

**AN ANALYSIS OF THE LEGAL, MARKET, AND
CULTURAL IMPEDIMENTS TO FINANCING SMEs IN
LAGOS, UTILISING OSTROM'S INSTITUTIONAL
ANALYSIS DEVELOPMENT FRAMEWORK**

By

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ABSTRACT

This research called for an investigation into the legal, market and cultural impediments to developing the SME sector in Lagos Nigeria. The thesis contemplates the need for reform in the current approach to financing business. The thesis raises the question that this sought-after development within the SME sector is not only hindered by access to finance but also ancillary elements like the attributes of the community, the norms and values the individuals in the community share; the legal regime, such as bankruptcy and insolvency laws, property rights; and market problems like high interest rates, inflation, and how these institutions affect the terms and conditions on which a loan is given or accepted.

To conduct this in-depth investigation, the thesis adopts a socio-legal method of enquiry. Drawing on the distinguished Noble Laureate Elinor Ostrom's *Institutional Analysis Development (IAD) Framework* as the tool of analysis. The IAD framework has been described as a diagnostic tool in which the interaction of participants is determined by the structural features of their situation. With each participant adopting different strategies based on information available to produce outcomes. An analyst observes their interactions, assessing them against evaluative criteria. It is through mapping features identified through research into the Lagos SME sector, and the observation of the interactions produced through the model that this thesis makes its findings.

To use the IAD framework, the thesis relies heavily on the discourse around SME policy in Nigeria, new institutional economics, game theory, market theory and rational choice theory. It is based on these theories that this thesis makes

assertions as what possible interactions can occur, what strategies will be adopted, and what outcomes produced, and what the costs and benefits of these strategies are. The thesis builds on these foundations to diagnose what these impediments to the development of the Lagos SME sector are.

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Bankruptcy and Insolvency (Repeal and Re-enactment) Bill 2016

Bank and other Financial Institutions Act (as amended) 1991 Cap B3, Laws of the Federation of Nigeria 2004

Collateral Registry Act 2017

Companies and Allied Matters Act 1990 Cap C.20 Laws of the Federation of Nigeria 2004.

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Lagos State Land Use Law 2018

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Limited Partnership Act (UK) 1907

Limited Liability Partnership Act (UK) 2000.

SMEDAN Act 2003

The Federal High Court Civil Procedure Rules 2009

The Federal High Court Asset Management Company of Nigeria (AMCON) Civil Proceedings Rule 2018

The High Court of Lagos State (Civil Procedure) Rules 2012

The High Court of Lagos State (Civil Procedure) Rules 2019

The Magistrate Court of Lagos State (Civil Procedure) Rules 2009

The Magistrate Court Law of Lagos State Practice Direction of 2018

The National Industrial Court of Nigeria (Civil Procedure) Rules 2017

LIST OF ABBREVIATIONS

ADR	Alternative Dispute Resolution
ACGSF	Agricultural Credit Guarantee Scheme Fund
AMCON	Asset Management Company of Nigeria
BOI	Bank of Industry
BVN	Bank Verification Number
CAMA	Companies and Allied Matters Act
CACS	Commercial Agricultural Credit Scheme
CBN	Central Bank of Nigeria
CPR	Common Pool Resources
DFI	Development Finance Institutions
EFCC	Economic and Financial Crimes Commission
GTB	Guaranty Trust Bank
IAD	Institutional Analysis Development
IDC	Industrial Development Centre
IFC	International Finance Corporation
KPMG	Klynveld Peat Marwick Goerdeler
LFN	Laws of the Federation of Nigeria
LSETF	Lagos State Employment Trust Fund
LLP	Limited liability partnership
LMDC	Lagos Multi-Door Courthouse
LUA	Land Use Act
LUC	Land Use Charge
MSMEDF	Micro Small and Medium Enterprises Development Fund

NACB	Nigerian Agriculture and Co-operative Bank
NAPEP	National Poverty Eradication Programme
NACRDB	Nigerian Agricultural Co-operative and Rural Development Bank
NBCI	Nigerian Bank for Commerce and Industry
NERFUND	National Economic Reconstruction Fund
NIDB	Nigerian Industrial Development Bank
NIE	New Institutional Economics
NIRSAL	Nigerian Incentive-Based Risk Sharing System for Agricultural Lending
MFB	Micro-Finance Banks
OECD	Organisation for Economic Co-operation and Development
PBN	Peoples Bank of Nigeria
RBS	Rural Banking Scheme
SME	Small Medium Enterprise
SMEDAN	Small Medium Enterprise Development Agency
SMECGS	Small and Medium Enterprises Credit Guarantee Scheme
SMIEIS	Small and Medium Industries Equity Investment Schemes
SICF	Small Industries Credit Fund
SSICS	Small Scale Industries Credit Scheme
SAP	Structural Adjustment Programme
SSM	Second Tier Securities Market
TEEP	Tony Elumelu Foundation Entrepreneurship Programme
NBCI	Nigerian Bank for Commerce and Industry
UBA	United Bank for Africa
UNIDO	United Nations Industrial Development Organisation

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Chapter One: Introducing the Thesis

1.1. Introduction

Nigeria was one of the fastest growing African economies in the world,¹ but its economy has been largely sustained through its export of crude oil. However, with the recent drop in the price of crude and in the demand for Nigeria's oil, it has now become pertinent to ask how future economic developments can be sustained within the country beyond the drilling and exportation of crude oil. Currently, there is a rising acknowledgment of the important role small and medium enterprises (SMEs) play in economic development.² It has been stated that SMEs present a unique opportunity for unbridled economic growth. The potential and fundamental role SMEs play within the economy has been recognized globally,³ and they are often described as efficient and prolific job creators, the seeds of big businesses and the fuel of national economic engines.⁴ As a result of this, the need to develop an endogenous SME sector in Nigeria cannot be overstated.

The administration which was sworn in on the 29th of May 2015 recognised this need and reaffirmed its commitment to expand the SME sector as part of their development plan for the country. In an address by President Muhammadu Buhari, he restated his administration's commitment to providing both short-term

¹ However, in 2016 the Country slipped into a recession, and is only now recovering from its effects.

² Mukole, Kongolo, 'Job creation versus job shedding and the role of SMEs in economic development' (2010) 4 African Journal of Business Management 2288. This was a study carried out in South Africa regarding the contributions to job creation and development by SMEs in the country. The study concluded by reflecting on how SMEs remained a source of growth and development.

³ Dalberg 'Report on Support to SMEs in Developing Countries through Financial Intermediaries' (2011) < http://www.eib.org/attachments/dalberg_sme-briefing-paper.pdf > Accessed on 10th December 2018.

⁴ Benjamin, Asunka, 'The significance of information and communication technology for SMEs in rural communities' (2016) 4 Journal of Small Business and Entrepreneurship Development 29, 29.

and long-term loans to SMEs⁵ to aid in their growth and development. He further enjoined the Central Bank of Nigeria (CBN) to create more incentives and ease credit terms to enable lending,⁶ and enhance the overall growth of the sector. It will be asserted in this work that the current legal environment, the cultural environment and market structure does not support this development of the SME sector. By market, this thesis adopts the new institutional economics perspective that the market does not automatically construct itself, but rather it is something that is constructed. The justification for taking this approach is that the market does not work for the financing of small and medium enterprises in Nigeria. We know this because the government has been trying to do this since independence as we shall see in Chapter Two of this work,⁷ and still has not created a viable sector to date.

This thesis will assert that the failure of the SME capital market to function efficiently can be explained by the institutional problems which we shall analyse. Against the background premise of legal, cultural and market factors, this thesis will demonstrate that viability of the sector requires more than availability of finance and easing of credit terms as President Buhari proposes, but a combination of finance and a conducive institutional environment in which to do business.

Thus, it now becomes pertinent to rethink how the overall growth of the sector can be achieved, moving away from the idea that finance is key, and looking to assess how this conducive environment can be created. However, before we do

⁵ Sani Tukur 'Buhari tables proposal for rescuing Nigeria's troubled economy' *Premium Times* (Nigeria, 2016) <<http://www.premiumtimesng.com/news/headlines/200528-buhari-tables-proposal-rescuing-nigerias-troubled-economy.html>> Accessed on 10th December 2018

⁶ *Ibid*

⁷ The layout of most of these schemes focused on proving finance rather than anything else.

this, we must first unravel the nature of what constitutes an SME and examine its perceived role in achieving economic development.

1.2. Defining SMEs

Before we begin the investigation of the legal, market and cultural impediments to financing SMEs, it is relevant to first discuss what is meant by the term 'SMEs' in this thesis. It should be noted that the definition of SMEs differs from country to country, as each country has different yardsticks for defining the size of businesses. Definitions are important because they determine the level of access to capital such enterprises have. There have been many arguments surrounding what criteria should be used to classify businesses into small or medium enterprises.⁸ It has been proposed that benchmarks such as total net asset; sale and investment level;⁹ business turnover;¹⁰ the size of loan¹¹ or a combination of such benchmarks could be used in the definition of SMEs. Notably, it was observed from a study of various definitions used across different countries¹² that the most common criteria used in defining SMEs are the number of employees. It was noted that this is because "the number of employees does not vary with consideration to inflation rate compared to other criteria's",¹³ furthermore, the

⁸ In this work, microenterprises have been excluded. The focus of this work is to examine the transition from small to medium and beyond. Note that in the European Union, the main factors determining whether a company is an SME are the number of employees and the turnover or balance sheet total. European Commission 'What is an SME' <[http://ec.europa.eu/growth/smes/busine The significance of information and communication technology for SMEs in rural communities' ss-friendly-environment/sme-definition/index_en.htm](http://ec.europa.eu/growth/smes/busine%20The%20significance%20of%20information%20and%20communication%20technology%20for%20SMEs%20in%20rural%20communities%20ss-friendly-environment/sme-definition/index_en.htm) > Accessed on 10th December 2018.

⁹ Meghanna, Ayyagari, Thorsten Beck and Asli Demirguc-Kunt 'A 'Small, and Medium Enterprises from Across the Globe' (2007) Small Business Economics 415, 416.

¹⁰ Joshua Abor and Peter Quartey 'Issues in SME Development in Ghana and South Africa' (2010) International Research Journal of Finance and Economics 218, 219.

¹¹ Oyar Ardic, Nataliya Mylenko and Valentina Saltane, 'Small and Medium Enterprises A Cross-Country Analysis with A New Data Set' (2011) World Bank Policy Research Working Paper <<http://documents.worldbank.org/curated/en/967301468339577330/Small-and-medium-enterprises-a-cross-country-analysis-with-a-new-data-set>> Accessed 10th December 2018, 8.

¹² Countries like Ghana, Thailand, China, and the European Union etc. all use the number of employees to define SMEs.

¹³ Maria-Madalina Buculescu, 'Harmonization Process in Defining Small and Medium-sized Enterprises; Arguments for a Quantitative Definition Versus a Qualitative One' (2013) 20 Theoretical and Applied Economics 103, 107.

use of employees as the basis of definition gives a clear description and allows an easy comparison between companies.¹⁴

However, the use of the number of employees as a tool for defining SMEs has also been subject to its own criticism.¹⁵ Nevertheless, it has still been used as a common denominator in all definitions. It has also been observed that utilising employees as a benchmark is usually an indicator used in combination with other criteria. It must be noted, however, that because of the varying benchmarks used by different countries in defining SMEs, it has been concluded that there can be no true harmonization of the definition of SMEs. Reaffirming this point, Buculescu in his article stated that *"the principal criteria according to which SMEs are classified include the number of employees, the turn over and the total balance sheet, so it is difficult to suppose that there will be a general quantitative SME definition which could satisfy all the characteristics of SME, regarding the different degree of development of economies around the world"*.¹⁶

It is also worth mentioning that the number of employees is not a fixed constant across countries, this varies as well. Some start at ten employees for small businesses, thereby implying that anything below ten falls into the category of micro-business.¹⁷ However, the United Nations Industrial Development Organisation (hereafter UNIDO) are of a different opinion. They have concluded

¹⁴ Maximillian Robu, 'The Dynamic and Importance of SMEs in Economy' (2013) 13 The USV Annals of Economics and Public Administration 84, 84.

¹⁵ It has been argued that "The volume of turnover of a business is in general a more appropriate measure of its relative size than either of the more conventional measurements by number of employees or value of assets" See Tom Gibson and H.J Van der Vaart, 'Defining SMEs: A Less Imperfect Way of Defining Small and Medium Enterprises in Developing Countries' (2008) Brookings Global Economy and Development. Available at < https://www.brookings.edu/wp-content/uploads/2016/06/09_development_gibson.pdf > Accessed 10th December, 2018, 3.

¹⁶ Buculescu (n 13) 105.

¹⁷ An area this work is not concerned with.

that small businesses can exist with less than ten employees,¹⁸ especially in developing nations. Hence, they have defined SMEs in developing nations as follows; micro businesses are businesses with less than 5 employees, small enterprises between 5 -19 employees and medium firms 20 – 99.¹⁹ However, this definition is not one that typically applies in a developing nation, rather each nation has sought to create their own definition as we shall see in the case of Nigeria.

In Nigeria, although different schemes set up by the different government agencies (Federal or State) and different industries within Nigeria provide varying definitions,²⁰ the CBN has nevertheless, provided its own comprehensive definition. The CBN has stated that a 'small enterprise' is an entity with an asset base of 5 million Naira and not more than 50 million Naira²¹ (excluding land and buildings) with between 10 and 49 employees, while a 'medium enterprise' is one with an asset base of 50 million Naira and not more than 500 million Naira (excluding land and buildings) with between 50 and 199 employees.²² Therefore, a small-medium enterprise is one which has between 10-199 employees and an asset base of N5 million – N500 million (excluding land and buildings). While this

¹⁸ Countries like Ghana have taken cognizance of the fact that there are small businesses which have less than 10 employees without falling into the definition of a micro business. See Joseph, K. Nkuah, John P. Tanyeh and Kala Gaeten. 'Financing Small and Medium Enterprises (SMEs) in Ghana: Challenges and Determinants in Accessing Bank Credit' (2013) 2 International Journal of Research in Social Sciences 12, 13.

¹⁹ Dalitso Kayanula and Peter Quartey, 'The Policy Environment for Promoting Small and Medium-Sized Enterprises in Ghana and Malawi' (2000) Finance and Development Research Programme Working Paper Series Paper No.15 <<http://www.microfinancegateway.org/sites/default/files/mfg-en-paper-the-policy-environment-for-promoting-small-and-medium-sized-enterprises-in-ghana-and-malawi-2000.pdf>> Accessed 10th December 2018, 9.

²⁰ As we will see when discussing the Lagos State Employment Trust Fund in Chapter Four, they classify SMEs through their turnover rate only.

²¹ As at the exchange rate to the pound on the 6th of August 2019, that's about £11, 000 and not more than £111, 000

²² Micro, Small and Medium Enterprises Development Fund (MSMEDF) Guidelines (Revised – August 2014) Development Finance Department, Central Bank of Nigeria. Available at <<https://www.cbn.gov.ng/out/2014/dfd/msmedf%20guidelines%20%20.pdf>> Accessed on 10th December, 2018.

is the definition coined by the central bank, it is, however, pertinent to consider whether this truly reflects the nature of Nigerian SMEs.

From the definition of SMEs given by the CBN, we can see that they are not of the same view as UNIDO. The CBN has taken a different approach in its definition; any business that has fewer than 10 employees come under the purview of a micro business. The Nigerian government does not recognize that small businesses can still exist with fewer employees than this number, or the fact that there is a viable informal economy that functions outside the coined definition of SMEs and contributes immensely to the economy. Nevertheless, for this research, we are more concerned with what the Nigerian government acknowledges as small businesses, and how legal, market and cultural impediments influence how they access capital.

Notably, from the definition given by the CBN, we can see that the number of employees and assets (excluding land and buildings) of the enterprise have been used as a criterion to define the nature of SMEs. The CBN criteria for the definition of SMEs are in tandem with the Organisation for Economic Co-operation and Development (OECD). The OECD have based their definition of an SME on both the number of employees and assets, and in doing so, they have concluded that "small firms are generally those with fewer than 50 employees, while micro-enterprises have at most 10",²³ reflecting the conclusion that a business is categorized as small when it hits the mark of 10 employees. With regards to the number of employees an SME should have, the CBN's definition is similar to that

²³ OECD 'Small and Medium-Sized Enterprises (SMEs)' Available at < <https://stats.oecd.org/glossary/detail.asp?ID=3123> > Accessed 10th December 2018.

of the European Commission.²⁴ While the Commission exceeds the Nigerian 199 employee cut off, they do agree that small firms start when employees exceed ten (10).

Nigeria also considers assets in conjunction with the number of employees, as does the OECD, the Philippine²⁵ and Thai governments.²⁶ Whilst the difference in currencies cannot provide for a more accurate comparison between countries, we must admit that 5- 500 million Naira in assets within the Nigerian context, is a large sum in business. There is no single right or perfect definition of SME.²⁷ Different countries work with different definitions based on their selected benchmark, and as we have seen most of these definitions do not recognise the fact that small businesses can exist with fewer employees than 10. The CBN definition is what generally applies in Nigeria; whether the definition is appropriate and needs reform will always be a topic for debate, however, we can accept that it adopts globally recognised yardsticks. An analysis of the Nigerian definition generates the question 'whether or not inspiration should be drawn from standards set by OECD and EC' as these consist mostly of nations that are categorized as developed, or if the UNIDO characterization of an SME offers a more acceptable definition, as it seems it has been tailored for developing nations and reflects that small businesses exist below the benchmark of 10 employees. Based on the discussions above, we have noted that there can be no true harmonization when it comes to defining SMEs. There is a range of criteria to

²⁴ The European Commission classifies any business with fewer than 10 employees as a micro business, 10 to 50 employees are classified as small, from 50 to 250 is classified as medium. See European Commission (n 8).

²⁵ Asterio Tenedero Miranda and Juneth Lourdes Fiel Miranda 'Status and conditions of small and medium-sized enterprises as predictors in empowering rural communities in Samar Island, Philippines' (2018) 12 Asia Pacific Journal of Innovation and Entrepreneurship 105, 107.

²⁶ Harri Ramcharran 'Financing Small and Medium-Sized Enterprises in Thailand: The Importance of Bank Loans and Financing Diversification' (2017) 19 The Journal of Entrepreneurial Finance 1, 11.

²⁷ Ruth Hillary, *SME and the Environment: Business Imperative* (Greenleaf 2000) 13.

base the definition on, and while very few countries agree on using the same two benchmarks, their definitions are not necessarily wrong. Authors have pushed for more multi-dimensional and differentiated definitions of SMEs.²⁸ This implies that an SME definition should be based on the most commonly used number of employees, turnover, and capital, but it must also consider the field of activity such as transport, telecommunications, trade, etc. While the CBN definition fails to take into consideration many factors, they have, however, used acceptable justifiable criteria in their definition of an SME. It could be asked if this definition used by the CBN actually reflects the nature of SMEs operating in Nigeria. As noted above, the CBN constructs its definition using accepted yardsticks. Therefore, based on this and the CBN's own survey of the sector, the government definitely thinks it is a true reflection of the Nigerian business environment.

1.3. Forms of Business Organisations.

Beyond defining the nature of SMEs, we must also consider what legal form these enterprises may choose to adopt while carrying out their activities. This is particularly important in the Nigerian environment because beyond the legal requirement to do so for some types of businesses, these businesses must function under the covering of corruption. Therefore, a shelter of legitimacy often needs to be established in order to conduct business internally and externally. This legitimacy is seen to be granted through the registration of the business; thus, a registration culture has been created, particularly in Lagos, Nigeria. This is not to say that every business being registered is free from engaging in illegal

²⁸ "I would rather be a supporter of multi-dimensional and differentiated approaches which points out the enterprise as a complex system, socio-economic, technical-material, dynamic and adaptive". Robu (n 14) 84.

activities, or is always set up for valid purposes, but being registered casts a favourable view on the organisation by people or organisations who might want to engage with it. Interestingly, what has been observed from practice is that sometimes the legal registration does not reflect the nature of the enterprise's activity,²⁹ but rather covering the need to have the registration documents.

As with Nigeria and the world in general, there are various types of organisations which can be used to carry out business. They often include the sole proprietor, partnerships and the Company. Each form of business has unique characteristics which have been assigned to it by law. It should be noted that Nigeria and the United Kingdom (UK) share a common origin with regards to applicable law. Both countries are governed by common law, and Nigeria as a former colony of the UK, has adopted most English laws and where necessary modified or created its own laws as lacunas were identified.

1.3.1. The Sole Proprietor, the Partnership and Registration of Business Names.

As the name implies the sole trader is a single person business. The sole trader is the exclusive owner of his business and shoulders all profit and loss. They contract in their own name and have personal liability for all the debts of their business. Under both Nigerian and UK law, there is no distinction between the personal asset of the sole trader and the business assets. For Partnerships, **Section 1(1)** of the UK Partnership Act of 1890 defines a partnership to be the 'relationship that subsists between persons carrying on a business in common

²⁹ It was observed from practice that forming a 'Company' was the most likely choice for individuals whether or not it was suitable for their purpose, "They simply wanted a company for business". This need for a company for business has created a registration culture within Lagos especially.

with a view of profit'. This Partnership Act of 1890 generally applies in Nigeria, except in the western region which applies the Nigerian Partnership Law of 1958. It should be noted that a partnership is not a separate legal entity and partners are jointly liable for the firm's debt and obligation without limit. However, in the UK³⁰ in 2000, the Limited Liability Partnership Act (LLPA) was enacted and this created a hybrid form of partnership, 'the limited liability partnership (LLP)'. The LLP is a body corporate with a legal personality separate from that of its members. This is in contrast with the general form of partnership where all partners share the liability of the firms' debt.

As noted above, partnerships in Nigeria are generally regulated by the United Kingdom Partnership Act of 1890. While the Companies and Allied Matters Act 1990³¹ (CAMA) also regulates the operations of partnerships in Nigeria, it does not repeal the English Act but limits the number of parties allowed in a Partnership to 20. Under the 1890 Act, only one type of partnership existed, that is the general form of partnership, where all partners are jointly liable for the debt of the firm, and no separate legal personality exists between the partners and the firm.

It should, however, be noted that Lagos State has now enacted their own Partnership legislation. In Lagos, the Partnership Act of 2003 was enacted and was again revised in 2009. The revisions sought to add the concept of a Limited Liability Partnership. This New Act in Lagos brings the law in tandem with the

³⁰ Note that the UK also has the Limited Partnership Act of 1907 which allows for sleeping partners, so long as there is a general partner who is liable and manages the business.

