conditions under which they operate (Osuji, 2018)

The financial superstructure erected over the substructure of informality in Nigeria, features development banks, agricultural banks, commercial and merchant banks, as well as microfinance and mortgage banks. With the exception of the microfinance banks and, to some extent, the mortgage banks, all the banks are not only concentrated in the urban areas, but are, by their very nature, not suited to serve the needs of the informal sector. The result is that the informal sector is plagued by limited access to credit. It is underserved by the existing financial institutions; lacks liquidity and bugged down by heavy reliance on cash for most transactions. It is in regard to the foregoing challenges and the fact that it hosts the bulk of our youths and will provide most the jobs to be created in the next few years that government recently passed the Collateral Registry and Credit Reporting Laws on 25th May 2017. These laws aim at affording small and medium enterprises the opportunity to access loans from financial institutions, using movable assets as security.

The incongruence of the financial superstructure superimposed on a substructure of informality has made it almost impossible for the banks to serve the needs of small business in Nigeria. As a result, thriving informal credit markets have developed, alongside formal credit markets, both in the rural and urban areas. Informal credit markets manifest in different forms including market unions, church societies, moneylenders, village meetings, pawn brokers and landlords. Other forms of this market are the Rotating Savings and Credit Schemes (ROSCAS) and Accumulating Savings and Credit Schemes (ASCAS). In the ROSCAS, participants contribute a fixed equal amount at specified intervals and take turns in pulling out the total funds contributed by all. On the other hand, participants in ASCAS make contributions of a fixed, often equal, amount at specified intervals and on the anniversary of the fund, usually a year, each person pulls out their portion of the fund and the contribution restarts. The result is that doing business in Nigeria has not been easy as evidenced by facts, including double digit interest rate, estimated to erode about 25 per cent of the return on capital of MSMEs; unstable power supply estimated to add 10 per cent to cost of sales and a ranking of 145 among 190 countries on the ease of doing business in 2017 – a very poor rating even though a major improvement from the 169 rank of 2016 (NCR 2017).

Review of Literature

The term MSMEs is not only dynamic, but also environmentally sensitive in the sense that what constitutes a small enterprise in one jurisdiction may be a large one in another. The term is often driven by the size of the host economy and its attributes. Therefore, there is no universal standard definition of an MSME operator. Rather, each jurisdiction determines the characteristics of enterprises in each class. In Nigeria, some attempts have been made to establish an objective set of criteria for membership of each category of enterprises. Accordingly, in Nigeria, microenterprises are business entities employing less than ten persons, and having assets (excluding land and building) valued at less than N5 million. By contrast, small enterprises employ between ten and 49 persons, and have assets, excluding land and building, worth between five and N50 million. Medium enterprises are those employing between 50 and 200 persons and have assets, less land and building, valued between N50 million and N500 million (NBS, 2013). Nigeria has a large and growing informal sector. According to Onyebueke and Geyer (2011), Nigeria has the largest informal sector in Africa. The informal sector is a critical part of the Nigerian economy (Ogbuabor and Malaolu, 2013)

Some statistics on the plight of MSMEs may be helpful. Of the 40 million small and medium enterprises in sub-Saharan Africa, only 18 million have bank accounts. Of that number, only 4 million have any form of bank loans, and 18 million are underserved. With regard to Nigeria, there are 37 million MSMEs, of which 36 million are microenterprises, whose only assets are either land or some chattels. To this category of entrepreneurs, bank financing is hard to come by. According to KPMG (2014), only 20 per cent of the loan portfolios of 84 per cent of the banks surveyed went to SMEs. Meanwhile, members of the sector constitute over 60 per cent of economic activity in the country. Empirically, it has been established that insufficient collateral is one of the main reasons their loan applications are rejected (Fleisig et al., 2006).

In their study of the impact of collateral registries, Love et al. (2010) analysed the effect which the introduction of movable asset registers may have on bank financing. Using firm-level data from 72 countries the study explored the impact of introducing collateral registries on firms' access to bank financing in seven countries that implemented collateral registration for movable assets. It finds that introducing collateral registries for movable assets increases firms' access to bank finance. The study also found that the impact of these registries was more pronounced or larger among smaller and younger firms. Flieseig et al. (2006) tried to determine why banks are unwilling to embrace SMEs but instead keep them at arm's length, when it comes to lending. The study was of the opinion that banks in emerging markets or creditors in general are usually afraid to accept movable collaterals. Indeed, one major problem with movable collaterals is that they are movable and quite often they do move away from the sight of the lender.