³¹ **CAP C20** Laws of the Federation of Nigeria (LFN) 2004.

current position under UK law in which Limited Liability Partnerships³² already exist.

It should be noted that the Act does not actually define what a Limited Liability Partner is, but it does establish how it can be created and what the liability of the limited partner is. Specifically, **Section 76 (3) (a)** states that a limited liability partner shall not be liable for the debts; actions; or inactions of the Partnership or Limited Liability Partnership beyond the amount subscribed to by such Limited Liability Partner. **Section 58 (5)** notes that a judgement against the partnership is not by itself a judgement against a partner. A judgement against a partnership may not be satisfied from the partner's asset unless there is also a judgement against the partner.

This implies a separate personality is created from the members as we see under the UK Limited Liability Partnership Act of 2000. Thus, like the UK, a Limited Liability Partnership is a hybrid of a general partnership and the concept of limited liability. It is a kind of Partnership in which some partners have limited liability. It contrasts with the principles of general Partnership in that a limited partner is not responsible for the conduct or acts of the other partners. This distinguishes it from the traditional/general form of partnerships applicable in the rest of Nigeria for states that are yet to enact their respective Partnership Laws.

Registration of Business names.

Even when trading as a sole proprietor or in a Partnership, registration of the business name in Nigeria is compulsory when the business name does not include

³² It is relevant to note that CAMA is currently being reviewed, the new CAMA 2018 bill introduces the Limited Liability Partnership and Limited Partnerships. Although this has not been passed into law yet since it is a Federal Legislation, its provisions will apply across the country. Also introduced by the bill is the single-member companies.

the true name of the owners. While registration gives no distinct personality i.e. the registered business name has no distinct legal personality different from that of the owner, it is still a requirement under law to be registered. Specifically, **Section 573 (1) CAMA** provides that:

"Every individual, firm or corporation having a place of business in Nigeria and carrying on business under a business name shall be registered in the manner provided in this Part of this Act if;

(a) in the case of a firm, the name does not consist of the true surname of all partners without any addition other than the true forenames of the individual partners or the initials of such forenames;

(b) in the case of an individual, the name does not consist of his true surname without any addition other than his true forenames or the initials thereof;

(c) in the case of a corporation, whether or not registered under this Act, the name does not consist of its corporate name without any addition."

There are however exceptions to the above, sub-section 2 highlights them as follows;

a) the addition merely indicates that the business is carried on in succession to a former owner of the business, that addition shall not of itself render registration necessary;

(b) two or more individual partners have the same surname, the addition of an "s" at the end of that surname shall not of itself render registration necessary; and

(c) the business is carried on by a receiver or manager appointed by any court, the registration shall not be necessary.

In the UK, registration of a business name is not compulsory, but if registered with Companies House, it is protected from other businesses trying using the same name. It is relevant to note that in Nigeria, after registration, a certificate of registration is issued by the registrar of the commission.

1.3.2. The Company

The Company is always distinguishable from all other forms of business organisations. Creations of a company unlike the sole proprietor and general partnership create a distinct personality from the individual or group of individuals that create it. This principle was reflected on in the renowned case of ***Salomon v. Salomon Co. Ltd [1879] AC 22***, where it was stated that:

"the company is at law a different person altogether from its subscribers to the memorandum, and... the company is not in law the agent of the subscribers or trustee for them".

As previously stated, Nigerian law is rooted in English law and as such has adopted English principles with regards to their company law. A Company, both in UK and Nigeria, is formed by one or more persons subscribing their names to a memorandum of association and complying with the requirements of registration. They can form an incorporated company, with or without limited liability and in the case of a company limited by shares, one which is either public or private.

Section 37 CAMA states that the effect of registering a company is that from the date of incorporation mentioned in the certificate of incorporation, the subscriber of the memorandum together with such other persons as may, from time to time, become members of the company, shall be a body corporate by the name contained in the memorandum, capable forthwith of exercising all the powers and functions of an incorporated company including the power to hold land, and having perpetual succession and a common seal.

1.4. Problem Statement and Research Context

Despite the potential role SMEs can play in developing the Nigerian economy, there are however legal, market, cultural and financial constraints which hinder the growth of the SME sector. These constraints affect the development of these SMEs, stopping the SME sector from truly becoming successful. This is concerning considering the current level of inflation in the country and the fact the country is still struggling out of a recession.³³ Nigeria has recently been ranked as the poverty capital of the world, overtaking India in terms of the level of poor people in the country³⁴ and without the necessary framework to sustain the SME sector, it is hard to see how development can be achieved and income generated, especially with the drop in demand for Nigeria's oil.

As we shall see over the course of the next few chapters, most SMEs in the country lack the right infrastructure, training, adequate information, collateral requirements and are often hindered by the government policies and regulations

³³ IMF 'Nigeria: Out of Recession and Looking beyond Oil' (2018) Available at < <https://www.imf.org/en/News/Articles/2018/03/15/na031518-nigeria-out-of-recession-and-looking-beyond-oil> > Accessed 26th March 2019.

³⁴ Bukola Adebayo, 'Nigeria overtakes India in extreme poverty ranking' *CNN* Available at < <https://edition.cnn.com/2018/06/26/africa/nigeria-overtakes-india-extreme-poverty-intl/index.html> > Accessed 10th December 2018.

put in place to aid their development. This study goes past the surface requirement of providing security/collateral as a means for obtaining loans, also examining the intricate relationship between rules, norms and all forms of human created constrictions as they affect the development of the sector. This study will show that the problems faced by SMEs is beyond the simple issue of obtaining finance- although this is part of it, but rather a combination of various factors of the legal and cultural environment which the enterprise is set in.

The study will be limited to an observation of the Lagos State SME sector, because of the progressive nature of the state in terms of policy and law as compared to the other states within the federation. It is also seen as the business hub of Nigeria.³⁵ Lagos also offers a somewhat clearer land registration system albeit problematic³⁶ as compared with its counterpart states. It is envisioned that because Lagos already stands as a forerunner in terms of laws, policy and development, any problems identified in a study of Lagos would be likely to be found across other states. In addition to the practicality of using Lagos as the setting for the thesis, as a researcher who is a Nigerian national, who has lived and worked in the Lagos sector and with family and networks within the country, information from such networks and experiences from living in Lagos will also be used to inform on areas in this thesis.

³⁵ Not only is Lagos the business hub of the country, it also acts as the home for technological advancement within the country. Because of the current innovations going on, the founder of Facebook paid a visit to discuss the learning science powering its developers. See Emmanuel Ogunsola, 'Mark Zuckerberg inspires nearly 200 Nigerian Developers during Andela Lagos visit' (2016) *TechPoint Africa*. Available at < <https://techpoint.africa/2016/08/31/mark-zuckerberg-visits-andela-lagos/> > Accessed 26th March, 2019.

³⁶ We shall examine this problem more fully in chapter five of this thesis.

1.5. Aims of Research and Research Objectives.

As stated earlier, there has been a renewed interest in the development of the SME sector in Nigeria, however, with this comes the potential danger of repeating the old mistakes of previous administrations that sought to develop the sector. This work aims to add to the existing body of knowledge by investigating and identifying the bottlenecks to creating sustainable growth in the SME sector. This will be done through an examination of not only historical antecedents of the SME sector, but also an examination of the institutions³⁷ that act as a catalyst within the sector. This study sets out to establish that sustainability can be achieved not only through a refinement of the current policies, norms and laws, but also through enhancement of secured lending laws to incorporate a variety of collateral options, development of institutional trust, greater creditor protection through a review of the bankruptcy and insolvency laws, and through an adoption of mechanisms and incentives to motivate individuals to develop the sector.

Aims:

Succinctly, the work will conduct an analysis of the legal, market, and cultural elements affecting the provision of lending to SMEs in Lagos with an emphasis on:

- (I) The legal institutions that play a direct role, such as debt recovery, insolvency regime, business forms; policy and laws aimed at developing the SME sector.
- (II) The perceived failures in the sector and the resulting inadequacy to develop the sector.

³⁷ Which includes both the formal and informal rules, the norms and culture that influence the decisions people make.

Objectives:

The objectives of the study include:

1. Exposition of the relevant law of business form (corporate, partnership, sole trader), security law (mortgages), debt recovery, and insolvency law.
2. Providing a historical narrative of the initiatives and schemes in Nigeria directed at improving finance to SMEs.
3. Identifying the problems that hinder the financing of SMEs in the Lagos business environment, examining issues such as the low levels of trust, weak rule of law, and the knowledge derived from the history of past failures.
4. Exposition of the analytical frame to be deployed in investigating the SME sector.
5. Analysis of the finance of SMEs in Lagos using the Ostrom framework.
6. Consideration of the results of the analysis.
7. Reflection upon possible legal reforms informed by the analysis.

1.6. Methodology

The thesis adopts both a doctrinal and socio-legal approach to answering its question. Doctrinal because it focuses on the law (as we shall see in the thesis, Debt recovery law, Company law, different rules of the various courts in Nigeria and Case Law). The doctrinal approach included access to all internal hard and grey law sources recognised in the jurisdiction. It is from such sources that data and information were generated and used for the study.

Access to such sources was obtained through libraries, relevant websites, and registries located in Nigeria (company & land registries for Lagos). Relevant reports by international bodies such as the World Bank, lending institutions,

business community organizations and law reform commissions in Nigeria were sought and used in determining what support for SMEs were available and if it was perceived as adequate; and if, as preliminary research indicates, support is not adequate, then what obstacles to the development of SMEs exist in the Nigerian – specifically Lagos context.

The thesis however moves beyond the doctrinal analysis and also adopts a sociolegal framing as we move away from looking at the law and policy but also consider how they are applied and its effects in society, to build a more contextual analysis, because the law does not operate in a vacuum but rather influenced by other attributes of society such as norms.

This socio-legal approach is specifically discussed through a new institutional economic perspective, that is an attempt to incorporate the theory how institutions play an important role in economic development. Generally, to do this, an empirical study would usually be required to test the merits of this theoretical assertion. However, given the limitations of the thesis, specifically an absence of any funding for fieldwork and my residence in the UK and not Lagos, it was decided that an actual empirical study could not be undertaken. Therefore, other methods akin to an empirical approach, which allowed for the same rigour, was required. Something that allowed for conducting the analysis of the sector but would also give an accurate, or as close to an accurate analysis of the Lagos SME sector and the problems within it, that an empirical study would reveal.

Thus, Ostrom's Institutional Analysis Development Framework (IAD) has been used as a substitute for the empirical study. What will be observed from the thesis as we study Ostrom's work and the use of her framework, is that the framework

allows for two possible applications, an actual empirical study; or a theoretical one where a conceptual community would be observed and assumptions about their behaviour and interactions would be made using behavioural theory. It is the latter application that this thesis adopts to make its findings.

Thus, the methodology is a classic combination of doctrinal investigation subject to evaluative criteria informed by extra-legal policy, with a desire to generate prescriptive potential.

1.6.1. Contribution to knowledge

The originality of the work comes in two parts; the location in which the research is carried out, and the method of carrying out the research. It must be noted that Nigeria operates a Federal system of governance (i.e. power is divided between the Federal and State government), and while some states occasionally cater to the development of SMEs within their region, the development of the SME sector has been largely advanced by the Federal government. Given the Federal character of Nigeria, it can be stated without doubt that some states are more progressive than others. For example, compared to other states, Lagos has a more effective land registration system and extends its forms of business organisations to include Limited Partnerships and Limited Liability Partnerships, an advantageous option for potential SMEs. The project will capitalise on the legal advancements made in Lagos, and its practices around SMEs to uncover policy and institutional changes that would be relevant to the Lagos SMEs but can also be extended to other states. Thus, contributing to the discourse on SME policy in Nigeria.

The thesis makes contributions to six distinct bodies of literature because of the specific context which the investigation is set in. The first being the SME policy literature already discussed above, the second being the discourse on law and development in the context of SME development and funding in Lagos. The third literature contribution is through the method used. Ostrom's theory and modelling is novel in the realm of SME funding, and the use of it will also be unique to the Lagos SME sector. Furthermore, the analysis of the problem of finance from a socio-legal standpoint will add to the body of literature.

The thesis further aims to contribute to knowledge by drawing on the discourses around Market Theory (that is, the discourse around self-generating and constituted markets). The discourse on Game Theory and New Institutional Economics, elaborating on them and how they influence the Lagos SME sector.

Through game theory, the thesis will identify how the corrupt system in Nigeria, specifically Lagos, degrades the quality of interaction and the ability to build cooperation, identifying a relevant cultural problem impeding the development of the SME sector. What this thesis does is move away from the general narrative of the politically corrupt in Nigeria but examines corruption of the everyday level of interactions between lenders, borrowers and low-level state employees.

Through New Institutional Economics, the importance of institutions, their structure, and their influence on the development and organisation of markets will be identified. This identification feeds into the proposed method of investigation and allows for the extension of Ostrom's IAD framework into the Lagos SME sector. This extension is enabled by the synthesis of information from the Lagos SME sector with the framework. This synthesis will reveal that for the

sector to thrive, priority should be placed on building normative and structural institutions which support people in the absence of trust.

Finally, it is asserted that methodological contributions will be made. The thesis generates a synthesis of legal doctrinal methods and NIE theory in an unusual and rigorous way, adding to the burgeoning socio-legal literature. The thesis also adds value through the use of life-world knowledge and the information networks available, creating a self-conscious reflection of the methodology and SME sector.

1.7. Structure of the Thesis

The thesis is divided into eight chapters, chapter one is the introductory chapter, which gives a general introduction to the thesis and definition of concepts. The chapter introduces the methodology to be used and identifies what contribution the thesis aims to make through the objectives. Following this is chapter two, this second chapter gives the reader an understanding of the historical context of the topic, looking at what has previously been done with regards to developing the sector and what is currently being done. The chapter gives a review from 1960 to date and draws preliminary conclusions on how most of the government interventions aimed at financing SMEs failed due to problems of mismanagement, corruption, high default rate by borrowers etc. This chapter demonstrates that there is no effective market for financing SMEs in Nigeria, or at least the market is inherently defective, thereby, highlighting specific challenges which makes the topic relevant and that the thesis will try to address.

Chapter three gives an elaboration of the thought process used in selecting a methodology, it considers theories like New Institutional Economics, Free Market theory and how these feed into the overall framework of the thesis. Chapter four

is the longest chapter in the thesis, and it establishes the methodology of the thesis. This chapter introduces the reader to the model (Ostrom's IAD framework) that will be used to investigate the legal, market and cultural impediments to financing SMEs in Lagos. The chapter familiarises the reader with crucial terminologies and concepts that form the foundation of the model. It was crucial to be as clear as possible when writing this chapter, because Ostrom's model has technical terms which needed to be explained. The explanation is necessary because if the framework is to be used as a diagnostic tool to affirm the conjectures made about the SME sector, understanding the institutional environment and determining how markets can be constructed, while also developing incentive structures to encourage lending despite cultural issues, then a clear understanding of the intricacies of the model is critical.

Chapter five gives a description of theoretical concepts that aid the use of the model. The chapter contributes to the thesis in three significant ways. The first contribution is the examination of game theory and rational choice theory which influences the actions and behaviours of the proposed actors in our model. The second contribution that this chapter makes, is to establish the significance of trust, that is, "Calculative trust" and the influence it has on an actor's action to engage with others. Finally, in this chapter, we discuss the Nigerian Legal environment, and the enforcement of contracts during bankruptcy and insolvency. In a nutshell, this chapter establishes the conceptual underpinnings of the thesis which validate the decisions the actors in the arena make.

In chapter six, the IAD framework is unpacked further, as is the evaluative criteria used in assessing the model. In this chapter I begin my first analysis of the Lagos SME sector and begin to identify issues hindering the development of SMEs,

drawing preliminary conclusions. The analysis done in this chapter acts as a foundation for the deeper analysis conducted in chapter seven.

Chapter seven goes to the heart of the thesis. This chapter looks finally at the legal, market and cultural impediments to financing SMEs in Lagos. The thesis here examines the impact of these institutions on the SME sector and similar to chapter five, draws conclusions. This chapter completes the analysis of how the IAD framework can be used as a lens to view different policy and institutional elements.

Chapter eight is the conclusion. It pulls together all the issues discussed in the previous chapters. It links back to what the research question tried to answer and provides a final perspective on the use of the model and the PhD overall.

1.8. Concluding Statement

In this chapter I outlined the overall background to the research and situated the context. This Chapter also highlighted the definition of SMEs which would be adopted. It was observed that SMEs have different definitions around the world and across industries because of different yardsticks used to determine their nature, thus, there can be no true harmonization of definitions. However, the chapter concludes by using the definition provided by the Central Bank of Nigeria. Also, in this chapter, the reader was fully familiarised with the research aims and objectives of the work. The aims being an examination of perceived policy failures and the resulting inadequacy to finance the sector, and discussion of the direct roles legal institutions play in developing the sector. Furthermore, the chapter briefly describes the methodology to be adopted which will be more fully

elaborated on in chapter three. Fundamentally, this chapter sets out the form which the ensuing chapters will take.

Chapter Two: A Succinct Overview of Schemes Aimed at Developing the Small-Medium Enterprise Sector in Nigeria

2.1. Introduction.

In the previous chapter, we gave a general overview of the nature and definition of SMEs. We noted that different countries defined SMEs using different benchmarks, and because of the variation of benchmarks, there could be no harmonization in the definition of SMEs. While agreeing with this conclusion, we nevertheless settled on a definition to be used within this work, and that was the one provided by the CBN.³⁸ Beyond defining the nature of SMEs, we also considered the different forms of business organisation which an SME may use to conduct business and noted a growing business registration culture in Nigeria, particularly in Lagos, which is where this study is set. The chapter also set out the aims and objectives of this study and began to give a preliminary framing of the problems faced by SMEs and how the work intends to tackle the problem.

However, before we can begin to tackle the perceived problems, we must first fully appreciate what they are. The aim of this chapter is to trace as far back as Nigerian independence in 1960 to present time, the SME financing initiatives created during each administration, and the contributions by some private sectors to SME development. This chapter will highlight briefly some of their features and

³⁸ According to the CBN, an SME is one which has between 10-199 employees and an asset base of N5 million – N500 million (excluding land and buildings). Central Bank of Nigeria 'Credit Delivery to Small and Medium Enterprises: Post Bank Consolidation in Nigeria' Occasional Paper No. 53 Available at < <https://www.cbn.gov.ng/out/2015/rsd/credit%20delivery%20to%20small%20and%20medium%20enterprises-post%20bank%20consolidationin%20nigeria.pdf> > Accessed on 2nd February 2016, 8.

identify where possible, the reason or reasons for their failures, if they no longer exist.

A large part of the history of SMEs in Nigeria can be tied to government interventions schemes or government financial grants to certain sectors or industries that have needed fiscal aid. This does not mean that there have been no private efforts to develop the sector,³⁹ but the majority of the developmental efforts have been undertaken by the government, with the aim of utilizing the vast labour market in Nigeria to reduce poverty and develop the economy. The establishment of schemes to aid in the development of SMEs in Nigeria can be traced to as far back as 1962. These schemes, as stated above, were often government initiatives and were mostly funded by them or in conjunction with an international or local body. The schemes often focused on parts of the economy the government wished to generate the interest in and develop as part of their economic plan, for example, agriculture, manufacturing, etc. The different schemes that arose were created as part of each administration's need to diversify the economy and eradicate poverty and were often tagged as "poverty alleviation programmes".

It is generally asserted that a robust interest in the financing of SMEs developed fully from 1970.⁴⁰ Notwithstanding this, it is pertinent to mention that back in 1962 the Nigerian government had appreciated the ability of SMEs to boost the

³⁹ We shall also consider some private interventions further on.

⁴⁰In 1970, the Central Bank of Nigeria expanded its credit guidelines to incorporate Small and Medium Scale Enterprises with effect from January 1971. With the directive, at least 10% of bank loans and advances were allocated to Small and Medium Scale Enterprises. Emmanuel O. Oni and Abdulazeez A. Daniya, 'Development of Small and Medium Scale Enterprises: The role of Government and other Financial Institutions' (2012) 1 Arabian Journal of Business and Management Review (OMAN Chapter) 16, 20.

economy of a country,⁴¹ in light of this, Industrial Development Centres (IDC's) were established within various states, later culminating in the creation of the Nigerian Industrial Development Bank.

Below we shall now consider some of the features of these initiatives introduced by the Government. The schemes will be considered under the different National development plans that were developed over the years. These plans were supposed to be broad programs aimed at promoting the welfare of Nigerians.

2.1.1. Schemes under the First National Development Plan

The first National Development Plan was supposed to last for a period of six years, this was to be from 1962 -1968. Under this plan, emphasis lay on promoting agricultural, industrial, transport and manpower development⁴² in Nigeria. The aim was to see a 4% increase in the GDP of the Nigerian economy, but the plan was interrupted by the Thirty-month Civil War which ended in 1970.⁴³ However, before the War, , Nigeria saw the development of two schemes under this plan in 1962 and 1964. The first was the Industrial Development Centres (IDCs), which were established to provide extension services to SMEs in such areas such as project appraisal for loan application, training of entrepreneurs, managerial assistance, product development, production planning

⁴¹ Under the First National Development Plan which occurred between 1962 and 1968, the Government planned to put the Nigerian economy on the path of accelerated growth by prioritizing agricultural and industrial development as well as training of high-level and intermediate manpower. Sanusi Lamido Sanusi, 'Central Bank of Nigeria: Nigeria's Economic Development Aspirations and The Leadership Question: Is There a Nexus?' (2012) < <http://www.cenbank.org/out/2012/ccd/Nigeria%27s%20Economic%20Development%20Aspirations%20and%20the%20Leadership%20Question%20-%20Is%20there%20a%20Nexus.pdf> > Accessed 1st February 2016, 3.

⁴² Jide Ibieta and Oghator Ekhosuehi 'Trends in Development Planning in Nigeria: 1962 to 2012' (2013) 15 Journal of Sustainable Development in Africa 297, 300.

⁴³ *Ibid*

and control.⁴⁴ It was noted that the first IDC was established in Owerri by the former Eastern Nigeria Government and the Ministry of Trade and Industry.⁴⁵ *"Through the IDCs, entrepreneurs were expected to learn about new production techniques, new types of machinery and their usage, how to develop a feasibility plan as well as establishing small scale businesses"*.⁴⁶ It was, however, stated that during this period, the IDCs were poorly implemented as they were inadequately equipped and funded.⁴⁷

After the creation of IDCs, "the Nigerian Industrial Development Bank (NIDB) was created in 1964 to address the problem of long term financing to large scale manufacturing and service industries in Nigeria".⁴⁸ While the NIDB focused on large scale industries, its small and medium-scale dealings were conducted through the intermediation of the various regional development corporations and other expanded credit institutions, including the World Bank.⁴⁹ It has been stated that the argument for the involvement of the World Bank in the development

⁴⁴ Sanusi Lamido Sanusi 'Overview of Government's Effort in the Development of SMEs and the Emergence of Small and Medium Industries Equity Investment Schemes (SMIEIS)' (2003) < <https://www.cbn.gov.ng/OUT/SPEECHES/2003/GOVADD-10BJUNE.PDF> > Accessed 25th January 2016, 4.

⁴⁵ It would seem that this was initially a state initiative because in 1970 it was appropriated by the Federal Government, and after the takeover more IDCs were established in other states.

⁴⁶ Hassan, M. Ayinde and Olaniran, S. Olawale 'Developing Small Business Entrepreneurs through Assistance Institutions: The Role of Industrial Development Centre, Osogbo, Nigeria' (2011) 2 International Journal of Business and Management 213, 216.

⁴⁷ Sanusi (n 45). We must, however, note that after the civil war some studies have claimed that the IDCs have now contributed immensely to the development of SMEs, in particular, the Osogbo IDC which was established in 1976. Ayinde (n 47). In 2009 these IDCs were turned over to the Small Medium Enterprise Development Agency (SMEDAN) for management, an agency which we shall examine in great detail in chapter six.

⁴⁸ Sama'ila I. Ningi and Tahir, H. Mairiga 'The Role of Bank of Industry (BOI) in the development of Small and Medium Scale Enterprises (SMEs) in Bauchi Metropolis' (2015) 2 Research Journal of Finance and Accounting 118, 120. It was noted that it was created through a reconstruction of the Investment Company of Nigeria. These banks were chartered to provide medium and long-term credit to existing industrial and mining firms in Nigeria. Nigerian Industrial Development Bank. Available at < http://nigerianwiki.com/wiki/Nigerian_Industrial_Development_Bank > Accessed on 17th January 2019.

⁴⁹ Eme O. Essien, 'The Role of Development Finance Institutions (DFIs) in the Financing of Small-Scale Industries' (2001) Central Bank Bulletin No.25 3, 3.

bank initiative was that such an institution would serve as a bridge for successfully extending the NIDB's credit facilities to local industrial operators.⁵⁰

It has been argued that operational constraints and environmental peculiarities helped to undermine the achievement of the bank's goals, thus in 2001 it was merged with NERFUND (National Economic Reconstruction Fund) and the NBCI (Nigerian Bank for Commerce and Industry to form the Bank of Industry (hereafter BOI).⁵¹

2.1.2. Schemes of the Second National Development Plan

The second National Development Plan⁵² lasted for a period of four years, this was from 1970 -1974. Under this plan, it can be said that the first fully formed interest in SMEs in Nigeria began, this is based on the initiatives that were created. During this period several small-scale industry financing schemes were initiated by the Government. It was stated that "selective credit allocation became imperative in the early 1970s when investment capital was scarce and access to bank credit was limited".⁵³ Between 1970 and 1974, several initiatives were developed, in 1971 the Small Scale Industries Credit Scheme (SSICS) was set up by the Federal Military Government to provide technical and financial support for the SMEs.⁵⁴ It was stated that the scheme operated as a matching grant between the Federal and State Governments and was designed to make credit available

⁵⁰ Green O. Nwankwo, *The Nigerian Financial System* (Macmillan Publishers 1980) 95.

⁵¹ Ezeoha, E. Abel 'Industrial Development Banking in Nigeria: A Forty Year Failed Experiment' (2007) 3 Journal of Economic Policy Reform 193, 194.

⁵² Also referred to as the Oil-Boom development plan because it coincided with the period Nigeria started making high earnings from oil. Ibietan (n 43) 301.

⁵³ Essien, S.N. and Akpan, N.I 'Credit Policies and Private Sector Investment in Nigeria' (2007) 1 Bullion Publication of the Central Bank of Nigeria 1, 1.

⁵⁴ Sanusi (n 42).

on liberal terms to the SMEs, this led to the creation of the Small Industries Credit Fund (SICF).⁵⁵ Management was left in the hands of the States' Ministries of Industry, Trade and Co-operatives but the scheme was unsuccessful because it lacked executive manpower to supervise and monitor projects. Thus, many unviable projects were funded leading to massive repayment default.⁵⁶

The next scheme under this plan was set up a year later in 1972, this was the Nigeria Agriculture and Co-operative Bank (NACB).⁵⁷ Their mandate was to provide affordable credit facilities to micro, small and medium scale farmers. The scheme utilised cooperative societies as a channel of loan disbursement and repayment.⁵⁸ Records available on NACB's financial services indicate that the number of agricultural projects that were granted loans by NACB increased from 2,446 in 1990 to 6,286 in 1994, which accounted for 157% growth in the number of loans approved by the bank in five years.⁵⁹ However, the scheme is now defunct because it was merged with the Family Economic Advancement Programme in 2000 to create Nigerian Agricultural Co-operative and Rural Development Bank (NACRDB).⁶⁰

After this, in 1973, the Nigerian Bank for Commerce and Industry (NBCI) was created.⁶¹ Again, like the other schemes in this period, it was set up to provide long-term investment financing and equity funds to small and medium industries.⁶² They engaged in "share underwriting, project identification and

⁵⁵ Sanusi (n 42).

⁵⁶ *Ibid.*

⁵⁷ Onyinyechi Josephine Nwanyanwu 'Micro Finance in Nigeria: Problems and Prospects' (2011) 19 African Research Review 87, 91.

⁵⁸ *Ibid*

⁵⁹ *Ibid*

⁶⁰ This shall be discussed in the year 2000 section.

⁶¹ Central Bank of Nigeria (n 39) 27.

⁶² *Ibid*

feasibility studies for SMEs and operated as an apex financial institution for the SMEs, thus would later go on to administer the SME I World Bank loan scheme of 1985".⁶³ Their main sources of funds included subventions from the Federal Government and the CBN through penalties imposed on commercial and merchant banks for credit shortfalls on loans to small and medium scale enterprises.⁶⁴ During its existence, they approved a total of 797 projects amounting to N965.5 million between 1973 and 1989, and disbursed N 141.82 million between 1987 and 1988.⁶⁵ Under the SME I scheme initiated by the World Bank, they financed a total of 126 projects.⁶⁶ The scheme, however, suffered from operational problems, culminating in a state of insolvency from 1989.⁶⁷

2.1.3. Schemes of the Third National Development Plan

During the third National Development Plan in Nigeria which occurred between 1975 -1980, one of the main objectives of the government was to create diverse economic activity.⁶⁸ An evaluation of the schemes during this period reveals that the diversification mostly focused on agricultural schemes. The development plan emphasised as part of its objectives; research into both food and cash crops for domestic and export purposes and research into and development of, livestock and veterinary practices and rural development.⁶⁹ Under this, the Rural Banking

⁶³ Central Bank of Nigeria (n 39) 27.

⁶⁴ *Ibid*

⁶⁵ *Ibid*

⁶⁶ Some of which were cancelled due to the failure of the project sponsors to contribute their counterpart funding. Central Bank of Nigeria (n 39) 27.

⁶⁷ Central Bank of Nigeria (n 39) 27.

⁶⁸ Lewis A. Olufemi, 'Nigeria's Third National Development Plan 1975-1980: An Appraisal of Objectives and Policy Frame' Available at < <http://onlinelibrary.wiley.com/doi/10.1111/j.1746-1049.1977.tb00370.x/epdf>> Accessed on 2nd February, 60.

⁶⁹ Ibietan (n 43) 302.

Scheme (RBS) was created in 1977.⁷⁰ The scheme mandated that commercial banks were required to open specified numbers of rural branches in different parts of the country with the objective of bringing the network of bank branches to rural areas, thereby drawing banking services nearer the rural populace.⁷¹ It was stated that under this scheme at least 50% of the total deposit in these rural banks were to be lent to borrowers within those rural areas, but in spite of the scheme, the informal sector in the rural areas remained largely underbanked.⁷²

About a year later, the Agricultural Credit Guarantee Scheme Fund (ACGSF) was set up in 1978, with an authorised capital of N100 million subscribed to by the Federal Government (60 %) and by the Central Bank of Nigeria (40%).⁷³ The main objective of the Scheme was to reduce the risks attached to bank lending by guaranteeing a very significant proportion of loans against default by the beneficiaries.⁷⁴ It was asserted that the scheme was shown to be biased in favour of small scale farmers.⁷⁵ By 1984, 97% of the borrowers were small-scale farmers and in 1983 and 1982, 95.3% and 95% of the borrowers, respectively, were of the small-scale variety.⁷⁶ However, Ike notes that in terms of value of the loans given out, this position is reversed; for instance, the 3 % large-scale borrowers in 1984 accounted for N13.2 million or 53.4% of the amount loaned out in the year.⁷⁷ It was noted that because of the high default rate the scheme was a failure. It was recorded that the loans guarantee repayment ratio was about 18:

⁷⁰ Onyebinama, U.A.U & Onyebinama I.C, 'Microfinance Banks and Economic Opportunities in the Informal Sector of the Nigerian Economy' (2010) 2 Pakistan Journal of Social Science 70, 70.

⁷¹ *Ibid*

⁷² *Ibid*

⁷³ Don N. Ike, 'Financing Agricultural Development in Nigeria: An Appraisal' (1986) 1 International Journal of Development Banking 13, 14.

⁷⁴ *Ibid*. Loans and advances granted by commercial and merchant banks for agricultural production are guaranteed up to 75% with concessionary rates of interest of 8% for cooperatives and 9% for individuals.

⁷⁵ Ike (n 74).

⁷⁶ *Ibid*.

⁷⁷ *Ibid*.

1 for 1981, the figures show that about 111.5 loans were guaranteed and only 6.3 were repaid with an outstanding 105.2 remaining.⁷⁸ In 1982, the repayment ratio was 14.3:1, 143.2 loans were guaranteed, 10.0 were repaid and 133.2 were left outstanding.⁷⁹

2.1.4. The Fourth National Development Plan

Under the Fourth National Development Plan the main goal was designed around the need to reduce the dependence of the economy on a narrow range of activities and broaden the economic base as well as develop the technological base of the country.⁸⁰ This occurred between 1981 and 1985. In pursuit of this plan, in 1984, the Federal Government signed an agreement with the World Bank for 41 million USD "SME II" loan which was administered by the NBCI.⁸¹ A total of 275 projects were approved under the scheme, out of which 149 were cancelled. This was due to the failure of project sponsors to contribute their counterpart funding, time and cost-overrun, and a harsh economic environment.⁸² After the cancellation, 126 projects were financed under the scheme with a total disbursement which amounted to 21 million USD (about 52 per cent of the total projects fund).⁸³ In order to simplify the stringent listing requirements for sourcing funds in the capital market, the Second Tier Securities Market (SSM) was established in 1985 to assist small and medium sized

⁷⁸ Ike (n 74).

⁷⁹ Ike (n 74) 19.

⁸⁰ Sanusi (n 42) 3.

⁸¹ Central Bank of Nigeria (n 39). The projects covered a wide range of industries with agro-allied and manufacturing sectors.

⁸² *Ibid*

⁸³ *Ibid*

indigenous enterprises to access funds from the capital market for expansion and modernization.⁸⁴

After the fourth national development plan, a new era was supposedly ushered in,⁸⁵ but by the mid 1980's Nigeria experienced a fall in oil prices which interfered with the administration's economic plan. Thus, in 1986, a Structural Adjustment Programme (SAP) was put in place. This programme, which was financed largely by the World Bank, combined policy reform measures with other policies designed to reduce the dependence of the Nigerian economy on oil.⁸⁶ The goal was not only to reduce the dependence on oil but also to expand economic activities as had been touted under the third national development plan (1975 – 1980).⁸⁷

Three years after the inception of SAP, the People's Bank of Nigeria (PBN) was created in 1989 to extend banking facilities to the poor who did not have access to credit facilities available at commercial banks.⁸⁸ The PBN made use of group lending to ensure high recovery of the loans granted. Prospective borrowers were required to organise themselves in groups of similar trades.⁸⁹ Each group, consisting of 13 members with a Chairman and a Secretary had to be duly registered with a neighbourhood centre operating under a branch of the bank.⁹⁰

⁸⁴ Sanusi (n 42) 8.

⁸⁵ It was realised that the five (5) year modelling structure did not provide a realistic long-term view of the problems of the economy, thus the modelling structure was dropped. Kelly B.O. Ejumudo, 'The Problematic of Development Planning in Nigeria: A critical Discourse' (2013) 4 *Developing Country Studies* 67, 75.

⁸⁶ 'African Development Bank (2013) Available at < http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project_Paper/Project_P-NG-B00-001_EXPORT_STIMULATION_LOAN_IL%20-%20EN.pdf > Accessed 2nd February 2016. It is important to note that as in 1986, Nigeria had already begun the rhetoric of reducing her dependence on oil, something that has still not been achieved to date.

⁸⁷ Under SAP, Nigeria experienced devaluation of its currency –the Naira; deregulation of interest rates which before the inception of SAP was below 10%. Ibietan (n 43) 304.

⁸⁸ John C. Anyanwu, and Uwatt, B. Uwatt 'Banking for the Poor: The Case of The People's Bank of Nigeria' (1993) 1 *African Review of Money Finance and Banking* 87, 88.

⁸⁹ *Ibid*

⁹⁰ Loan requests were sent to the field officers at the various centres who then forwarded them to the respective branch managers. The branch managers evaluated the requests and made recommendations to the respective zonal managers for approval. Anyanwu (n 89).

It was stated that the funds came from subventions from the Federal Government, donations from state governments and individuals' savings deposits and interest earned on fixed deposits with some commercial and merchant banks in the country.⁹¹ Nevertheless, despite the array of funding sources, it was noted that it was still not enough to sustain the scheme. Final reports concluded that the bank was underfunded, this coupled with fraud, greed, ethnic rivalries (the north-south syndrome)⁹² led to inefficiency, and maladministration.⁹³

2.1.5 Rolling Plans and Vision 2010 (1989 to 2010)

Under this era the government introduced two types of national plans, the rolling plan-which was to last for 3 years and the perspective plan which was to last for 15 years. In 1989, in order to further expand the credit allocation to SMEs, the Federal Government negotiated a programme of financial assistance with the World Bank to complement other sources of funding, this became the World Bank Assisted SME II scheme which started in 1990.⁹⁴ Together, this facility involved a total of 270 million USD for lending to the SMEs through participating banks and administered by the CBN.⁹⁵ Between 1990 and 1994, 211 projects valued at 132.8 million USD between 1990 and 1994 were approved, and a total disbursement of 107.1 million USD for 102 projects were recorded as at June

⁹¹Anyanwu (n 89).

⁹² Since colonial times, there has always been a divide between the predominately Christian south and the predominantly Muslim north in Nigeria, a divide which has often led to clashes even within present day Nigeria. This divide not only stems from religious differences but also a wealth and literacy gap between the two regions. With the South being perceived as more developed than the North.

⁹³ Anyanwu (n 89).

⁹⁴ Zainab Dabo 'The Impact of Economic Reforms on Entrepreneur's Performance: A Study of Small and Medium Enterprises in Kaduna (Northern Nigeria)' Available at < <https://www.essex.ac.uk/conferences/ief/10th/documents/10IEFpapers/The%20Impact%20of%20Economic%20Reforms%20Zainab%20Dabo.pdf> > Accessed on 1st February 2016, 7.

⁹⁵ *Ibid.* The CBN also established an SME Apex unit for its efficient implementation.

1996.⁹⁶ However, final reports from the CBN, stated that the scheme struggled to make a noticeable impact; low awareness of it coupled with a tedious and confusing application process resulted in a painfully slow distribution of funds.⁹⁷

Also, in 1990, the National Economic Reconstruction Fund (NERFUND) was set up by the Federal Government, with the CBN as one of the facilitating institutions.⁹⁸ The scheme was aimed at providing medium to long-term loans (5-10 years) to SMEs at concessionary interest rates.⁹⁹ It was reported that between 1990 and 1998 NERFUND disbursed 144.9 million USD (foreign exchange component) and N681.5 million (Naira component) to support 218 projects.¹⁰⁰ Further reports, however, state that NERFUND's lending activities were seriously constrained by the impact of Naira devaluation which worsened the burden of debt servicing under the programme in 2001. Therefore, that same year, NERFUND was merged with two other Development Finance Institutions (DFI) to form the Bank of Industry (BOI).¹⁰¹

In 1997, the Family Economic Advancement Programme (FEAP) was set up, it was designed specifically for local based producers of goods and services and potential entrepreneurs in the establishment of cottage industries.¹⁰² The scheme provided basic working capital to low income families; co-operative societies; members of the armed forces, the Nigeria Police Force and the para-military

⁹⁶ Dabo (n 95).

⁹⁷ Nikhil Gehani, 'The Central Bank of Nigeria's Small and Medium Enterprise Equity Investment Scheme: A Critical Analysis' Available at <
https://www.academia.edu/7839439/The_Central_Bank_of_Nigerias_Small_and_Medium_Enterprises_Equity_Investment_Scheme_A_Critical_Analysis> Accessed 1st February 2016, 5.

⁹⁸ Sanusi (n 42) 6.

⁹⁹ *Ibid*

¹⁰⁰ *Ibid*

¹⁰¹ *Ibid*

¹⁰² Family Economic Advancement Programme (Establishment) Act Available at <
<http://www.placng.org/new/print.php?sn=178>> Accessed on 1st February 2016.

services. It was, however, merged in 2000 to create the Nigerian Agricultural Co-operative and Rural Development Bank.¹⁰³ The Nigerian Agricultural Co-operative and Rural Development Bank (NACRDB) formally came into being 2001.¹⁰⁴ As with NACB, it was set up for the provision of affordable credit facilities to micro, small and medium scale farmers and provided direct financing investment in the form of equity capital.¹⁰⁵ The loans were aimed at rural dwellers and co-operative ventures. It has been reported that the performance of NACRDB was very low, mainly due to high default rate by beneficiaries.¹⁰⁶

2.1.5.i. Schemes from 2001 to 2010 (The Failure of the Vision for 2010)

The idea behind 'Vision' was to improve the country economically by 2010, eradication of poverty was a top priority under this scheme. It has been asserted that 'Vision 2010' was a failure.¹⁰⁷ As with the previous years, they approached the Vision through the creation of schemes.

2001 -2005:

In 2001, the National Poverty Eradication Programme (NAPEP) was created by the Federal Government with the prime aim of eradicating core (extreme) poverty

¹⁰³ Family Economic Advancement Programme (n 103)

¹⁰⁴ Odi Nwankwo, 'Agricultural Financing in Nigeria: An Empirical Study of Nigerian Agricultural Co-operative and Rural Development Bank (NACRDB): 1990-2010' (2013) 2 *Journal of Management Research* 28, 31.

¹⁰⁵ *Ibid*

¹⁰⁶ Nwankwo (n 103). Also, a study carried out in 2018 on the Agricultural credit facilities schemes enacted in Nigeria stated that the NACRDB has not significantly impacted agricultural productivity in Nigeria. See Ezema, Clifford Anene and Onah. Clement Ejike 'Impact of Agricultural Financing to Agricultural Productivity in Nigeria; 1995 – 2016. ENGEL - GRANGER Residual Based Approach' (2018) 5 *International Journal of Research in Economics and Social Sciences* 18, 2

¹⁰⁷ Sanusi (n 45) 305.

in the country by the year 2010.¹⁰⁸ Structurally, NAPEP had five main divisions and the General Micro Credit and Grants division dealt with providing loans for SMEs.¹⁰⁹ Its projects were primarily funded or supported by the Government's annual budgetary allocations and Public Private Partnership.¹¹⁰ In 2015, it was stated that NAPEP had not been able to fully realize its objectives 10 years after the introduction of the programme.¹¹¹

Likewise, in August 2001, the Small and Medium Industries Equity Investment Scheme (SMIEIS) was launched. The scheme required that all banks in Nigeria set aside 10% of their profit (before tax) for equity investment in SMEs.¹¹² The main aims were to assist the establishment of new viable SMEs projects in the real sectors such as, agro-allied, information technology and telecommunications, manufacturing, educational establishments, services, tourism, solid minerals and construction.¹¹³

In October of the same year, through a merger of the then Nigerian Industrial Development Bank (NIDB) Limited, Nigerian Bank of Commerce and Industry (NBCI) and NERFUND, the Bank of Industry (BOI) was created.¹¹⁴ The BOI¹¹⁵ devotes 85% of the bank's resources to SMEs and 15% to large enterprises who have links with small or medium enterprises.¹¹⁶ Since its inception in 2001 and 2010, the total cumulative value of loans and investments stood at N114.3 billion.

¹⁰⁸ Sunday O. Onwe and Michael C. Nwakamma, 'Assessment of National Poverty Reduction Programmes in Nigeria: A Study of National Poverty Eradication Programme (NAPEP) Ebonyi State' (2015) 2 *International Journal of Humanities and Social Science* 227, 229 and 230.

¹⁰⁹ *Ibid*

¹¹⁰ Commercial banks and other financial intermediaries, Business firms, including multinationals; Foundations, individuals and families; foreign Government assistance and support; religious bodies. Note 104 above

¹¹¹ Onwe (n 109).

¹¹² Babafemi D. Ilori and Adeshey M. Ilori 'Small and Medium Scale Enterprises Financing and Development in Nigeria: A Critical Assessment' (2015) 1 *Journal of Finance and Bank Management* 190, 195

¹¹³ *Ibid*

¹¹⁴ Central Bank of Nigeria (n 39) 25.

¹¹⁵ This Bank shall form part of our analysis in chapter six.

¹¹⁶ Central Bank of Nigeria (n 39) 25.

Of this amount, 96 per cent went to SMEs, while the balance went to large enterprises.¹¹⁷

By December 2010, the BOI had managed some specialised development funds which included: the Central Bank of Nigeria's N500 billion Intervention fund for the Power and Aviation Sectors and the Refinancing/Restructuring fund to the Manufacturing Sector, introduced in September 2010;¹¹⁸ the Federal Government's \$500 Credit Delivery to Small and Medium Enterprises; N100 billion Cotton, Textile and Garment Industry Reviving Scheme introduced in 2009; N10 billion Rice processing Special Intervention Fund in 2010; and the N18 billion National Automotive Development Fund, among others. According to the last accessible annual report, which is that of 2016, it was stated that of the disbursements made non-performing loans stood at 3.72% which seems respectable, but this was 3 years ago, so the current state cannot be assessed.¹¹⁹

In 2003, the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) 2003¹²⁰ was established by the SMEDAN Act to promote the development of micro, small and medium Enterprises. The Act¹²¹ states its main functions as being the stimulation, monitoring and co-ordinating the development of the SME sector. The policy idea behind SMEDAN was to promote and facilitate

¹¹⁷ Central Bank of Nigeria (n 39) 25.