Historically, MSMEs, especially microenterprises, do not rely significantly on bank funding. In his study of enterprises in Nigeria, Osuji (2005) established that micro-entrepreneurs are predominantly male aged below 30 years. Their principal areas of

business are wholesale and retail trading, services and minor manufacturing. They source their initial capital mostly from personal savings and gifts from close family members. Formal bank loans as a source of capital account for less than 5 per cent of start-up capital funds for female and 9 per registry has the effect of spurring access of firms to bank financing.

The classical theory of secured credit transactions recognizes security in terms of interest of a person called the creditor in the property of another, called the debtor. This interest makes certain rights available to the creditor over the property, in order to satisfy an obligation or debt owed by the debtor (Sykes and Walker, 1993). In other words, security is the right given to one party in the assets of another party, as a means of securing the performance by that other party of the payment of an obligation (Goode, 1988). Essentially, the classical concept of security conveys the idea of agreement or consensus between the debtor and the creditor, ie, creation of security is by consensus. However, in reality not all security interests are created by agreement. Security interest may be created or could arise by the operation of law. A lien, for instance, may creep into an asset from elsewhere to attach to a property. Several forms of business interchange may lead to the creation of security even when there is no consensus. For example, certain trade conventions, practices and traditions give rise to security interests being created without agreement. For example, when a man sells his property to another and collects part payment, he has security interest in the property. Similarly, when goods are carried on a sale or return basis, security interest arises but not consensually.

Real property has been the preferred asset form that lenders use to secure loans (NCR, 2017). Incidentally, land is the most common asset available to the poor in Nigeria. It ought to be their main source of security to back up loans. Unfortunately, that has not been the case. The Land Use Act, 1978, puts some serious hurdles in the way of those who want to use land as security for bank lending. It gives the federal and state governments control of all lands in their domains. It therefore compels all land owners (or allottees, because people no longer own but merely occupy the land at the mercy of government) to seek and obtain governor's consent for every mortgage transaction. The result is that land, which ought to be the easiest bankable security of the poor and which is preferred by lenders (Fleisig et al., 2006), has been taken away from them and handed over to government. They are therefore unable to use their land effectively to borrow money. They now resort to chattels, which until the passing of the present law on movable securities was not attractive to lenders. According to Smith (2001), security interest need not be created by the parties themselves. They could evolve by operation of law; for example a lien.

Banks prefer real property because of the difficulties associated with movable assets. However, collateral registry removes much of those difficulties and unlocks dead capital thereby increasing SMEs access to finance (Etopidiok, 2017). In addition, transactions secured on movable collaterals give more confidence to lenders than ordinary pledges. They boost creditors' confidence and raise the creditors' rights index, which is currently low at 3 in Africa compared to 7 in Europe (Fasanya-Osilaja, 2017).

Methodology

This study uses the content analytical method to analyse and present developments in the finance of MSMEs and its impact on financial inclusion, following the introduction of the law on movable assets as collateral for bank lending in Nigeria. This law, which has suddenly given life to previously 'dead capital' assets, holds promise for Nigeria's plan to reduce financial exclusion to 20 per cent by 2020. Following Gonzalez-Vega (2003) and his insufficiency gap analytical framework, this study reviews the current state of the provision of financial services to the informal sector, based on published statistics and reports of the industry regulators (Nigerian Deposit Insurance Corporation) on the basis of Gonzalez-Vega's insufficiency gap theory and the potential supply of financial services that could follow the collateral registry innovation.

Financial Inclusion and Secured Credit Situation in Nigeria

The IFC reports that there are up to 445 million MSMEs in emerging markets. Of this number, about 30 million are formal SMEs; 70 million are formal microenterprises; and about 345 million are informal enterprises. Formal SMEs (those operating with appropriate structures and modern procedures) contribute up to 60 per cent of total employment and up to 40 per cent of the gross domestic product of emerging economies. The contribution and numbers will actually be much higher when informal SMEs are included (World Bank, 2015). In terms of job creation, the World Bank estimates that about 600 million jobs will be needed in the next 15 years to absorb the growing global workforce mainly in Asia and sub-Saharan Africa. In terms of employment generation, most formal jobs are generated by SMEs, which also create 4 out of every 5 new positions in emerging markets. Further statistics show that sub-Saharan Africa is home to about 40 million SMEs. Of this number, only 18 million have bank accounts while only 4 million have any form of credit facility from the banks.

In the case of Nigeria, the NBS (2013) reports that there are about 37 million MSMEs and over 95 per cent of them are microenterprises, with assets (les land and building) of less than N5 million. These enterprises are not only mostly unregistered and poorly capitalized, but are also predominantly in the rural areas, without contact with financial institutions. The features of the informal sector and its operators, such as the opaqueness of their operation and lack of organization tend to guarantee that banks avoid them. As a result, over 90 per cent of their loan requests in 85 per cent of banks surveyed by KPMG (2014) were rejected.