¹¹⁸ The facility was instituted to provide liquidity to banks in support of their financing productive sectors of the economy (i.e. agricultural production, information technology manufacturing etc.). The RRF was designed to provide temporal relief to banks that faced liquidity problems because of having committed their resources to long-term financing to the specified productive sectors. Under the facility, banks could access up to 60 per cent of qualifying loans which must have been held for not less than one year. Central Bank of Nigeria (n 39) 29.

¹¹⁹ Bank of Industry Annual Report and Accounts (2016) Available at < <http://www.boi.ng/downloads/2016ANNUALREPORT.pdf> > Accessed 27th March 2019, 36.

¹²⁰ Nwanyanwu (n 58) 93.

¹²¹ **Section 8 (I)** of the SMEDAN Act of 2003 sets out its functions

development programmes, implement support services to accelerate the development and modernization of SME operations.¹²²

After 2003, the next development was the creation of Micro-Finance Banks (MFB) in 2005.¹²³ The banks were set up with the main objective of supporting the delivery of very small, un-collateralized, or less than normal collateralized loans or other financial services, such as savings or insurance for low income clients.¹²⁴ Two categories of MFBs were licensed to operate, the unit or community banks and the Microfinance Banks licensed to operate in states.¹²⁵ The CBN has supervisory and regulatory authority over MFBs. It was noted that in December 2011, there were 821 MFBs operating in the country.¹²⁶ It was observed that the impact of the MFBs on credit delivery to SMEs is still marginal given the many challenges faced by them, principally, a lack of credible information on borrowers given the absence of a functional and robust credit registry on customers.¹²⁷ It was further noted that there have been cases of corrupt public officials diverting credit meant for small scale farmers. Sometimes loans were being disbursed to friends and relatives in a manner that did not suggest that it was meant for business.¹²⁸ It was also stated that the banks suffered inadequate financing, and loan losses, especially in rural areas where about 70% of micro credits given were not recovered.¹²⁹ A study revealed that most of the staff recruited in the

¹²² Nwanyanwu (n 58) 93.

¹²³ CBN 'Microfinance Policy, Regulatory and Supervisory Framework for Nigeria' Available at <
<http://www.cenbank.org/out/publications/guidelines/dfd/2006/microfinance%20policy.pdf>> Accessed on 2nd
February 2016.

¹²⁴ *Ibid.*

¹²⁵ *Ibid.*

¹²⁶ Charles N.O. Mordi and others, 'Central Bank of Nigeria Credit Delivery to Small and Medium Enterprises: Post Bank Consolidation in Nigeria' (2014) <
<https://www.cbn.gov.ng/out/2015/rsd/credit%20delivery%20to%20small%20and%20medium%20enterprises-post%20bank%20consolidationin%20nigeria.pdf>> Accessed 25th January 2016, 24.

¹²⁷ *Ibid.*

¹²⁸ Nwanyanwu (n 58) 96.

¹²⁹ *Ibid.*

microfinance institutions, particularly at management level, have little or no experience in microfinance banking and practice.¹³⁰

2009 – 2010:

The Commercial Agricultural Credit Scheme (CACS) was established by the CBN in collaboration with the Federal Ministry of Agriculture in 2009.¹³¹ The objective of the scheme is to promote commercial agricultural enterprises in Nigeria. Federal bonds fund the scheme, and all deposit money banks were expected to participate in the administration.¹³² The cumulative disbursement from the scheme since its inception to March 2013 amounted to N1, 199.3 (one billion, one hundred and ninety million) disbursed through 19 Deposit Money Banks to 271 projects including 30 state governments who lend to their farmers using cooperative societies.¹³³ While the overall outlook of the scheme looks positive¹³⁴ it has been recorded that most states could not provide the list of beneficiaries of the funds given to them.¹³⁵

As part of its efforts towards unlocking the credit market, and to ensuring that credit flows to the SMEs, the CBN embarked on the quantitative easing of bank burden through its roles as a "lender-of-last-resort". The CBN provided a N200 billion for refinancing/re-structuring of banks' existing loan portfolios to the manufacturing sector and SMEs in 2010.¹³⁶ The major objective of the fund was

¹³⁰ Nwanyanwu (n 58) 96.

¹³¹ Central Bank of Nigeria (n 53) 34.

¹³² *Ibid*

¹³³ Central Bank of Nigeria (n 53) 34.

¹³⁴ A 2018 statistics report on the CACS states that through impact assessment, it has been demonstrated that there is substantial positive growth difference between firms with access to CACS facility and overall national growth. See CBN ' Commercial Agricultural Credit Scheme Evaluation and Impact Assessment Report' (2018) Available at < https://www.cbn.gov.ng/Out/2018/STD/CACS%20Evaluation%20and%20Impact%20Assessment%20Report_compressed.pdf > Accessed 28th March 2019.

¹³⁵ *Ibid*, 38.

¹³⁶ Central Bank of Nigeria (n 53) 33.

to fast-track the development of the manufacturing sector by improving access to credit, as well as improving the financial position of Deposit Money Banks. The loan limit for a single obligor was fixed at a maximum of N1billion in respect of re-financing/re-structuring with an interest rate of 7 per cent payable on quarterly basis. All banks in the country, as well as development finance institutions (DFIs), excluding the BOI, were to participate in the fund. As of March 2013, a total sum of N235 billion had been disbursed to 535 projects.

Also, in 2010 the Small and Medium Enterprises Credit Guarantee Scheme (SMECGS) was established.¹³⁷ The CBN is the managing agent and is responsible for the day-to-day administration of the scheme. The scheme has a fund of N200 billion wholly financed by the CBN. Some objectives of the scheme include providing guarantee for credit from banks to SMEs and manufacturers; and increasing the access to credit by promoters of SMEs and manufacturers¹³⁸. The guarantee cover shall be 80% of principal and interest and shall be valid up to the maturity date of the loan with a maximum tenure of 7 years, inclusive of a 2-year moratorium.¹³⁹ A 2012 report notes that this scheme has been underutilized because commercial banks are required to lend at prime rate which is unlikely to cover all costs.¹⁴⁰ In addition, rather than provide full coverage the scheme

¹³⁷ CBN Guideline for the administration of the N200 Billion Small and Medium Enterprises (SME) Credit Guarantee Scheme (SMECGS) Available at < <http://www.cenbank.org/Out/2010/publications/guidelines/dfd/GUIDELINES%20ON%20N200%20BILLION%20SME%20CREDIT%20GUARANTEE.pdf>> Accessed on 31st January, 2016.

¹³⁸ *Ibid.*

¹³⁹ *Ibid.*

¹⁴⁰ Gunhild Berg and Michael Fuchs 'Bank Financing of SMEs in Five Sub-Saharan African Countries: The Role of Competition, Innovation and the Government' (2012) World Bank Policy Research Working Paper. Available at < <http://documents.worldbank.org/curated/en/734811468048848246/text/WPS6563.txt> > Accessed 2nd April 2019. It should also be stated that it is the author's view that the unreliability of the government may also have influenced the underutilization of the scheme. First when administrations change, there is usually no continuity of government, i.e. the new administration would usually not complete or continue funding projects of the previous one. Also, the administrations themselves are unreliable due to corruption, while money may be set out to fund a project, along the way, it may be looted and become unavailable.

requires that all loans are collateralized, and banks have to confirm that the collateral is adequate and realizable before the loan can be guaranteed. Furthermore, where creditors fail to repay, banks have to exhaust recovery efforts before being compensated by the guarantee scheme. This considerably reduces the banks' incentive to utilize the scheme, given the weaknesses in the judicial system and contract enforcement.¹⁴¹

It was noted by Jide¹⁴² in his article that the Vision 2010 became stillborn due to budgetary constraints.¹⁴³ Observing the schemes under this period, we note that NAPEP never realised its objectives, the MFBs were overwhelmed by mismanagement, and CACs, as it stands, cannot identify the beneficiaries of their loans. It would be easy to agree with Jide's assertion.

2.1.6. After 2010 to Date

The CBN, in collaboration with various stakeholders aimed at expanding agricultural lending in Nigeria, created the Nigerian Incentive-Based Risk Sharing System for Agricultural Lending (NIRSAL) in 2011.¹⁴⁴ The scheme was aimed at simultaneously addressing the risk, and capacity bottlenecks along the agricultural and financial value chains.¹⁴⁵ It has been stated that the introduction of the scheme has helped to stimulate a new form of strategic partnership and alliances among banks to expand their volume of lending.¹⁴⁶ So far, it has been

¹⁴¹ Berg (n 141) 12-13

¹⁴² See Note 41 above.

¹⁴³ Ibietan (n 43) 305.

¹⁴⁴ Central Bank of Nigeria (n 53) 35.

¹⁴⁵ *Ibid*

¹⁴⁶ *Ibid*

recorded that NIRSAL has guaranteed 631 projects up to ₦65.53 Billion in loans and has a total interest drawback paid to date of ₦849,185,339.66.¹⁴⁷

Summarily, it should be noted that a vast majority of these programmes and institutions have disappeared without leaving traces, while some have been merged to create new financing initiatives.¹⁴⁸ An evaluation of the financing schemes would reveal that most of them were underfunded, mismanaged or suffered from a combination of both. There have been reports of corrupt practices, in which funds meant for investment have been diverted, sometimes loans even disbursed to friends and relatives in a manner that does not suggest it was meant for business.¹⁴⁹

If this weren't enough, among the challenges faced by these schemes, there is also, especially with regards to MFBs, a lack of credible information on borrowers given the absence of a functional and robust credit registry on customers.¹⁵⁰ Furthermore, there have been loan losses especially in rural areas where about 70% of micro credits given to micro enterprises via government microfinance scheme were not recovered.¹⁵¹ In light of this, perhaps it is not improbable to conclude that banks will be less likely to lend given these circumstances. It is suggested that a combination of all these factors have led to the failure of most of these SME financing initiatives.

¹⁴⁷ NIRSAL Statistics Available at < <https://www.nirsal.com/statistics/> Accessed 28th March 2019.

¹⁴⁸ As we noted with NERFUND and the NBCI which merged to form the Bank of Industry; NACB which merged with FEAP to form (NACRDB) etc. and with others which continue to function.

¹⁴⁹ Ibietan (n 43).

¹⁵⁰ Olufemi (n 69)

¹⁵¹ Onyebinama (n 71).

2.2. The Role of the Banking Sector and Private Interventions

Generally, banks as part of their organisational structure, provide credit facilities to businesses. This role will be considered further when we conduct our analysis in chapter six, however, here it is worth considering some of the great initiatives created by some prominent banks in Nigeria to create access to finance. The first is the Access Bank 'W' Community Initiative.¹⁵² Access Bank is one of the top five banks in Nigeria and has been operating since 1988.¹⁵³ The 'W' Community was set up to provide credit facilities to women. According to the bank, some of the privileges for women and their families under the initiative include access to a comprehensive range of loan products and credit facilities, and access to 'W' community with helpful advice on family and finance matters, home and family articles.¹⁵⁴

It was stated that their decision to finance women, was because 30% of SMEs in the country were controlled by women. It was also noted that from the banks experience and research that women had a far lower default ratio than men on loans repayment.¹⁵⁵ The programme 'W' community programme initially started in 2006 but was re-launched again in 2014. In 2006, the International Finance Corporation (IFC) partnered with Access Bank to open the first credit line for Women Entrepreneurs.

¹⁵² Access Bank Plc Available at <<https://www.accessbankplc.com/media-centre/press-releases/83-news/561-financial-services-access-bank-offers-succour-to-women>> Accessed 15th January 2017.

¹⁵³ Access Bank Plc Available at <<https://www.accessbankplc.com/pages/About-Us/our-history.aspx>> Accessed 27th March 2019.

¹⁵⁴ Access Bank Plc (n 153).

¹⁵⁵ *Ibid*

The IFC, as part of the partnership, provided funds and training for women borrowers and worked with Access Bank staff to address challenges commonly faced by women borrowers such as a lack of traditional collateral and a lack of credit history.¹⁵⁶ Access Bank for its part provided a mentoring programme where women could help each other grow their businesses in a structured manner.¹⁵⁷ Successful women would mentor and guide younger women identified by the bank.

While investigating this scheme, only the initial report on the program from 2006-2009 could be sourced. It was stated by the IFC that over a period of three years more than \$35m¹⁵⁸ in loans was disbursed to women entrepreneurs with a non-performing loan ratio of less than 1% maintained, 650 women had been trained and several new products and services developed.¹⁵⁹ Women-friendly and more flexible collateral options developed, such as the pledging of equipment, and cash flow-based lending. The success of the program in Nigeria led to Access Bank replicating this in Gambia, and in Rwanda in 2011.

2.3. Guaranty Trust Bank (GTB) SME Market Hub

GTB was established in 1990, the bank has offices across West Africa, East Africa and Europe, and has an asset base of over N3.11trillion.¹⁶⁰ GTB introduced the SME Market Hub, which seeks to accelerate business growth by encouraging

¹⁵⁶ Access Bank Plc (n 153).

¹⁵⁷ *Ibid*

¹⁵⁸ No other documentation which I have seen indicates more money has been put into the program, this sum is in excess of the \$15m given by the IFC and the \$400k advisory sum. It may be loans which the bank disbursed from its own funds but there is no evidence to support this.

¹⁵⁹ International Finance Corporation "Banking on Women Pays Off: Creating Opportunities for Women Entrepreneurs" Available at < http://www.intracen.org/uploadedFiles/intracenorg/Content/About_ITC/Where_are_we_working/Multi-country_programmes/Women_and_trade/Banking%20on%20Women%20pays%20off.pdf > Accessed on 29th January 2017.

¹⁶⁰ Guaranty Trust Bank Plc Available at < <https://www.gtbank.com/about> > Accessed 27th March 2019.

entrepreneurs in Nigeria to connect, buy and sell on its free service portal.¹⁶¹ The SME Market Hub is a website, where small businesses can create a fully hosted online store for their businesses, add products and receive payment online with any debit card in the country.

The SME Market Hub offers the resources SMEs need to grow their businesses and provides the tools they need to trade online and gain visibility. To gain access to the bank's Market Hub, the business owner is required to be a customer of the bank.¹⁶² In addition to the online market, the bank also hosts a fashion weekend every year, which exhibits talents from the fashion industry and allows consumers to purchase products. The event seeks to not only create visibility and trade opportunities for indigenous businesses, but also facilitates learning workshops and encourages e-commerce as a sustainable avenue for driving growth.¹⁶³

2.4. Tony Elumelu Foundation

The Tony Elumelu Foundation Entrepreneurship Programme (TEEP) is a programme founded by entrepreneur, and investor Tony O. Elumelu.¹⁶⁴ The vision of TEEP is to establish a Pan-African entrepreneurship programme and create 10,000 start-ups across Africa within the next 10 years to generate significant employment and wealth.¹⁶⁵ One of the main functions of the foundation is to grow businesses through business skills training, mentoring,

¹⁶¹ Guaranty Trust Bank Available at <<http://gtbank.com/media-centre/press-releases/49-media/gtbank-in-the-news/527-a-better-understanding-of-gtbank-s-sme-markethub-2>> Accessed 15th January 2017.

¹⁶² *Ibid*

¹⁶³ Guaranty Trust Bank (n 162)

¹⁶⁴ Tony Elumelu Foundation <<http://tonyelumelufoundation.org/programme/about-us/>> Accessed 20th January, 2017

¹⁶⁵ *Ibid*.

access to seed capital funding, information and membership in its Africa-wide alumni network.¹⁶⁶

The TEEP process, involves several stages carried out within a 12-week programme. The programme is done with the belief that entrepreneurship and business skills are teachable and learnable. The entrepreneurs are taught the basic skills required to run their businesses at the early stage of their growth.

Mentoring is also part of the TEEP process, the foundation assembles mentors from across Africa and internationally, who faced similar challenges whilst running their business. From the outset, TEEP start-ups are assigned a mentor who dedicates time and shares their business experiences, listens to their mentee's goals and expectations and provides guidance and support throughout the programme. They keep the start-ups on track to complete their business plans and to help them build a business with a solid foundation.¹⁶⁷

The foundation hosts an annual showcase to engage, network and learn. At the closing ceremony, the graduates are presented a non-returnable seed capital funding and invited to join the alumni network.¹⁶⁸ The start-ups are continuously monitored on both a portfolio and individual basis. The qualifying start-ups that have progressed their business plans sufficiently will each qualify for a second stage seed capital investment of 5,000 USD that will be provided as returnable

¹⁶⁶ Selection into the programme is through a process with no quotas of any kind, it simply identifies the game changers in the continent. The programme supports selected Tony Elumelu Foundation Entrepreneurs through the 7 Pillars of TEEP, a framework that includes mentorship, online and live learning, as well as access to information, networking and seed capital. See note 159 above.

¹⁶⁷ Tony Elumelu Foundation (n 165). Start-ups, alumni and mentors' access curated online resource library of case studies, sample business plans, research documents, video presentations, industry articles and podcasts. All course content and training materials used at the boot camp are also cross-linked with the training modules, accessible in the online resource library.

¹⁶⁸ Tony Elumelu Foundation (n 165).

capital.¹⁶⁹ This seems to be the only project that shows records of successful participants, tracking how many employees the SME has been able to hire, and the progress of the business. This information is available on its online page.¹⁷⁰

2.5. Lagos State Government Interventions

Beyond the schemes mentioned above which because of their federal nature apply in all states, there is a Lagos specific intervention aimed at developing the state's SME sector. The Lagos State Employment Trust Fund (LSETF) was established by the Lagos State Employment Trust Fund Law in 2016. The aim of the scheme was to provide financial support to residents of Lagos and tackle unemployment. The Fund operates with an initial capital of N25 Billion contributed over four years by the Lagos State Government, and through additional funding from other sources like donor partners, development agencies, corporate organizations and individuals.¹⁷¹

As stated on its mandate, "*LSETF will focus on promoting entrepreneurship by improving access to finance, strengthening the institutional capacity of MSMEs and formulating policies designed to improve the business environment in Lagos State*".¹⁷² Through the scheme, registered small and medium sized businesses can get a loan of up to N5, 000,000, all at 5% interest rate per annum.¹⁷³ Findings from the social impact report released in January 2019, states that the scheme

¹⁶⁹ Tony Elumelu Foundation (n 165).

¹⁷⁰ A source which has worked with the foundation stated that the foundation also works closely with the United Bank of Africa (UBA). Tony Elumelu worked in UBA and was CEO until he retired in 2010. Because of this relationship with the bank, start-ups that have passed through his programme are looked on favourably by the bank when it comes to loan application. This information is not available publicly but was just confirmed orally.

¹⁷¹ LSETF Available at < <https://lsetf.ng/> > Accessed 28th March 2019.

¹⁷² LSETF Available at < <https://lsetf.ng/content/overview> > Accessed 28th March 2019.

¹⁷³ LSETF 'Social Impact Report 2018' Available at < <https://lsetf.ng/downloads> > Accessed 28th March 2019, 6

had funded 7,817 MSMEs as against the expected 18,705 by 2018, representing a 41.7% effectiveness of the scheme.¹⁷⁴ Specifically, according to the report, during its two year operation, 6,439 SMEs applied for loans and 1,005 have been approved.¹⁷⁵

The report further states that beneficiaries affirmed that the fund had improved their finances and personal life.¹⁷⁶ This improvement was recorded in their capacity to meet business and financial obligations. The report however noted that about 3.9% of the sample size surveyed¹⁷⁷ said their businesses were worse off, while about 24% said the business remained the same.¹⁷⁸

In terms of repayment, the report records that only 11% have had to use both business proceeds and other sources to pay off their loans.¹⁷⁹ The report further asserts that repayment is easy because of the loan interest rate of 5%. It suggests that this is one of the best features of LSETF because other loans in the financial market are granted with 35-37% and the loan repayment terms were said to be onerous, with borrowers and their guarantors enduring much harassment from the lenders in the event of a default.¹⁸⁰

¹⁷⁴LSETF (n 174) 8.

¹⁷⁵ *Ibid* at page 20. As will become apparent when we examine LSTF in more detail in the final chapter of this work, the major problems of the scheme were documented as the experience of the people when they tried to access this service, complaints of rudeness and the fact that people quickly became aware that they were more likely to get abused than the loan required, the fact that they were asked to pay for forms that were supposedly free and a poor awareness of the scheme.

¹⁷⁶ LSETF (n 174) 9.

¹⁷⁷ The details of this survey will be examined further in chapter eight.

¹⁷⁸ LSETF (n 174) 9.

¹⁷⁹ LSETF (n 174) 24.

¹⁸⁰*Ibid*.

2.6. Conclusion

This chapter outlines the various schemes undertaken by the government to support the SME sector. As we can see from this fairly succinct history, which although not fully capturing every venture undertaken both privately and publicly, does highlight a fair and impressive attempt to finance small businesses. The chapter first takes the reader from 1960 to present day through different Federal initiatives, it then reports on some bank and private interventions, culminating in the discussion of LSETF in Lagos.

The narrative begins to highlight the fact that there is a problem faced by the SME sector, and it is not solely capital based. It begins to highlight that there is also a loan recovery issue at play. From a report carried out by the Oxford business group in 2017,¹⁸¹ according to the Central Bank, there had been an increase in non-performing loans from 11.7% in June 2016 to 14% by the end of 2016. Thus, this overview has spurred the need for further investigation into the area. Having stated this, it now becomes relevant to discuss the method to be used in carrying out this investigation.

¹⁸¹ Oxford Business Group 'The Report: Nigeria 2017' Available at < <https://oxfordbusinessgroup.com/nigeria-2017>> Accessed 23rd January 2018.

Chapter Three: Identifying Theories; Finding a Method of Analysis

3.1. Introduction

The previous chapter gave us an overview of the different schemes (private and Government funded, previous and on-going) aimed at developing a viable SME sector. From an observation of the schemes, it can be seen that a lot of financial resources have been invested in the sector, but despite this, a successful SME sector is still far from being reached. From the failures of the schemes observed, we could also begin to identify reasons such as mismanagement, corruption, and a poor debt recovery record as the reason why the schemes failed, and sustainability has not been achieved within the sector. However, a more conclusive investigation into these perceived reasons is needed to fully grasp the rationale as to the successive failures of most of the schemes and lack of growth in the sector. Could poor management, corruption, inefficient debt recovery system etc. truly be that counterproductive to the success of the sector or are there other underlying reasons beyond these factors that could possibly hinder the growth of the Lagos SME sector?

Thus, with this in mind, it became necessary to decide on a method of inquiry. As stated in chapter one, the preliminary evaluation was to be elaborated on through doctrinal methods. We studied regulations which guided the creation of different business forms and other relevant regulations which influence the survival of the SME; we looked at the Central Bank of Nigeria policy documents; reports from the World Bank; information from OECD and UNIDO; and various articles and text. In essence, we looked at all internal and external sources.

Given what was evaluated we can surmise that institutional structures have a key role to play in our analysis, and by institutional structure we mean those restrictions we create that influence how decisions are made.¹⁸² It is averred that the perception of the inadequacy of the SME sector rests essentially in the law, social and economic sphere. Thus, a need arose to consider theories that allowed for the interplay between these three parts, to determine the most appropriate method to fully evaluate the sector. In the subsequent subheading an attempt will be made to walk the reader through the thought process as to how a final method of analysis was decided on.

3.2. The Free Market and the Invisible Hand

The first thing that became apparent was the need to consider the 'market' structure in which the Lagos SME sector operated. At this point, the thesis seemed to lean more towards pure economics and a consideration of the role of the invisible hand.¹⁸³ Adopting the assumption that the market should automatically correct the problem of supplying finance i.e. if there were a demand for finance then there would be lenders willing to lend, and that competition within the market should automatically promote better options, for example better lending rates for borrowers or better investment options for lenders.

However, this idea did not sit well within the established framing done in chapter two which already showed that access to finance was still a problem. It was

¹⁸² Note that before coming across this definition of institutions and the ones discussed subsequently, the writer had a narrow idea that it was strictly synonymous with law. But as the thesis developed and wider reading was done, it was realised that the word institution was far broader than originally envisioned. As we shall see Douglass North views them as "human constructed constraints" See Douglass C. North *Institutions, Institutional Change, and Economic Performance* (Cambridge University Press 1990) 2.

¹⁸³ A theory put forward by Adam Smith in his book *The Wealth of Nations*. Adam Smith, *The Wealth of Nations* (Strahan and Cadell, 1776); Reprint: (Bantam Classic, 2003).

established there, from the various schemes highlighted, that there is a credit market within Lagos, which should be efficiently funding these SMEs, but the policy consensus deems it inadequate for the purpose. Therefore, just saying that the market should solve the problem will not take us very far in answering the question of how to get more finance to SMEs. Aside from that, there was also a strong assumption that an 'invisible hand' did not operate in the market, this idea is rooted in neoclassical economics. Hayek in his text, discusses this concept as 'Catallaxy',¹⁸⁴ that is the notion of endogenous or self-generating markets,¹⁸⁵ and how they arise naturally if they are not prevented from doing so. He believes that the market is created as a result of individuals voluntarily organising themselves, to Hayek, the idea of catallaxy is the order brought about by the mutual adjustment of many individual economies in a market.¹⁸⁶ Thus, a "catallaxy" is a special kind of spontaneous order produced by the market".¹⁸⁷

However, rather than catallaxy, it is believed that a combination of other factors working together, influence how the market is created and how it operates. It is suggested that for a market to function in the first place, some sort of intervention is needed from the government. Establishing a functioning market would naturally take a long time and this is often achieved through the government policies in place, that create a conducive environment to doing business in. So indeed, some form of 'visible hand' is present.¹⁸⁸

¹⁸⁴ Friedrich A. Hayek *Law, Legislation and Liberty: A New Statement of the Liberal Principles of Justice and Political Economy* (Routledge 1993) 37

¹⁸⁵ This is what he calls spontaneous order. *Ibid.*

¹⁸⁶ Hayek (n 185) 108.

¹⁸⁷ *Ibid*, 109.

¹⁸⁸ The Office of Fair Trading explores this need of having some form of intervention.

The Office of Fair Trading in 2009 released a policy document which examined the role of government in markets. In that document, it was established that the government can be market makers, often playing the role of designers, supervisors and enforcers.¹⁸⁹ The policy stated, that left to their own devices, markets will not necessarily deliver best outcomes, and in order to address this, the government sets legal and institutional frameworks for the market to operate in.¹⁹⁰ We can somewhat see that the Nigerian Government is taking this approach through the government schemes they set up, trying to influence better lending to SMEs. But it is clear that there is still a problem with these interventions. Mismanagement problems, corruption, and enforcement problems in the form of debt recovery, etc have already been identified. At this point, it behoves us to consider more fully not only the legal policies in place but also how the cultural environment affects their effectiveness. This eventually led to the exploration of other possible methods to investigate the problem and given the need for interventions from the government in establishing the market, a more institutional approach was required.

3.3. Exploring New Institutional Economics

To fully evaluate the Lagos SME sector, it was decided that recourse must be made to an economic model of institutional structure. It has been asserted that “Douglass North, along with Ronald Coase and Oliver Williamson, transformed the early intuitions of new institutional economics into powerful conceptual and

¹⁸⁹ Office of Fair Trading ‘Government in Markets: Why Competition Matters-A Guide for Policy Makers’ (2009) Available at < https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/284451/OFT113.pdf > Accessed 29th July 2019, 34.

¹⁹⁰ *Ibid*, 1.

analytical tools”.¹⁹¹ North, in an address delivered at the Washington University in St. Louis, stated that the key distinguishing feature of the new institutional economics (NIE) from neo-classical economics is that “the new institutional economics is an attempt to incorporate a theory of institutions into economics”.¹⁹² This feature identified by North resonated with the intentions of the thesis, in that the thesis by identifying legal, market and cultural impediments to financing SMEs in Lagos sought to examine the role institutions¹⁹³ could play in the development of the sector, thus NIE as a theory warranted further exploration.

3.3.1. From Douglass North to Geoffrey Hodgson

Douglass North acted as the first gateway into this field. From North, preliminary ideas began to develop on how the institutions (the rules in place) mattered in economic development.¹⁹⁴ Further understanding of his work was needed, thus the need arose to explore and consult not only his work, but others who had a firmer understanding of his approach. Julio Faundez,¹⁹⁵ while asserting that North’s work undoubtedly poses serious challenges to the non-specialist reader,¹⁹⁶ writes that North’s work should be of interest to lawyers because it not only addresses the questions of the role the law plays in sustaining institutional change; why countries find it difficult to establish stable institutions to protect

¹⁹¹ Claude Ménard, Mary M. Shirley, ‘The Contribution of Douglass North to New Institutional Economics’ (2011) HAL < <https://halshs.archives-ouvertes.fr/halshs-00624297/document> > Accessed 29th July 2019, 1.

¹⁹² Douglass C. North “The New Institutional Economics and Development” Available at < <http://www2.econ.iastate.edu/tesfatsi/NewInstE.North.pdf> > Accessed 22nd July, 2019, 1. North further notes that NIE extends neo-classical economics by adding institutions as a critical constrain. He also asserts that it is necessary to analyse the role of transaction costs as the connection between institutions and costs of production.

¹⁹³ At this point, law. (n 183).

¹⁹⁴ According to North, these are “Institutions are the rules of the game in society or more formally, are the humanly devised constraints that shape human interaction.....” (n183).

¹⁹⁵ Julio Faundez ‘Douglass North’s Theory of Institutions: Lessons for Law and Development’ (2016) 8 Hague J Rule Law 373.

¹⁹⁶ *Ibid*, 375

property rights and enforce contracts etc., but also offers points for reflection when it comes to law and development.¹⁹⁷ From the expositions on North's works and a study of his development of NIE, it became more apparent that having strong property rights¹⁹⁸ was important for economic development. Thus, this highlighted a real need to consider property rights in Lagos within this work.

Beyond property rights, another important point of reflection raised through exploring North's work, was the role of transaction costs and how it influences decisions.¹⁹⁹ Again, at this point, the scope of reasoning began to broaden and take a more defined outline. It became established that peripheral issues beyond the simple fact of whether loans were available, and whether there were borrowers available needed to be considered. While the history of SMEs in chapter two somewhat establishes this fact i.e. it was not really a question of availability of finance or a market question. Literature supported this assertion and established furthermore a need to consider the costs associated with getting the loans, and from the lender's perspective, offering the loans was a significant point raised through North's work.

These points of reflection began to shape the direction of the thesis, obviously the question of "what role the law plays" raised by North was still paramount, but law was only a part of what the thesis originally envisioned as institutions. So, more questions that needed answers were being raised. A need to further understand what was meant by institutions emerged, before exploring more fully, its role in economic development, specifically the development of the Lagos SME

¹⁹⁷ Faundez (n 196) 374

¹⁹⁸ We shall see the impact of a weak property rights system in chapters six and chapter seven where we look more closely at the SME sector in Lagos.

¹⁹⁹ When we elaborate in chapters six through seven with the modelling selected, we shall see how transaction costs influence the decisions to borrow and lend.

sector. Initial research produced an article written by Geoffrey Hodgson simply titled 'What are Institutions'.²⁰⁰ His statement in the second paragraph reflected the current dilemma, "it is not possible to carry out any empirical or theoretical analysis of how institutions or organizations work without having some adequate conception of what an institution or an organization is".²⁰¹ In this work, Hodgson offers general critique of the different definitions of institution, considering different interpretations provided by authors such as Alan Wells and John Searle. But what was of particular interest, was his focus on some of North's ideas as to what institutions are, thus, considering his work to further develop the idea of institutions raised by North seemed a natural progression.

Hodgson does suggest that North's exposition of institution presents some problems of ambiguity, which left it open to misinterpretation by others.²⁰² In this piece of writing, he proceeds to explain why. He states that the way North characterises institutions²⁰³ and organisations²⁰⁴ leads to a misinterpretation of North's characterisation by others who perhaps do not understand what North was trying to say. This misinterpretation has led to the belief that organisations are not institutions. Hodgson, however, believes that they are. His justification for this belief is based on the fact organisations involve structures or networks, which cannot function without rules of communication, membership, or sovereignty. Because of the existence of these rules within organisations, it means that organisations must be regarded as a type of institution.²⁰⁵

²⁰⁰ Geoffrey M. Hodgson 'What are Institutions' (2006) 40 *Journal of Economic Issues* 4

²⁰¹ *Ibid* 1

²⁰² The definition Hodgson works with is taken from North's book – Douglass C. North *Institutions, Institutional Change, and Economic Performance* (Cambridge University Press 1990) 2-3

²⁰³ From Hodgson's account, North sees this as the rules of the game in society. Hodgson (n 201) 8.

²⁰⁴ These are the players within the game.

²⁰⁵ Hodgson (n 201) 10.

It is suggested that the unpacking of North's characterisation of institutions as rules of the game and organisations as players within the game is not a distinction between exclusive types of things but is a functional or analytical one. That is, whether some "things" are institutions or organisations depends on the activity being analysed. For example, in terms trying to influence government policy, the CBN is an organisation, a player subject to rules it must accept or try to change. When operating as lender of last resort, it is an institution. The question being asked, and the perspective of the questioner determines the classification for that analysis.

Again, Hodgson suggests that North does not make a clear distinction between formal rules and informal constraints and submits that some distinction between formal and informal needs to be made.²⁰⁶ Hodgson suggests that the distinction between formal rules and informal rules are important because if all rules are seen as formal, and institutions are essentially rules, then all institutions are formal.²⁰⁷ He further reasons that without this distinction, it becomes open to different interpretations, and he suggests three possible interpretations. The first is the possibility of identifying the formal with the legal and seeing informal rules as non-legal, even if they are written down.²⁰⁸ The second possibility is that they could be interpreted to mean explicit (formal) versus tacit (informal) rules.²⁰⁹ Alternatively, in literature, formal could be interpreted as designed, while informal could be seen as spontaneous institutions.²¹⁰

²⁰⁶ *Ibid* 11.

²⁰⁷ *Ibid*.

²⁰⁸ *Ibid*.

²⁰⁹ Hodgson (n 201) 11.

²¹⁰ *Ibid*.

It seems that Hodgson's main contention is the choice of words used by North in his definition. He recommends that because they are ambiguous, that they either be used with extreme care, or be abandoned completely.²¹¹ Ultimately, Hodgson adopts a broader conception of institutions that accommodates the informal basis of all structured and durable behaviour. Thus, he defines them as durable systems of established and embedded social rules that structure social interactions, rather than rules as such, in short, institutions are social rule-systems, not simply rules.²¹²

It is relevant to note that North does revisit his definition of institutions. He later defines institutions as the humanly devised constraints that structure political, economic and social interactions. They consist of both informal constraints (sanctions, taboos, customs, traditions and codes of conduct), and formal rules (constitutions, laws and property rights).²¹³ We can observe here that he is more elaborate with his explanation of what formal and informal is, and also adopts a broader definition of what institutions could be. It is important to note that his definition was revisited before Hodgson's article, but it is assumed that Hodgson still maintains his aversion to the words formal and informal.

Now that a moderate understanding of what institutions are has been developed, the next stage of the journey was to look at these institutions within my specific context, that is, the Lagos SME sector.

²¹¹ Hodgson (n 201) 13.

²¹² *Ibid*

²¹³ Douglass C. North 'Institutions' (1991) 5 Journal of Economic Perspective 97, 97.

3.4. Beyond Theory – Looking Towards Empirical Confirmation.

Aside from the theoretical discussions arguing that institutions play an important role in economic development, empirical studies have been conducted to test the merits of this theoretical assertion. It was averred in a study conducted in 2014, that there is a gap in the literature on how institutions are important to economic development, and this gap could derail the conversation.²¹⁴ It was stated that there was a need for empirical data linking the theory of institution and economic development, measuring institutions and identifying their precise roles in shaping economic behaviour and outcomes, without which, it can neither be completely confirmed or denied that these institutions are actually important to economic development.²¹⁵

The merits of the above assertion, that there is need for more empirical evidence can be appreciated. The nature of empirical evidence is that it corroborates truth and establishes that theory does correspond with reality. A salient point that was uncovered from the analysis conducted in the previous study was that there are “various methodological innovations that are making it possible to test some of the claims made by institutional theory concerning the co-evolution of legal systems and economic forms, including the business enterprise”.²¹⁶ The article states that such methods could involve a Lexi-metric approach, which provides comparative data on legal systems and facilitating statistical analysis.²¹⁷ There is

²¹⁴ John Buchanan, Dominic Hissang Chai, and Simon Deakin ‘Empirical analysis of legal institutions and institutional change: multiple-methods approaches and their application to corporate governance research’ (2014) 10 *Journal of Institutional Economics* 1, 2.

²¹⁵ *Ibid.*

²¹⁶ Buchanan (n 215) 7.

²¹⁷ *Ibid*

also an econometric approach, this method, involves a study of the interaction of legal rules with financial variables over extended time periods, and enables the distinction between short-term and long-term effects of legal change.²¹⁸ Summarily, it was asserted that with improved empirical methods being adopted to test institutional theory, we would become better informed on the role institutions play in supporting economic development and growth.²¹⁹

To test the impact of an empirical analysis, it was worth reflecting on works which sought to apply an empirical approach to test if law did matter in economic development. One such work was a study done in China, on whether the absence of the type of autonomous legal institutions found in the West threatened institutional economic theory which placed emphasis on the importance of law for economic development.²²⁰ At the heart of the study was how China seemed to ignore key points such as securing property rights and enforcement of contracts which are central to NIE but it was nevertheless developing as an economy.²²¹ It was initially asserted that China relied on their *guanxi* system of interpersonal trust, as a basis of contractual relationships and this was the reason for their development. Key findings of the study, which was conducted through interviews, stated that there was no evidence to support the claim that China's economic growth was achieved through the absence of law.²²² The study itself actually confirmed the suggestion that the Chinese version of the rule of law, will in future, involve less reliance on *guanxi*, and a greater emphasis on judicial

²¹⁸ Buchanan (n 215) 7.

²¹⁹ *Ibid.*

²²⁰ Ding Chena, and others, 'Law, trust and institutional change in China: evidence from qualitative fieldwork' 17 (2017) *Journal of Corporate Studies* 257.

²²¹ *Ibid.*, 1

²²² According to the article this may have been true when the economy initially began developing, but same cannot be said in present times. There has now been a move from this *guanxi* system.

independence and objectivity. The idea of *guanxi*, (that interpersonal trust) again raised another point to reflect on within the Lagos SME sector. While this will be dealt with more fully in chapter five when we explore the idea of calculative trust, it is relevant to point out here that it will be averred that Nigeria is a low trust society. There is low trust between individuals²²³ and low trust in the government, and because of this, some way of establishing trust needs to be considered, along with securing property rights and enforcing contracts.

3.5. Encountering Elinor Ostrom

From the framing done above, it was understood how the various parts and concepts, for example, the market, property rights, transactions costs, both formal and informal institutions etc., were going to be important in the development of the Lagos SME sector. However, a clear picture of how to conduct an analysis of the sector, examining these individual components within the sector, could not yet be seen. At this point, they stood as words on paper, ideas understood individually, concepts that were important but not allowing for the diagnosis and identification of the exact impediments within the Lagos sector. Perhaps this was due to a failing to become more familiar with North and Hodgson's work, or as already asserted above, some form of empirical analysis was needed to support the theory.

²²³ Speaking as a Nigerian, there is a strong likelihood of personal trust if individuals share the same tribal origins (i.e. trust between two 'Yoruba' people, even if they may not have met previously). This reflects the shared communal need to be one's brother's keeper, especially if working in an area different from their origins. You often find market associations based on tribes, where they share information and market secrets and sometimes may stand as guarantors for each other.

As it seemed likely that the analysis required an empirical approach if NIE theory was to be applied to the Lagos SME sector, it became relevant to consider the best way to implement this. Given the limitations of the thesis, it was decided that an actual empirical study could not be undertaken. Therefore, other method akin to an empirical approach, which allowed for the same rigour, was required. Something that allowed for conducting the analysis of the sector but would also give an accurate, or as close to an accurate analysis of the Lagos SME sector and the problems within it, that an empirical study would reveal.

It was at this point the work of renowned Nobel Laureate Elinor Ostrom was discovered. Ostrom herself was an economist associated with NIE, thus was a perfect fit within the established framing. What was observed from a study of Ostrom's work, was that it allowed for two possible applications: an actual empirical study; or a theoretical one where a conceptual community would be observed and assumptions about their behaviour and interactions would be made using behavioural theory. It is the latter application that this thesis adopts.²²⁴

In using Ostrom's framework, the goal was to uncover problems which had not been obvious to generations of reformers within the sector. What was observed from the history in chapter two was an identification of these failures. We noted that definitely efforts were being made, resources being expended, and institutions set up to solve a presumed problem. It is asserted from the history that the "presumed problem" was a question of finance, getting more money to these SMEs, either through focusing on funding the agricultural sector or based on geographical location. We did observe a few schemes which tried to focus on

²²⁴ Chapter six provides a fuller explanation of this, particularly the second application. This is what the thesis uses to diagnose the SME problem.

giving these SMEs the skills to manage their business²²⁵ but largely, the focus was on financing them, thus different credit schemes were created.

But these schemes, policies and regulations did not work for various reasons, one of which was an enforcement problem especially in regard to debt recovery,²²⁶ another was because of corruption. This raised the question of whether these policies could ever be effective, were they being created in a vacuum without consideration of the realities in the country? But whatever problem they were trying to solve, their solution definitely seemed to be inadequate, and their remedies have not been suited to solve the problems. We can assert this based on the fact that even now, it is still a high on the current administrations' agenda. This suggests that there has actually been a misdiagnosis. The reason that government interventions have not been working, is that either the problems that exist are not the problem the authorities think they are, or the remedies being deployed are being enacted in a system that will not allow them to have the effect expected. Without actually knowing what the problem is, a solution that fits will not be possible.

Thus, the need for Ostrom's IAD framework to diagnose these problems before policy is created, taking into consideration property rights, the role of formal and informal institutions, enforcement of contracts etc.

²²⁵ When we conduct the analysis of the sector, we shall focus on one in particular, the Small Medium Enterprise Development Agency of Nigeria (SMEDAN).

²²⁶ In chapter five, this will be discussed in more detail, especially the failures of the Asset Management Company of Nigeria (AMCON) which was a government institution charged with the recovery of bad banking debts within the country.

3.6. Conclusion

This chapter was a reflecting process of how the chosen method of analysis was discovered. In this chapter, a few theories were examined, specifically, the free market theory and new institutional economics. It was asserted that markets were not created by some invisible hand, rather through institutions and because of this assertion it became relevant to explore more deeply what the theory of NIE was about. Through this exploration of NIE, several points of reflection or themes were identified. It is believed that; trust; transaction costs; securing property rights; enforcing contracts; formal institutions; and informal institutions, are all concepts that would impact the subsequent analysis to be conducted.

As stated in the first paragraph of the section above which discussed NIE, North acted as the first gateway into this field, and influenced the new direction of the thesis. While North did provide some valuable insights, ultimately, it was felt that Douglass North was too high a level of abstraction to be used effectively. While it is possible to reduce it down in scale to examine financing SMEs in Lagos, it was believed that this presented more of a hindrance to the work. As another institutional economist, Hodgson's perspective on what institutions are, and their role in markets²²⁷ provided more insight into the field. But as the understanding of the theory began to develop, and more writers consulted, it was realised that a more rigorous approach would be best suited to address the research question. Thus, Hodgson became like North, more of a gateway to the understanding NIE,

²²⁷ That belief that the market is not seen as automatically constructed or naturally occurring, but rather a product of institutions.

and another author, Ostrom and her analytical tool would be used to address the research question.

Now that a somewhat firmer grasp of the theory and how it related to the Lagos SME sector has been developed, it was determined that there was a need for an empirical approach to the problem. Due to limitations, it was determined that Ostrom's IAD framework suited the needs of the thesis, and still presented a rigorous way of analysing the sector. While not ultimately concluding that it is the best approach, it serves its purpose within the limitations of this work, thus worth further exploration. A more detailed discussion of Elinor Ostrom and her framework will be carried out in the next chapter.

Chapter Four: Elinor Ostrom and her Development of the Institutional Analysis Development (IAD) Framework

4.1. Introduction

The previous chapter gave us an overview of the thought process behind concluding on a method of investigation. It explored Free Market theory and the role of the 'invisible hand', and how New Institutional Economics acted as the foundation of the analysis to be conducted. Eventually the chapter concluded by determining that Elinor Ostrom's IAD framework best suited the needs of the thesis. It was suggested that this was the preferred option to conduct the investigation because the IAD framework acts as a lens to view different policy elements,²²⁸ and presents a rigorous way of analysing the SME sector without adopting an empirical approach.