Low creditors' rights index

The World Bank reports that Africa has very low Creditors' Right Index. This is an index that measures the efficacy of the procedures and machinery established to protect the ability of creditor's to collect their money as at when due. This index encompasses the ability of a creditor to put a lien on a debtor's property; to effect a seizure and thereafter the debtor's property; to effect a garnishee order on the debtor's wages, and to set aside certain purchases or gifts made by the debtor as irregular or fraudulent conveyances. These enablers, as they are, however must be taken together with other factors such as the reason why the debt arose in the first place and the content of any written agreement. For Africa, the Creditors' Right Index is a paltry 3 compared to 7 in Europe. There is a great need for reforms. The Collateral Registry Law is therefore aimed at these challenges (Fasanya-Osilaja 2017).

1. Financing gap in the SME sector

The following table shows the extent to which the informal sector is marginalized with regard to access to financial services in Africa, Middle East, Latin America and the Caribbean.

Table 1: SME financing gap

Place	*Total*	*No. with Chq Acct*	*No. with loans/OD*	*No. underserved*
SS Africa	40	18	4	22
S/Africa	78	34	11	36
East Asia, Pacific	188	62	23	92
Middle East, N/Africa	21	9	3	10
Latin Ame. Caribbean	52	25	13	27

Source: IFC

Insufficiency of credit and some data on MSME finance

Commercial bank' loans to MSMEs as a percentage of total credit to the economy has been on the decline over the past few years. It was 0.12% in 2014, 0.099% in 2015 and 0.067% in 2016 (CBN, 2014 and 2016). This is in spite of the fact that net loans and advances of microfinance banks rose from N129 billion in 2014 to N198 billion in 2016. The rejection rate of SME loan applications by nine commercial banks surveyed from 2011 to 2014 stood at 50 per cent. This is very high, considering that most MSMEs are reluctant to use bank financing (KPMG, 2014). The fact that only about 20 per cent of MSMEs have applied for bank loan in the last 5 years speaks loudly about their tendency to do without the banks. About 89 per cent of loans required collateral and the average collateral coverage is up to 150 per cent of the loan amount and the MSME loan portfolio of most tier 1 banks is less than 5 per cent (NCR, 2017). Evidently, these are serious gaps of insufficiency that need to be filled.

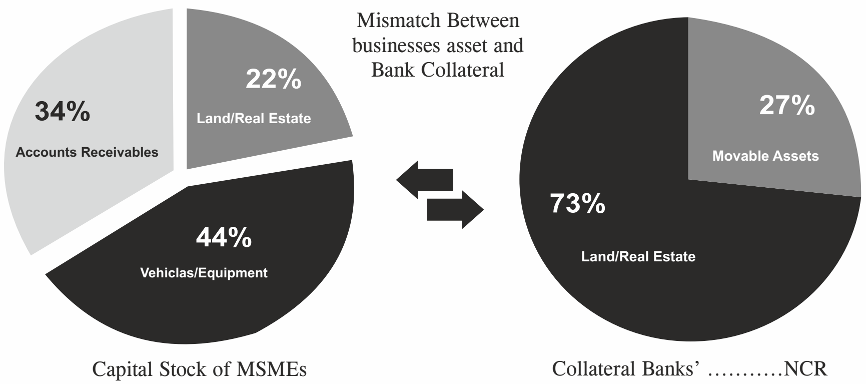

Figure 1: Distribution of bank credit to MSME assets

Source: NCR

Key elements of the collateral registry law and status of implementation

The national collateral registry has been fully established, as a kind of notice-based registry for collaterals. It is a publicly available database of security interest in movable assets. Essentially, the registry is a data bank where security interests in moveable assets are registered for the purpose of being used as collateral to obtain facilities from financial institutions. The register allows borrowers to prove their creditworthiness and lenders to announce their interest in a security and know the priority ranking of their interest in the event of claim against a given collateral. It enables lenders to track the asset, so that even while it moves, it does not move beyond the lender's reach. These features not only improve creditor confidence, they positively influence access to credit and induce prompt repayment – a simultaneous win-win situation for the parties. The Central Bank of Nigeria has since rolled out guidelines for deposit money banks and other institution regarding their participation and compliance.

National Collateral Registry Auction (NCR auction)

The creation of the Collateral Registry has led to the development of an active market for the valuation, due diligence, underwriting and auction of movable assets used or that might be used as collateral. The NCR commodity auction is in partnership with the registry to provide this service to lenders and borrowers. The registry has therefore tackled one of the major problems that hinder the flow of credit to MSMEs – low creditor's right index - as it introduces some certainty in the recovery of loans. First, it re-energizes previously 'dead capital' by permitting their use as collateral; serves notice of encumbrance to everybody who cares to find out; and establishes priority ranking among lenders thereby assuring them of the recovery of their money. This raises the creditors' right index and motivates lending.