To understand Ostrom, the most appropriate place to begin would be her book *'Governing the Commons: The Evolution of Institutions for Collective Action'*.²²⁹ Succinctly as possible, the main inquiry of the study was to illustrate how a group of people who are all dependent on a resource but are in competition for its exploitation can organize and govern themselves to maintain and extend the long-term economic viability of the resource.²³⁰ Ostrom sets her stage with the use of common-pool resources (CPRs) and how degradation will occur through use, but it can nevertheless be efficiently maintained by self-organised groups. Ostrom's objectives were to illustrate that the community which

²²⁸ Michael D. McGinnis 'An introduction to IAD and the Language of the Ostrom Workshop: A simple guide to a complex framework' (2011) 39 The Policy Studies Journal 169, 170.

²²⁹ (Cambridge University Press 1990).

²³⁰ Elinor Ostrom, *Governing the Commons: The Evolution of Institutions for Collective Actions* (Cambridge University Press 1990) 1.

benefited from the use of the CPRs, were the most appropriate body to devise mechanisms to efficiently manage the resource. Below, we shall now expound on the principles identified by Ostrom.

4.2. What are Common -Pool Resources and how are they maintained?

To begin an analysis of Ostrom's work, it becomes pertinent to give a definition of what is meant by a 'common-pool resource'. A CPR is "a resource made available to all by consumption and to which access can be limited only at high costs. Some classic examples of common-pool resources are fisheries, forests, underwater basins, and irrigation systems".²³¹ As mentioned above, degradation of CPRs will naturally occur through its use. This degradation is reflected in the economic theory which states that deterioration of a natural resource or environment will occur whenever people come in contact with the resource, this has been coined "the tragedy of the commons".²³² A distinction must be made between pure public goods and CPRs. It must be noted that public goods are non-rivalrous and non-excludable, that is the consumption of the good does not deplete the amount available to others, and it is available to all, and its availability cannot be withheld. This is in contrast to CPRs, where outsiders can be excluded from the use of the common pool if protective norms and practices are put in place. Ostrom notes that when compared with public goods, "crowding effects" and "overuse" problems are chronic in CPR situations but absent in regard to pure public goods, that is, one's use of public security (which is a pure public

²³¹ Encyclopaedia Britannica 'Common-pool Resource', Available at < <https://www.britannica.com/science/common-pool-resource> > Accessed on 22nd October 2016.

²³² Garrett Hardin, 'The Tragedy of the Commons' (1968) 162 Science, New Series 1243.

good) does not subtract from the availability or reduce the general level of security available in a community.²³³

Ostrom suggests that this tragedy occurs as a result of the paradox that "individual rational strategies lead to collectively irrational outcomes".²³⁴ This simply means that a resource can be used rationally²³⁵ by one individual to obtain maximum benefit. However, when a group of individuals use it in the same rational manner to obtain the same maximum benefit, deterioration occurs much more quickly. This proposition is reflected in the 'Prisoners Dilemma game' model,²³⁶ this model asserts that persons working for their own benefit when pursuing a course of action, do not create optimal results. The typical prisoner's dilemma is arranged in such a way that both parties choose to benefit even if it is at the expense of the other participants.²³⁷ It has been stated that a distinctive feature of the Prisoner's Dilemma is that short term, neither side can benefit with a selfish choice enough to make up for the harm done to it from a selfish choice by the other, thus, if both cooperate, both do fairly well.²³⁸

However, in playing the game, there is a dominant strategy, and that is to defect. A rational player in the game believes that defection gives them the highest payoff. That is, if one defects while the other cooperates, the defecting side gets its highest payoff, and the cooperating side gets its lowest payoff. Naturally, the

²³³ Ostrom (n230) at 32 She further notes that propositions derived from a theory of public goods that are based on the non-subtractive attributes of those goods are not applicable to an analysis of CPRs and the use of subtractable resources. CPRs and subtractable resources are more closely related to the theory of private goods than to the theory of public goods.

²³⁴ Ostrom (n 230) 5.

²³⁵ It is suggested that the term 'rational' in this context means to maximise one's personal return without regard for anyone else. In this context it would be irrational to care how anyone fares.

²³⁶ Ostrom (n 230) 4.

²³⁷ In the Hardin herders' game, the 'defect strategy' is for each herder to graze as many animals as he thinks he can sell at a profit. Ostrom (n 230) 4.

²³⁸ Robert Axelrod 'Effective Choice in the Prisoner's Dilemma' (1980) 1 Journal of Conflict Resolution 3, 4.

consequence of this is that it gives both sides an incentive to defect. However, the catch is that if both do defect, both do poorly.²³⁹ Thus, as a result of following a purely rational thought process, both participants find themselves in a worse state than if they had cooperated with each other in the decision-making process.²⁴⁰

The meaning of 'rational strategy'²⁴¹ within the context of the game has been examined, and it has been asserted that rather than the idea that a player will only use rational strategies, which creates the strategy to defect, it is more of a common knowledge of rationality, that is used.²⁴² By common knowledge of rationality, it is meant that if all players are rational, and they know all players will be rational, then the common knowledge. Based on this assumed common understanding and belief that the other player is also rational, this forces defection because defection is the rational choice of the other player.

This paradox, as represented in the prisoners' dilemma, presented difficulties when it came to the management of CPRs, hence Ostrom's commitment to investigate and find ways in which 'these rational strategies' could be manipulated and redirected to prolonging the economic-life of the CPR. Ostrom sets out in 'Governing the Commons' to illustrate how the community in which the CPR is used can sufficiently manage the resource within the community itself with little

²³⁹ *Ibid*

²⁴⁰ Axelrod notes that the interactions being repeated is important to the game. He states that "If the two sides knew that there would be only a single choice, there would be every incentive to defect, since no matter what the other player chooses, defection yields a higher payoff than cooperation. But actors often have ongoing relationships with both an informative history and an important future. Making effective choices in such an ongoing relationship requires insight into the structural implications of strategic interaction". – Axelrod (n238)

²⁴¹ Aumann makes the argument that "simple rationality on the part of each player - each player being a utility maximiser is certainly not enough" Robert J. Aumann 'Backward Induction and Common Knowledge of Rationality' (1995) 8 *Games and Economic Behavior* 6, 7

²⁴² Herbert Gintis *The Bounds of Reason: Game Theory and the Unification of the Behavioral Sciences* (Princeton University Press, 2009) 87; Aumann states this as "in some sense, the players must also ascribe rationality to each other.....all players know that all are rational, all know this and so on ad infinitum...." Aumann (n241)

or no input from an external source.²⁴³ She takes a bottom-up approach to this,²⁴⁴ in that she identifies through an analysis of different CPRs and the collective governing mechanisms developed to manage them, how rules were generated between users on how to manage and share the resource, and these rules even transcended the community itself to become laws.²⁴⁵

It is worthy to note that Ostrom concludes that neither market nor state regulations have consistently nor reliably been able to govern the commons efficiently, each has underperformed when compared with some collective action governance schemes.²⁴⁶ This underperformance, provoked Ostrom's need to explore an alternative to managing CPRs. This by no way means that Ostrom's alternative is the only way to manage CPRs, but rather she proposes that it is the optimal way to do it.

Ostrom's contention with state and market forces rests in the fact that neither theories resolve the question of supplying a new set of institutions;²⁴⁷ making credible commitments; and mutual monitoring within self-organised groups. As we know, the theory of the firm centres around economic theories that explains how the structure and behaviour of firms, companies and corporations interact with the market and influence outcomes within the market (for example, pricing of goods and services).²⁴⁸ The theory of the state on the other hand, as depicted by Ostrom, states that rather than an entrepreneur (firms, corporations etc.), it

²⁴³ By external source, we refer to government institutions or market forces.

²⁴⁴ Starting at the lowest level and moving up through the system.

²⁴⁵ This scenario will be explored later in greater detail as this work progresses.

²⁴⁶ An interesting point to consider within our own SME sector. We have noted the failures of government interventions as a defect in the market, as we continue forward in successive chapters we shall also consider policy interventions, but at this point it is not presumptuous to state that the policy interventions may not have had the desired effect, considering that it is still on the government agenda to revitalise the sector.

²⁴⁷ That is formal or informal rules that govern human behaviour, or systems for changing those rules. They define the benefits that will be attached to different actions.

²⁴⁸Ostrom (n 230) 40; Also, Ronald Coase, 'The Nature of the Firm' (1937) 4 *Economica*, New Series 386.

becomes a ruler who recognises that considerable benefits can be gained by organising some activities.²⁴⁹ Ostrom submits that both theories require the interference of an outsider²⁵⁰ supplying the institutional changes to organise activities, the entrepreneur or the ruler makes the commitments to punish rule breakers and monitor activities.²⁵¹

Ostrom's rejection of these theories' rests on the fact that it requires outside influences to aid self-organised groups, when within the community, the individuals can successfully govern themselves and monitor their activities. By presenting the above analysis, Ostrom seeks to affirm that successful self-governance is possible, thus rejecting the need for external coercion. It should be noted that while Ostrom maintains that the key situation is self-governing without external influence, she nevertheless concedes that there will be situations where external influences will have a use. By this, we mean that the state can confer legitimacy on self-organised groups by recognising the rules created by the groups, or even taking it a step further by helping to enforce rules (through the court system) on erring individuals within the group.²⁵²

From the above, we can clearly note that Ostrom favours a self-governing system within communities when it comes to managing and maintaining a CPR. Ostrom nevertheless submits that it would be erroneous to conclude that individuals with common interest would voluntarily act together to further that interest.²⁵³ She rests this submission on the work done by Mancur Olson in 1965, in his book *The*

²⁴⁹Ostrom (n 230) 41.

²⁵⁰ As (n 210) above suggests, external forces (outsiders) refer to government institutions or market forces.

²⁵¹ Ostrom (n 23) 40

²⁵² Ideally within Ostrom's theory, the self-organised group should be able to carry out both monitoring and sanctioning functions, but realistically that is not always the case, Ostrom accepts that in a situation such as this, the use of external influence will be unavoidable.

²⁵³ Reaffirming the paradox in the prisoners' dilemma game.

Logic of Collective Action.²⁵⁴ She cites Olson's assertion that unless there is some form of persuasion to make individuals act in their shared interest, self-interested individuals will not act to achieve common interest.²⁵⁵ Ostrom further extends the spectrum of Olson's assertion and restates it. She infers that "one who cannot be excluded from obtaining the benefits of a collective-good, once the good is produced has little incentive to contribute voluntarily to the provision of the good". She terms this as the 'free rider' problem.²⁵⁶ The free rider is simply that person in every group or collection of individuals who wants something for doing nothing, that individual who will act opportunistically when given a chance, defying the collectives' rules and not making efforts to achieve the shared interest.

4.3. The Problem of the Free-rider and the Common-pool Resource

Above we highlighted briefly who a free-rider is, but now it becomes apt to explore how the concept of free-riding informs our analysis of the tragedy of the commons. The problem of the free rider is tied to the economic nature of public goods. By public goods, it means goods that can be enjoyed jointly by many people who are hard to exclude from its use, for example, peace.²⁵⁷ CPRs are public goods, but they must be distinguished from goods such as peace, as free-riding affects each differently. This distinction lies in the sub-tractability of the goods. "Enjoyment of peace as a public good does not subtract from the enjoyment of others, but with CPRs, each person's enjoyment of the resource

²⁵⁴ Ostrom (n 230) 5.

²⁵⁵ Ostrom (n 230) 6.

²⁵⁶ *Ibid*

²⁵⁷ Elinor Ostrom *Understanding Institutional Diversity* (Princeton University Press 2005) 23.

subtracts units from that resource".²⁵⁸ This is why exclusion becomes necessary, if everyone tries to free-ride, the resulting effect is that the common resource will be destroyed because no one is contributing to maintaining it.

Exclusion mechanisms are fundamental to overcoming the free-rider problem. If exclusion is a direct consequence for individuals not participating in maintaining the resources, it is possible to conclude that the fear of exclusion will coerce individuals within the community to engage in maintaining the resource. Ostrom submits that the community is best placed at deciding what these 'exclusion terms' should be. They are the ones affected, they possess more information about the resources and how it is accessed, and this puts them in the best position to design effective rules which have greater impact on the individuals within the community.

Given the issues of over-exploitation of resources and those of the free rider concept highlighted above, Ostrom explores ways in which the resources could be maintained within a community without the aid of external influences. She embarks on this study through a comprehensive scrutiny of several long-standing and viable common property systems. Ostrom attempts to develop a series of reasoned conjectures about how it is possible that some individuals organise themselves to govern and manage common pool resources and others do not. An instructive example of how individuals can organise themselves to maintain a resource by self-governance is the California water basin study, a part of this study will be discussed below.

²⁵⁸ *Ibid.*

The Raymond water basin negotiations²⁵⁹ which shall be analysed, presents a market type system in which extractors had property rights, and there was no co-ordination between those property holders. Thus, on the face of it, a market solution was failing. The market was not complete, external costs imposed required internalising, and to avoid the free-rider or over-exploitative property owners maximising personal returns at the expense of other users and the resource, a solution needed to be found.

A summary of the Raymond Basin negotiation is presented thus:

*Water rights in California had been defined on the basis of whether a producer owned the overlying land and used the water on that land (overlying landowner) or used the water to serve areas other than the land owned by the water producer (appropriator). Under the common law, an overlying landowner held a riparian right to the 'full flow' of the water supply underlying his or her land. Where there existed a dispute between rights of overlying land owners, by virtue of the doctrine of 'correlative rights' developed in the case of **Katz v. Walkinshaw**,²⁶⁰ it was held that in times of shortage the court will treat all owners as coequal owners, and gain proportionate share of the water, rather than absolute share. In the **San Bernardino v. Riverside**²⁶¹ case of 1921, the overlying*

²⁵⁹ Ostrom (n 230) 111.

²⁶⁰ (1903) 141 Cal. 116

²⁶¹ (1921) 186 Cal. 7

landowner's rights over water was further limited to only taking what could be put to beneficial use.

Apart from the competition between overlying landowners, there also existed appropriators. The appropriators pumped ground water to be used on land not owned by those withdrawing water. The doctrine of appropriative rights allowed appropriators to withdraw surplus water or water that was not being put to beneficial use. Appropriator's rights were defined by the doctrine of first in time, i.e. depending on their history of use. Among appropriators, a court resolved conflict over scarcity of water would usually exclude junior appropriators. However, appropriators were potentially subordinate to overlying landowners.

The simultaneous existence of correlative rights and the doctrine of appropriative rights created uncertainty about the relative rights of the ground water basin. This was compounded by a third common-law doctrine which allowed ground water producers to gain rights through adverse use. That is, if a person occupies a land, in an open, notorious and continuous manner for a set period of five years, and the owner does not eject him, the original owner loses the rights to the land. Due to all these uncertainties, over extraction was the logical outcome.

The Raymond water basin negotiation:

Los Angeles (LA) is a semiarid region, and thus relies heavily on ground water basins for its water supply. Ground water basins are delicate resources of nature and can thus be destroyed by over extraction and/or pollution. If more water is taken per year than the regular level eventually the resource will be ruined. In LA, over extraction threatened all of the groundwater basins until institutional changes were initiated by those affected. In the Raymond Basin negotiations, the city of Pasadena bore the responsibility and the costs of replenishing and maintaining the ground water basin, thus their individual action was benefitting all others using the basin but not contributing to the cost (it is suggested that all others thus be adjudged free riders).

At a certain point the city of Pasadena declared that it would no longer bear the costs of replenishing and maintaining the basin. The city tried unsuccessfully to negotiate voluntary settlement with the other users, whereby all users will reduce the amount of water being withdrawn by them. With the failure of the negotiations, Pasadena initiated legal action, the case was referred to the Division of Water Resources of California to determine the safe yield of the basin and whether there was surplus. The process was lengthy and costly, and it was reported that pumping needed to cease to curtail their pumping to the safe yield. Not sure what judge would decide, and because of how rights were assigned (meaning that some would get more, while others will be left out), it dawned on the participants

that failure to agree would result in a pumping race. At Pasadena's instigation they all sat down to negotiate between themselves in the shadow of the court, and within six months they had drafted stipulations and signed the agreement except for two holdouts. The parties agreed that the safe yield had been exceeded and they needed to cut back to the safe yield of the basin, and the cut back was to be shared proportionately. The parties further guaranteed each other's proportional share of the safe yield. After another 6 months one of the holdouts agreed with the stipulations. The last holdout on took them to court, but rather than impose its own solution the court upheld the stipulations agreed by the parties, and imposed it upon the holdout, who was thus forced by law to "agree".

The parties went one step further and obtained legislation to permit taxation to be raised for the purposes of monitoring the agreement, and repair of the water basins that had been damaged.²⁶² It might be worth noting that in this example both market and State (law) forces are used by the users of the common resource.

This above scenario reaffirms Ostrom's arguments that self-organisation is possible without the need for external influence, and this is just one of the many cases portrayed throughout her work. Despite the above, Ostrom nevertheless presents a balanced argument. She concedes that self-governance will not work

²⁶² Ostrom (n 230) 111-135.

in every situation and illustrates this point with the scenario of Bodrum Fishery²⁶³ among others. In the Bodrum situation, the local fishing cooperative struggled unsuccessfully to mediate in conflicts among small-boat fishers, the new entrants and trawlers.

From her study of successes and failures of self-governing systems, Ostrom was able to develop eight factors that when present, permitted the development and successful government of common property. These principles are: a clearly defined boundary of both individuals or households who have rights to withdraw from a particular resource, and also of the resource itself; congruence between rules governing the use of common goods to local needs and conditions; those affected by the rules should participate in modifying the rules; ensure that those monitoring behaviours are accountable to the appropriators or are the appropriators; the use of graduated sanctions for rule violators; provision of accessible and low-cost means for dispute resolution; the rights of community members to make rules should be respected by outside authorities; and the responsibility for governing the common resource lies in nested tiers from the lowest level up to the highest. Another important point raised, was the ability to effectively exclude those who violate the rules as a form of sanction, this was to serve as a reinforcement of the importance of following the rules within the community. Without an effective way of exclusion and enforcing sanctions by those who use the resource, then, the CPR would suffer degradation.

²⁶³ Ostrom (n 230) 144.

4.4. Review of Governing the Commons

In the section above a concise version of Ostrom's work was presented. While not every aspect was explored in detail, it touched on some key aspects. It was noted that common-pool resources will always be subject to degradation where there are no limitations placed on its use. Ostrom's work undertook a thought-provoking exercise to determine who was best suited to put into place those limitations. She opposed the use of external influences such as the state, but rather promoted the use of self-governing mechanisms. Despite this opposition, she does accept that some situations will benefit from the legitimacy which state forces can confer. She further affirms that self-organised groups can work together to decide the best possible way to use a resource and attain maximum benefits for each participant. She cautions that it would be erroneous to conclude that individuals with common interest would voluntarily act together to further that interest without some form of persuasion. She also notes that there will always be opportunistic free riders taking advantage. But sanctions will keep the free riders in check and self-monitoring by those who have a vested interest to maintain the resource will always be more efficient than external coercions.

While exploring her work, it became apparent that concepts which she adopts would prove relevant to this thesis. The bottom up approach Ostrom takes in *Governing the Commons* seemed on the face of it crucial to creating a viable SME sector. Given that she recognises that the people who use the resource – in our case finance - are best placed to make the laws and set up institutions that govern its use, it was worth considering if between the SME and lender²⁶⁴ who transact

²⁶⁴ Again, this could be a Government lender or a private lender.

on a day-to-day basis, if they should be the ones who develop the rules (institutions) as to how they transact,²⁶⁵ mostly likely supported by in Ostrom's words "external influences" to give it legitimacy. But a question left unanswered was how to clearly develop these institutions, therefore it became apparent we would need to move beyond Ostrom's contextual examination of CPRs to her more generalised model, so as to analyse the subject matter of the thesis. Hence, it became relevant to consider her next book in order to get a deeper understanding.

4.5. Understanding Institutional Diversity.

Following the publication of 'Governing the Commons,' Ostrom came to the realisation that the factors and processes she was analysing in that context could be potentially usable in broader contexts beyond CPRs. Thus, she endeavoured in a final major work to produce a universal account of an institutional structure in which users of economic markets were able to self-govern and self-transform the market in the face of problems and dysfunctions within the market. In *'Understanding Institutional Diversity'*, Ostrom tries to extend and apply the comprehension of the principles of governing CPRs identified above in a broader context. She does this by analysing the heterogeneity of rules and norms, and how they are established and in what situations they will be obeyed. Ostrom's

²⁶⁵ For example, when we move on to the chapters in which we conduct our analysis of the Lagos SME sector, we would note that identification of persons was a barrier within the sector. In terms of identification, one common means was the use of the Nigerian National Identity Card., Rather than get national ID which is a difficult thing to achieve, it becomes relevant to consider whether between lending institutions and borrowers they can develop some other means of identification between themselves. These banks and schemes operate in the same community through branches and can thus generate their own forms of identification. Banks have 'know your customer' requirements in which they generate information, thus it is relevant to consider what other alternatives could be.

discussion is supported by an extensive array of empirical work. She presents hypothetical scenarios which depicts human behaviour to certain external influences and draws patterns within institutions. In governing the commons, she started with concrete and real-life situations (i.e. CPRs in individual case studies) and created a theory of CPR management based on common linkages from her study. However, in *Understanding Institutional Diversity* she works from high generality and abstraction to create an analysis theory that can be used across different situations. It is this abstraction that is of particular interest to this work. Ostrom's later analysis is potentially applicable to any market which is dysfunctional, and as the SME capital market in Lagos Nigeria is seen to be dysfunctional, this broader approach can be applied.

It is suggested that Ostrom seeks to understand interactions within institutions²⁶⁶ i.e. what an institution is, and how the institution functions. However, her work is not only a conceptual analysis of institutions, but rather she gives a modelling of how institutions can be changed. She understands and recognises that institutions are diverse, and that this diversity extends to how interactions occur within the institution. Nevertheless, she maps out a framework for analysing these diversities and interactions and concludes that the framework can be transposed across institutions to effect change. In short, she created a dynamic meta-framework of analysis.

²⁶⁶ We have previously defined institution to mean the formal or informal rules that govern human behaviour, or systems for changing those rules. They define what benefits that will be attached to different actions, see note 247 above.

4.5.1 The Action Arena as a Framework for Institutional Analysis

Ostrom in developing her meta-framework focuses on what she calls 'action arenas' and how external variables affect the structure of the action arena, provoking interactions that create outcomes. Ostrom defines action arenas to include situations in the home; neighbourhood; local, regional and international councils; firms and markets etc.²⁶⁷ It is suggested that these arenas are the lowest levels of analysis within the institutional structure, and it is at this level she seeks to effect change.²⁶⁸ Within Ostrom's arena, there are components that must interact to produce outcomes; the action situation and the participants.

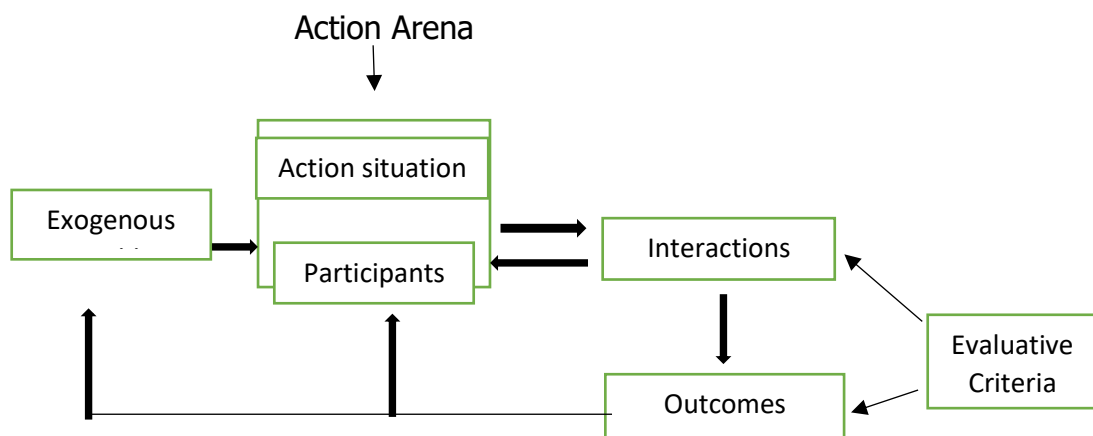


Fig. 1.1: Taken from Ostrom's text, representing the action arena, where variables interact with components of the arena i.e. the action situation and the participant, thereby producing outcomes. Evaluation occurs through an observance of these interactions and outcomes by an analyst or by the participants of the arena. **(Permission to reproduce has been granted by Princeton University Press).**

At this juncture, it is pertinent to distinguish between what the action arena is, and what an action situation means. Simply put, the action arena is the place in

²⁶⁷ Ostrom (n 257) 13.

²⁶⁸ This draws to mind the bottom-up approach she adopted in her management of CPRs. Starting from the lowest level to influence change.

which things happen, the action situation is what happens within the place. Thus, an action situation is the “social space where participants with diverse preferences interact, exchange goods and services, solve problems, dominate one another, or fight (among the many things that individuals do in action arenas)”.²⁶⁹ Ostrom further characterizes her action situations by using seven clusters of variables.²⁷⁰ They are the participants; positions; potential outcomes; action-outcome linkages; the control that a participant exercises; type of information generated and; the costs and benefits assigned to actions and outcomes. All this combine to create the internal structure of Ostrom’s the action situation.

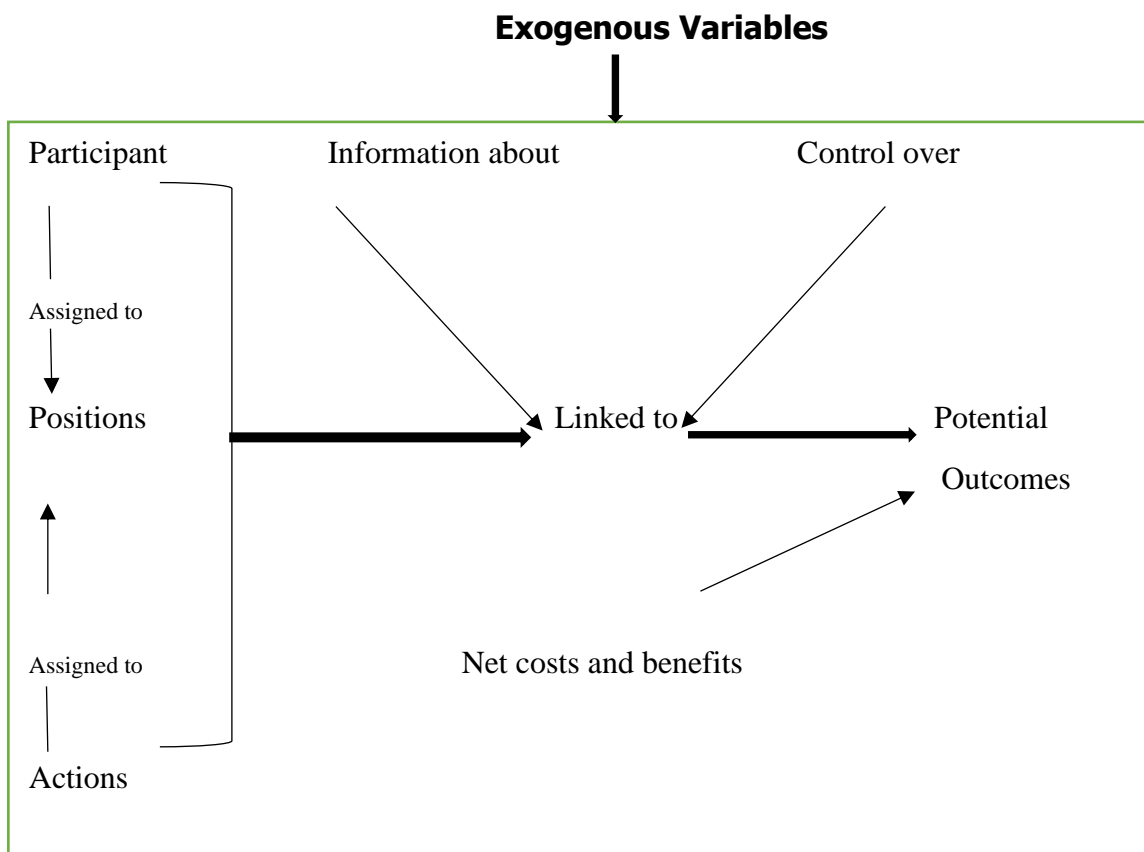


Fig. 1.2 The internal structure of Ostrom’s action situation, depicting the seven variables that create the action situation.

(Permission to reproduce has been granted by Princeton University Press)

²⁶⁹ Ostrom (n 257) 14.

²⁷⁰ *Ibid.*

But what do all these variables mean? If we recall, there are seven of them. Firstly, the participants, this refers to the decision-making entities assigned to positions and are capable of selecting actions from different alternatives and generating new alternatives. The second variable is the position, this is the connecting link between participants and actions, and it distinguishes the levels different participants can occupy. The position is an anonymous slot which participants can move into and out of, for example, players, voters, legislators, buyers, sellers etc.²⁷¹ The third is the potential outcomes, this refers to the possible results from the actions taken by participants. The fourth variable is the action-outcome linkages; this simply means the resulting effect of a decision made by a participant in a position, it is a direct action taken by participants to produce results. The fifth variable is the control that participant exercises, as we noted different participants occupy different positions, some can influence actual change (the decision makers) and some cannot, that is, some can exercise more control than others - the extent of control can vary from absolute to none.

The sixth variable is the type of information generated, this is simply the amount of knowledge the participants have about the full set of actions available to them and resulting outcomes, and how these actions are linked to the outcomes. Ostrom notes that participants in the action arena can have access to complete or incomplete information.²⁷² She nevertheless notes that complete information rests in the realm of assumption about things within the arena. The information might be complete, but a distinction needs to be drawn between perfect complete

²⁷¹ Ostrom (n 257) 40. Depending on the structure of the situation, a participant may simultaneously occupy more than one position.

²⁷² Ostrom (n 257) 50.

information and imperfect complete information.²⁷³ To understand this distinction, the general examples used are games of chess or card games. It has been suggested that a chess game is a game of perfect information because the state of the game is described by the positions of the pieces and whose turn it is, and this information is available to both players.²⁷⁴ But with imperfect information, while they may have some information, other strategies are revealed gradually. For example in the card game bridge, the first move of the game is to deal the cards at random, each player knows the contents of their own hand, but the contents of the other players' hands are revealed only gradually, as cards are played one by one.²⁷⁵

The final variable is the costs and benefits assigned to actions and outcomes. Ostrom submits that rewards and/or sanctions maybe be distributed to participants in positions depending on the path taken to achieve a particular outcome.²⁷⁶ All these variables will interact in the action situation, to produce outcomes in an action arena.

While Ostrom's illustrations serves the purpose of depicting her explanation of the arena, it became pertinent to translate her depiction into a relatable image for the writer's own understanding. Thus, for the purpose of this thesis, the arena was reimaged as a house, with the exogenous variables being the foundation on which the house was built, provoking interactions within the house and producing

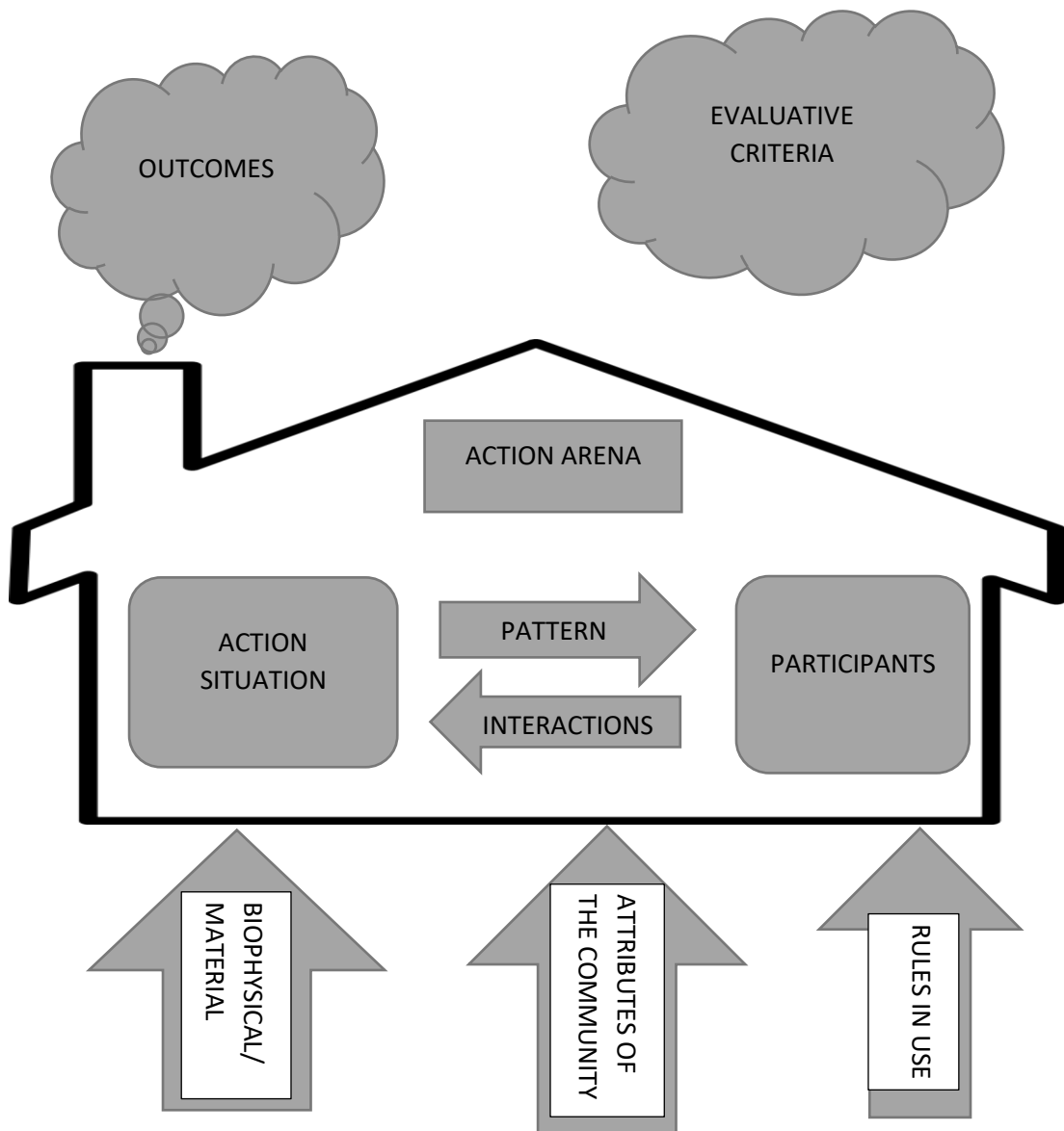
²⁷³ It is worthy to note that Ostrom believes analysts are more likely to assume that participants have access to incomplete information.

²⁷⁴ Jean R. S. Blair, David Mutchler, and Cheng Liu 'Games with Imperfect Information' (1993) AAI Technical Report Available at <<https://www.aaai.org/Papers/Symposia/Fall/1993/FS-93-02/FS93-02-009.pdf>> Accessed 20th August 2019, 62.

²⁷⁵ Blair (n 274).

²⁷⁶ Ostrom (n 257) 52.

outcomes, all subject to evaluative criteria.²⁷⁷ The re-imagination is depicted thus:



F.1.3: The re-imagined structure of the action situation makes some of the abstracting metaphors used by Ostrom more concrete. It also makes the foundational nature of exogenous factors clearer. Finally, process is given two directions of change: side to side for interaction; from bottom to top for significant consequences of the interaction.

²⁷⁷ These criteria will be discussed subsequently in chapter four, however note that they are: efficiency; accountability; equity; adaptability, resilience and robustness; and conformance to general morality.

4.6. How does the Action Arena Effect Change?

Before attempting to answer the question posed above, it is relevant to independently consider other concepts ingrained in Ostrom's work which will influence the answer to the proposed question. These aspects are the importance of rules, and what sanctions are appropriate. Above we have hinted at the impact rules and sanctions will have on the action arena, below we shall now endeavour to consider more fully what these impacts might be.

4.6.1. The importance of rules and norms.

It should be noted that rules are particularly important in Ostrom's action situation because rules are used by participants in an action arena to order their relationships.²⁷⁸ Ostrom suggests that rules are only important in that they allow the outcomes resulting from the participants' choices. For Ostrom, these rules are also used to rule out certain actions, or rule in some actions. Given the important role that rules play within the action arena, it becomes necessary to answer the self-posed question 'what are rules?' In defining rules, Ostrom adopts the definition from Black's law dictionary. This definition embraces four features of the meaning of rules, they are: regulations; instructions; precepts; and principles.²⁷⁹ Regulations are the laws that come from an authority.²⁸⁰ Instructions denote a manual used to solve a problem, and precepts reflect honest moral behaviours, while principles are codes of conduct. So, when the

²⁷⁸ Ostrom (n 257) 15.

²⁷⁹ Ostrom (n 257) 16.

²⁸⁰ Government, Legislature etc.

word rule is used, it encompasses law, strategy and moral behaviour, codes of conduct. In Ostrom's modelling they are intertwined.

It is suggested that the concept of moral behaviour, that is, the precept form of rules is hinged on the personal norms of participants. These personal norms can either be internalised individual norms or a group norm, but the key thing is that both are internalised. By this, it is meant that it can be a belief specific only to the individual, or a belief shared by individuals within the same group, which the group is aware of and abides by. It should be noted that norms are a reflection of the participants' culture and community. According to Ostrom, "norms are prescriptions held by an individual that an action or outcome in a situation must, must not, or may be permitted".²⁸¹ In other words, they are the accepted behaviours which an individual adheres to, they are in a way, an informal institution. Ostrom suggests that over time as rules subsist in society, they gradually become norms i.e. socially accepted personal behaviours.

As Ostrom did in her own work to illustrate the importance of rules and norms, let us theorise our own snatch game²⁸² regarding SMEs in Lagos. Note that the snatch game characterizes situations where the individuals involved do not share norms and rules. In this game, participants (lets term them A and B) are required to trade with each other. But each participant works with different sets of rules and norms. An example of a different set of norms or rules can be, for participant B there are no norms which prohibit him from taking participant A's goods forcefully. Ostrom suggests that in this 'snatch game,' if given the chance, participant B will snatch the goods of A because he stands to gain more this way,

²⁸¹Ostrom (n 257) 121.

²⁸² Ostrom (n 257) 36.

rather than through an equal trade. In our own snatch game, we have lenders and borrowers, and given the well-known corrupt nature of Nigeria as a country, we can hypothesize that some norms the participants may have will include fraudulent behaviours i.e. not paying back loans with no legitimate reason, not using loans for the purpose they were meant, absconding with loans etc. Lest we paint all participants with the same brush, it should be stated that not everyone will share this trait. Some are genuine and honest. Nevertheless, this does not eliminate the bona fide fear that dishonest behaviour is a possibility.

To play our theorized game, lenders and borrowers are faced with several moves which they can play.

1. They can deal with each other despite the uncertainties. With this move, the lenders take a gamble and hope their money is going to a genuine borrower. The lender may have conducted personal research, but how credible is the information? They run the risk of the borrower making off with his money.
2. The lenders can impose stringent requirements on the borrower in the form of collaterals.²⁸³ Several things can happen here; the borrower may not have the capacity to provide said collateral, so they walk away, or they provide false documents which supposedly show ownership of property somewhere, which he hands over to the lender. In the event of a default, the lender calls in the collateral and realizes that the loan was never

²⁸³ Frederick Onyango 'Banks Demand More Collateral as Loan Defaults Rise' (2016) *Lagos Television* Available at < <http://www.lagostelevision.com/banks-demand-collateral-loan-defaults-rise/> > accessed on 7th December, 2016.

secure.²⁸⁴ Or we can have a genuine borrower, who can legitimately meet the requirements.

3. There are no willing lenders, or there are no borrowers capable of meeting the requirements set by lenders, so no one plays the game.

We now begin to see how important rules are, especially their precept form.²⁸⁵

Societal and cultural influences affect our assumptions of the behaviour of others and their assumptions of our behaviour. It may seem like an overused opinion to restate that corruption has a negative effect on the business environment of a country, but this assertion remains valid even now. It ties back to the issue of trust which has been hinted at as forming a basis of our analysis,²⁸⁶ and the lender's bona-fide fear of encountering a dishonest borrower. Corruption sets up a system in such a way that taking advantage is seen as the better strategy, over that of playing the game legitimately so all participants can benefit.

The question of how to get individuals to act cooperatively, and maximize collective individual returns becomes paramount. Ostrom's underlying focus rests on the premise that given the right set of rules, individual responses i.e. the choices the individual will make, can be predicted if the right costs and benefits are attached. "The opportunity and constraints individuals face in any particular situation, the information they obtain, the benefits they obtain or are excluded from, and how they reason about the situation are all affected by the rules that structure the situation".²⁸⁷ The challenge as Ostrom states, lies in knowing

²⁸⁴ Gbenga Bada 'EFCC arraigns man for forgery over N50m bank loan' (2016) *PulseNG* Available at < <http://pulse.ng/gist/in-lagos-efcc-arraigns-man-for-forgery-over-n50m-bank-loan-id5593357.html> > accessed on 7th December, 2016.

²⁸⁵ Ostrom assumes that individuals are fallible learners trying to do the best they can in the long term by using norms and heuristics in making their immediate decisions. Ostrom (n 257) 7.

²⁸⁶ This would be discussed more fully in chapter five.

²⁸⁷ Ostrom (n 257) 1.

enough about the structure of the situation to select the appropriate assumptions about human behaviour that fit the type of situation under analysis. This suggests that before attempting to apply her modelling, we must identify fully what our situation is.²⁸⁸

Ostrom further states that rules are “a set of instructions for creating an action situation in a particular environment”. She uses working rules to illustrate this premise. By working rules, Ostrom refers to the set of rules to which participants in an action arena would ascribe as the reason they did a particular thing. Ostrom suggests that following a particular rule may become a ‘social habit’, and that as individuals consciously adopt different rules over time their behaviour changes and conforms with the rule.²⁸⁹ This suggests that rules can influence the way an individual behaves and in turn become norms. However, Ostrom advises caution when working with rules. She states that “all rules are formulated in human language and as such share the problem of lack of clarity and misunderstanding”.²⁹⁰ The use of the concept of working rules begins to suggest that Ostrom’s action situation may adopt a creationist approach to structure the action arena. The rationale behind this statement is that, if in creating the action situation there already exists a set of instructions or manual which participants follow, this suggests that a design of how things can play out has already been formulated. This reflects the nature of game theory, where possible strategies that can be made by players within a game have been set up, and the game is played when players pick one or more strategies to achieve an outcome.

²⁸⁸ Succeeding chapters will establish this more fully, culminating in the synthesis of the information with Ostrom’s framework that will be carried out in chapter’s six and seven.

²⁸⁹ Ostrom (n 257) 19.

²⁹⁰ Ostrom (n 257) 20.

Going back to Ostrom's definition of rules which she takes from the Black's law dictionary, it suggested that her definition of the concept of rules is too restrictive given the broad nature of law. On the face of it, it may look as if she misses other relevant concepts such as facilitative rules, co-ordination rules, and the channelling effect of rules; these are aspects worth addressing and clarifying before moving further. As a form of warning when addressing these above concepts, one should be careful of not rewriting Ostrom's work and turning it into what we want her definition of law to be, due to our own understanding of the nature of law. Delving into these other concepts of rules brings about a jurisprudential quality²⁹¹ which is not made clear in Ostrom's work, but it seems necessary to highlight them because they may or may not inform our own analysis and understanding.

It is suggested that while not addressed straight on, Ostrom does highlight the importance of facilitative rules. The concept of facilitative rule, while not part of her definition is implicit in her work, thus deserves to be elucidated. In her first book '*Governing the Commons*', if we recall the California water basin case previously discussed, we noted that the parties changed the way in which they governed their commons by sitting down to agree on how to maintain the resource and drafting an agreement to that effect. This depicts the facilitative aspect of law. By facilitative, we mean the individual's ability to use rules to order or structure their relationships, for example this can be done through the use of contracts. Furthermore, in '*Understanding Institutional Diversity*', Ostrom talks about shifting through levels of analysis from one situation to a deeper rule

²⁹¹ In H.L.A. Harts *Concept of Law* (Oxford University Press, 1961), Hart provides a descriptive theory of the nature of law, its origins and its relationship with morality

changing one.²⁹² This change can occur because *"all rules are nested in another set of rules that define how the first set of rules can be changed.....What can be done at a higher level will depend on the capabilities and limits of the rules at that level and at a deeper level"*.²⁹³ The above suggests that the changing of rules through level shifting is facilitative in nature, because participants have recognised constraints on the current level which they are on, to re-order the situation, they move up another level so things can be changed.