The impact of the registry is already being felt, as Nigeria moved up 24 points on the World Bank's ease of doing business index, soon after the twin laws of Secured

Transaction on Movable Assets and Credit Reporting were passed in 2017. It is expected that the current double-digit interest rates will respond to the improving environment and come down as the registry is used by more persons and organizations. It should be noted, however, that only depository or financial institutions licensed by CBN under the Banks and Other Financial Institution Act (BOFIA) can take a security interest in movable collaterals (CBN, 2014). Nigeria recently moved up 24 points in the World Bank's ease of doing business ranking to 145th position out of 190 countries. This achievement has been largely attributed to the establishment of the legal framework for the use of movable assets as security for loans and the establishment of a credit reporting system in 2017.

Achievements of the registry

The first two weeks after the national collateral registry took off, 28 transactions worth N32 million took place on the platform, which was operational on 16th November 2016, according to the Governor of Central Bank, Godwin Emefiele (Akintola, 2016). Several entities have since registered to use the platform and more transactions are taking place currently. The registry is also carrying out enlightenment campaigns to attract public support.

Impact of movable assets register in some jurisdictions

The introduction of collateral registry laws in other countries improved access to finance for their MSMEs. There is no reason why the same should not happen in Nigeria. Below are highlights of some positive stories of the implementation of the movable assets collateral laws in some countries. Ghana introduced the law in 2008 and recorded over 20,000 transactions in one year. In China, where the law became operational in 2007, the total number of commercial loans involving movable assets grew by 21 per cent per year in 2008-2010. In doing business 2012, China gained 6 points out of an 8-point scale on the 'legal rights' index of the 'getting credit indicator'. By 2012, the Credit Reference Centre in China recorded cumulative accounts receivable financing of about USD$3.5 trillion from October 2007, when it was launched, representing around 385,000 registrations (World Bank, 2012).

Romania introduced collateral registry law in 1999. The result was that registration increased from 65227 in 2000 to 536, 067 in 2006. This growth continued at 60 per cent per annum subsequently. Not only was the system accepted by local organizations, but also foreign banks, including the European Bank for Reconstruction and Development (EBRD) and some Austrian banks secured transactions with movable assets. The unique aspect of the Romanian experience was the establishment of data bases and appointment of six registrars to facilitate the work. In the same manner, collateral registry was introduced in Slovenia in 1990, with improvements in the country's bankruptcy laws. They also removed certain complications around notarization of credits that hampered the use of movable assets as security. Annual registration rose from 7,508 in 2003 to 31,968 in 2007 and grew at 50 per cent annually

Despite being launched at the height of the Ebola crisis in 2014, the new collateral registry in Liberia facilitated more than $226 million in loans to MSMEs. The registry was established in 2007 and by 2011, 385,000 registrations had been done with a value of $3.5 million and the registry had been searched over 490,000 times. Movable assets lending went up from 12 per cent to 20 per cent.

Expected impact of the registry

One of the expected outcomes of the Registry is the diversification of lending portfolio of banks. With increasing confidence in the realisability of movable security, NCR predicted a decrease in loan default rates and a 20 per cent year-on-year increase in banks' acceptance of moveable assets as security for loans. This will impact the larger economy by boosting production and creating employment as increased access to credit will increase productive capacity and generate employment. Collateral registries reduce information asymmetry, improve the liquidity of assets, especially short-term assets, such as accounts receivables and cut down the cost of verifying borrowers, which positively impact interest rates and reduce non-performing loans.

Recommendations

For the Nigerian economy to maximally benefit from the collateral registry law, there is need for a lot more work in the following areas of implementation anchored on publicity and training:

1. There is need to bring the law and its twin complement, the Credit Reporting Law, to the knowledge of all Nigerians through extensive publicity and briefing. It should be mandatory for all financial institutions to be members of the registry and patronize it. Government should mount a full scale campaign of training and education to sufficiently inform Nigerians not only of the existence of the law but the opportunities and benefits available to all therefrom.
2. There should be continuous review of the laws in related areas, such as bankruptcy, to ensure no impediments crop up to cripple the new law.
3. Ultimately, whatever happens in regard to the use the registry depends on the cooperation of banks and other lenders to whom this law is addressed. Accordingly, the banks have key roles to play in the following areas: utilization of the national collateral registry platform to leverage moveable assets for lending to MSMEs; training of staff on asset-based lending as well as use of moveable collateral; creation of moveable assets lending desks in all financial institutions to focus on movable assets lending and nomination of NCR administrators as champions of the project. Finally, the banks are expected to comply with the Secured Transaction in Moveable Assets Act 2017 just as they comply with other regulations issued by their regulators.

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