As stated above already, rules also channel²⁹⁴ or coordinate behaviour, even though there might not be an enforcement mechanism. The fact that there is a rule, allows people to channel their behaviour and act accordingly. The channelling behaviour takes over the role of sanctioning. For example, the rule of the road, where driving on the left side is the accepted. If you drive on the right, you are most likely to crash, so your behaviour is adjusted to drive on the left to avoid crashing. It is proposed that this channelling and coordination aspect of rules is reflected in the way Ostrom uses "norms". If we recall, *"norms are the prescriptions held by an individual that an action or outcome in a situation must, must not, or may be permitted"*.²⁹⁵ It has been suggested that norms help coordinate behaviour. "Norms impose uniformity of behaviour within a given social group".²⁹⁶ Given that norms are synonymous for rules within Ostrom's arena, it can be concluded that norms reflect the coordination and channelling aspects of rules. The problem of Ostrom using the definition in Black's law

²⁹² Ostrom (n 257) 56.

²⁹³ Ostrom (n 257) 56.

²⁹⁴ Fuller notes that this is a function performed by legal formalities. Lon L. Fuller 'Consideration and Form' (1941) 41 Columbia Law Review 799, 801.

²⁹⁵ Ostrom (n 257) 121.

²⁹⁶ Steven N. Durlauf, and Lawrence E. Blume, 'Social Norms' Available at <
<http://www.economics.ox.ac.uk/materials/PalgraveSocialNormsJuly07.pdf> > Accessed on 3rd January, 2017.

dictionary as the basis for her explanation of rules is that one is left to draw conclusions on how these other concepts fit into her action situation. She hints at their existence within the action situation but does not expressly add them as part of her definition rules.

Another salient feature of Ostrom's definition of rules is that it also extends to cover legal positivism. This is reflected when she adopts the definition of how law comes from an authority. By legal positivism, we refer to John Austin's command theory. "Austin's particular theory of law is often called the 'command theory of law' because the concept of command lies at its core: law is the command of the sovereign, backed by a threat of sanction in the event of non-compliance".²⁹⁷

Now let us take it another step further to review our understanding of Ostrom's use of rule. If we are in agreement that although the words facilitative, coordination and channelling are not expressly stated they are nevertheless implicit in her work, we can classify Ostrom's rule into 'Primary' and 'Secondary' rules. This classification or distinction of rules was created by H.L. A Hart, and he expressed that "primary rules are rules of conduct; they tell you what you are legally obligated to do (or refrain from) and what consequences attach to obedience or disobedience. Secondary rules include everything except primary rules. The category of secondary rules includes legal rules that allow for the creation, extinction, and alteration of primary rules; these secondary rules are power-conferring rules",²⁹⁸ this again suggests the facilitative aspect of rules.

²⁹⁷ See John Austin, *The Province of Jurisprudence Determined* (Cambridge University Press, 1995); Also 'John Austin's legal positivism' Available at < http://www2.law.columbia.edu/faculty_franke/CLT/Summary%20of%20John%20Austins%20Legal%20Positivism.pdf > accessed on 9th January, 2017 where he discusses the command theory.

²⁹⁸ Legal Theory, Available at < http://solum.typepad.com/legal_theory_lexicon/2004/06/legal_theory_le_2.html > Accessed on 8th January, 2017. Also, Austin (n 297).

More importantly, secondary rules permit people to develop their own primary rules that regulate their private relationships, and it is how to develop and change these rules that Ostrom focuses on in her action situation.

We started off this section by talking about the importance of rules, we noted they were used to order the relationship of participants in an action situation. More importantly for Ostrom, her focus on rules rests on two basic reasons. To quote her:

*“First, institutional analysts conducting policy analysis are frequently asked to analyse the impact of some change in rules—either a change that has already occurred or the possible impacts of a proposed change. Second, institutional analysts working to craft solutions to negative outcomes in an action situation recognize that changes in the rules may be easier or more stable than attempts to change the situation through changes in the biophysical world or attributes of the community”.*²⁹⁹

Throughout her work, Ostrom makes reference to an ‘analyst’ who it seems structures and observes the action situation. Again, she states that this analyst ‘works to craft solutions to negative outcomes in an action situation’. It is suggested that her reference to the analyst again creates an assumption of a creationist model.³⁰⁰ While this reflects the nature of setting up ‘the game’ in game theory, this however conflicts with the bottom up approach which she justifies as the reason for her action situation. However, the understanding of the

²⁹⁹Ostrom (n 257) 138.

³⁰⁰ This will be dealt with more deeply later on in this chapter, when we discuss Mechanism Design, as we consider if Ostrom’s modelling is the only approach to analyse the thesis question.

role of the analyst is more generally to observe the interactions that occur within the action arena, rather than design the situation. It is from this observing of the arena playing out naturally in reaction to the exogenous variables that we begin to see where changes can occur.

4.6.2 What are the appropriate sanctions?

The stability of ruled ordered relationships is also dependent upon enforcement, breaking rules is always a possibility to individuals in an action arena but associated with breaking rules is a risk of being monitored and sanctioned.³⁰¹ “If one person can cheat without being caught, others can also cheat with impunity”.³⁰² This suggests that if there are no adequate sanctions attached to the rules made, the rules may not be followed and predicting outcomes becomes unstable. What should be understood is that sanctions can be either positive or negative. Positive in the sense that it comes in form of an incentive to encourage better behaviour among participants, and negative in that it excludes rule breaking participant from attaining benefits or imposing a direct loss or detriment. Here, Ostrom restates her conclusion from her earlier work about self-governance. She suggests that the enforcers of the rules should come from participants within the institution itself, this is because they are more motivated to monitor the situation as they have vested interest in the success of the institution.

Using our new understanding of the role of rules and sanctions we shall now explore how these concepts influence our arena and the outcomes they produce.

³⁰¹ Ostrom (n 257) 20. This is John Austin’s command theory that laws must be backed up by sanctions.

³⁰² Ostrom (n 257) 21.

4.7. The Arena and Changing Outcomes

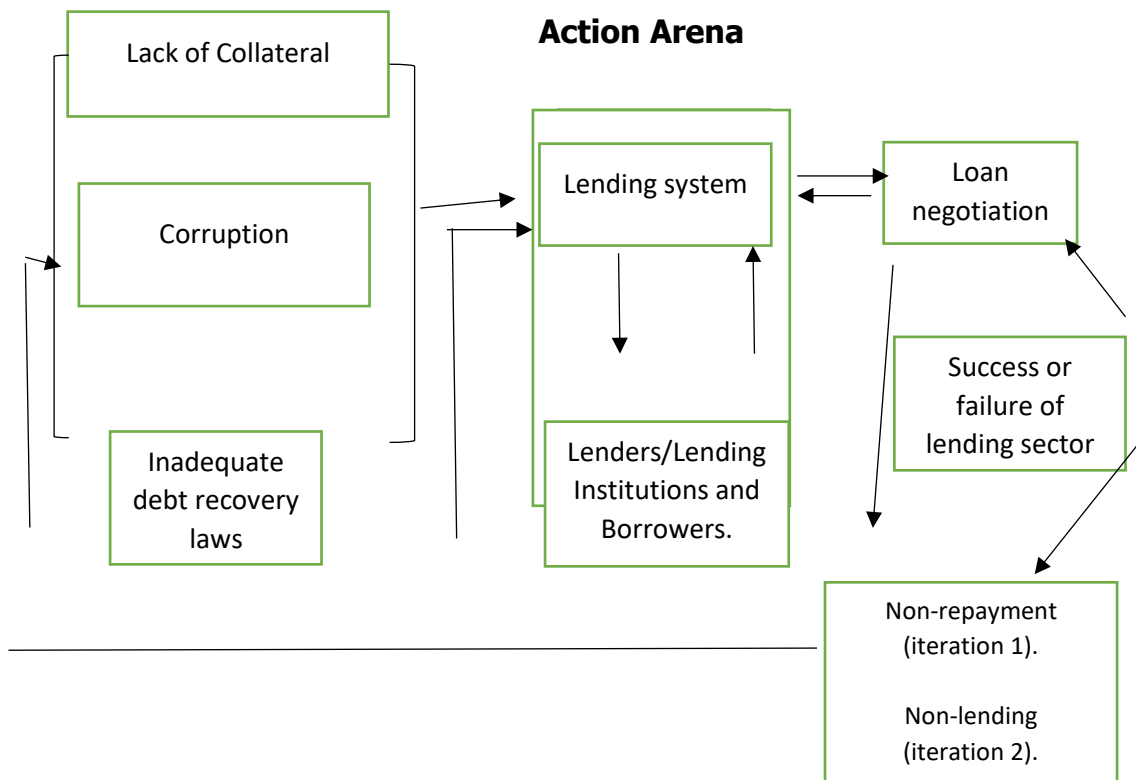
It should be noted that there can be many action situations nested within an action arena, but each action situation will be operating at different levels. These nested action situations are interconnected, and sometimes participants within the situation can occupy institutional functions at different levels.³⁰³ By nested, it is meant that within that same arena, new levels of interactions and action situations can be created based on the initial outcomes produced.³⁰⁴ If we recall the diagram in Fig 1.1, we can see that when exogenous variables³⁰⁵ interact with components of the arena i.e. the action situation and the participant, outcomes are produced. These outcomes feedback into the action situation, and back into the variables in a loop-like fashion. This feedback loop will initially occur on the same level of analysis, i.e. participants doing the same things, producing the same outcomes, and nothing changes. For example, a same level feedback loop can be: in a situation where, exogenous variables such as lack of collateral; corruption; inadequate debt recovery system exist, a lender gives out a loan, the borrower doesn't pay, the lender is unable to recover the loan due to system failure, and it can be assumed that an outcome can be the lender not giving out loans again. This loop will look like **fig. 1.4** below:

³⁰³ In Nigeria, CBN plays the role of lenders, but are also involved in policy making regarding how financial institutions operate.

³⁰⁴ Ostrom generally has three levels, the operational level, where the day-to-day interactions take place, the constitutional level where new laws can be created and the meta-constitutional level.

³⁰⁵ By exogenous variables we can mean culture, societal norms, rules, the community (which can be corrupt) etc.

Exogenous Variables



As we can see, in an unchanging loop all the variables remain the same, and the same variables and interactions will produce the same outcomes. Therefore, something within the action situation must change to create a different set of information that will be looped back to the arena and variables. The moment the participants start taking steps to change, a new action situation (new level) will be created and new outcomes produced. But how does this change occur? It is suggested that a reassessment of the produced outcomes by the participants involved in the situation can stimulate this change. Also, an awareness of the impact of the exogenous variables, can stimulate the desired change within the action arena. With an awareness of the impacts of outcomes on the lending system, a change that can occur within the situation can be where the borrower doesn't pay back the loan, the lender/lenders can actively seek new legislation to

help recover debts in a more efficient manner. This depicts how an analysis of an outcome can change the rules. The outcomes will feedback on the participants and the situation and may transform both over time.³⁰⁶

It is suggested that Ostrom's action arena can be effectively used to understand and influence changes in rules and regulations. As noted above already, Ostrom prefers a bottom up approach when it comes to institutional changes. This goes to her argument that states and/ or market forces often lack the required information to efficiently produce the desired better outcomes. If individuals who are crafting and modifying rules do not understand how a particular combination of rules affect actions and outcomes in a particular ecological and cultural environment, rule changes may produce unexpected and at times disastrous outcomes.³⁰⁷

The action arena offers an opportunity to approach rule changing from the lowest level. So how are these rules made? As we can see from the example presented above, if we want to change the rules, we use action arenas, the participants occupying different positions in the action situations determine the rules to change³⁰⁸ and consequences can be attached to these rules,³⁰⁹ thereby changing the interactions and influencing outcomes. Below an attempt will be made to construct what this rule changing situation could look like.

³⁰⁶Ostrom (n 257) 13.

³⁰⁷ Ostrom (n 257) 3

³⁰⁸ As we noted in the credible lending illustration, the lenders sought to influence the debt recovery laws.

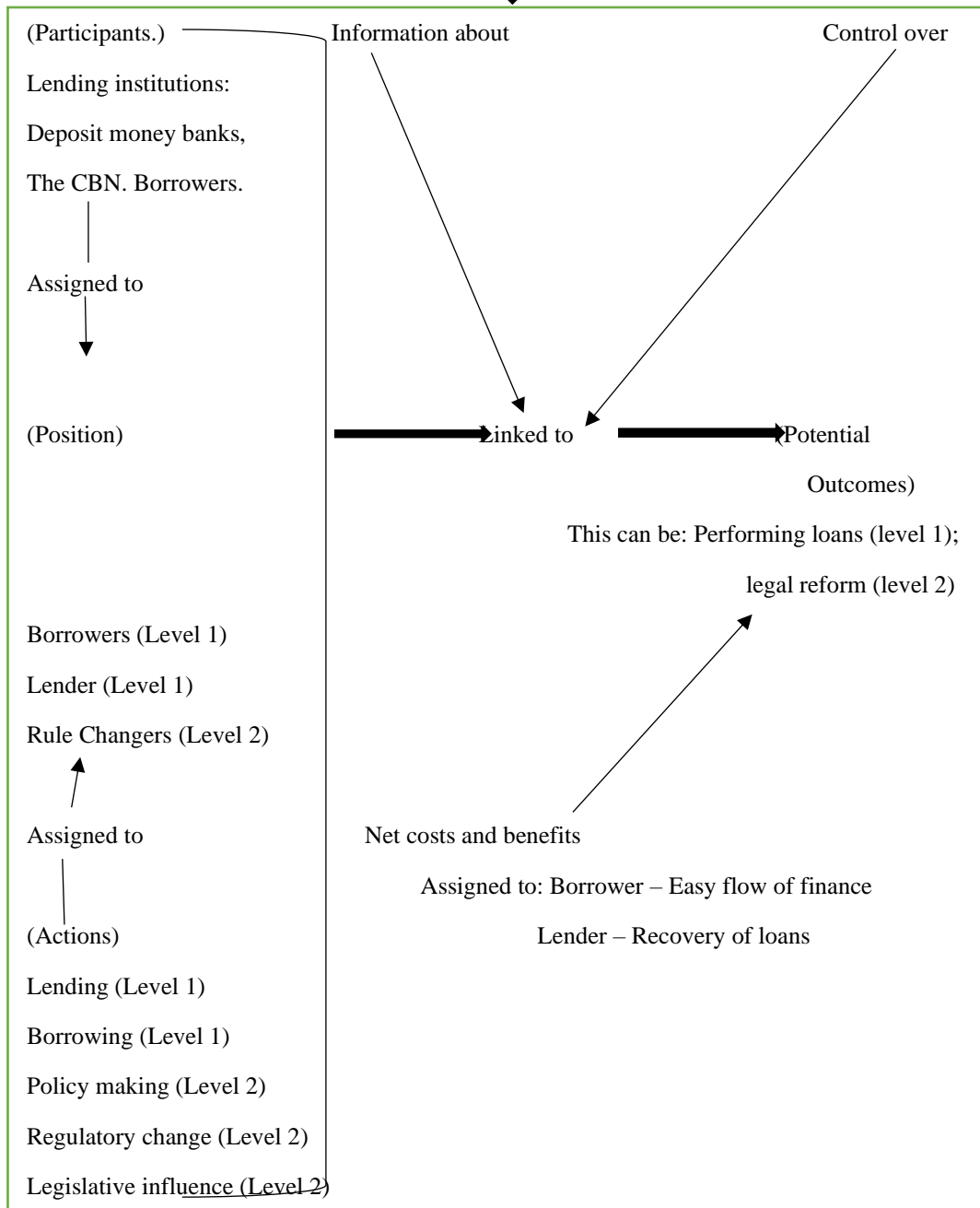
³⁰⁹ See (n 301) above, which makes reference to Austin's use of sanctions to strengthen the law.

4.8. Rule Changing Action Situation

Ostrom's modelling is about influencing outcomes and possibly changing exogenous variables. The question to ask ourselves is what are these outcomes and variables we want to influence? To start, an outcome to change could be creating a credible lending system and counteracting the lack of trust embedded within the system. A variable to change that can help create the desired credible system could be inadequate debt recovery laws. Another variable that can influence the outcome of creating a credible lending system could be changing the laws concerning acceptable forms of collaterals. In short, we are trying to change some rules that affect an SME sector. From the above, we have submitted that when these changes start to occur, they can occur on different levels (action situations) but all in the same arena. Now let us explore what these nested levels will look like. ***Action situation one (Fig.1.5):***

It must be remembered that all these interactions are occurring within the same arena but at different levels, below it has been separated for ease of understanding.

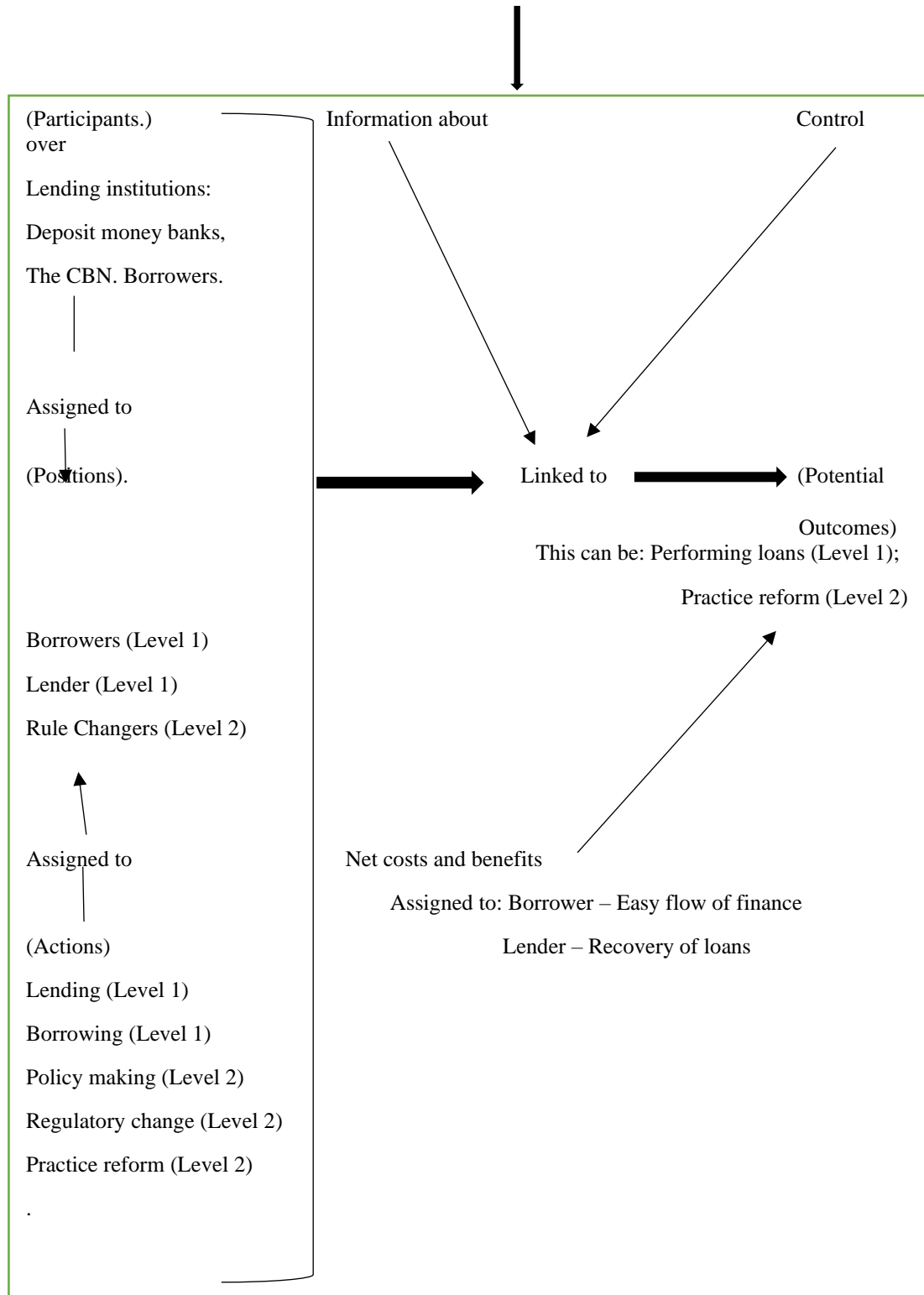
**Inadequate debt recovery laws.
(Exogenous Variable)**



Action situation two (Fig.1.6):

Inadequate collateral laws.

(Exogenous Variable)



Analysis:

The first thing we notice from the two situations is that they share common participants. This is because to influence the overall arena we have set up; these participants need to communicate on all levels. Their interactions will influence the changes that will be made to both the collateral law, and the debt recovery law. For example, we may change the laws to extend the criteria of acceptable collateral to include "patents". However, if lenders cannot accept that patents offer them real value for money the change in law will not make a difference because the lenders will still reject it as a form of collateral. On the other hand, if the debt recovery laws are revised and made extremely creditor friendly, this might stimulate fear among borrowers, and reduce the amount of people actually taking out loans. To create a change in variables that is acceptable to all participants, they must interact and exchange information.

The second things noticed are the positions available. As we know, the positions are the connecting link between participants and actions. In our scenario, the deposit money banks, will occupy the position of lenders, the borrowers will borrow, and the CBN shifts into rule changers. It should be noted that the CBN's position can shift between lender and rule changer. Now that the positions have been filled, we can determine their actions. This being lending, borrowing and policy making. It should be noted that in both diagrams, rule changing can be performed through four types of action: policy making, regulatory change, practice reform or legislative influence.

The third thing to be picked out from the situation are the potential outcomes. This refers to the possible results from the actions taken by participants. Looking

at the diagram, we note that the word 'potential outcome' is used, meaning that this is desired change we hope to achieve by changing the variables of the arena. Illustrating them within the diagram does not mean they are the outcomes produced, a change needs to occur, before they become actual outcomes, rather than potential outcomes.

The fourth element noticed is the action-outcome linkages; this simply means the resulting effect of a decision made by a participant in a position; the direct action taken by participants to produce results. As already noted, for there to be a change that leads to the desired outcomes, the participants in positions need to interact with each other, meaning that they must exchange information between themselves and this exchange of information will influence what actions should be taken.

This leads us to the fifth item, the type of information generated. This is simply the amount of knowledge the participants have about the full set of actions available to them and resulting outcomes, and how these actions are linked to the outcomes. Some potential information that can be generated within the arena can be; a consensus on what can be used as collaterals; finding a middle ground that is acceptable to all participants with regards to what the debt recovery laws allow; what interest rates are acceptable to both borrowers and lenders etc.³¹⁰ Exchanging information like this can help achieve the desired potential outcome.

The next element is the control that the participant exercises, as we noted, different participants occupy different positions. Some can influence actual

³¹⁰ We should however keep in mind that it is nearly impossible to have complete information in an action arena, and even if complete, it might still be imperfect. See (n 273) above.

change (the decision makers) and some cannot. In our situation, it is implied that the CBN is the only participant with any real control. They change and influence policy, if there is to be a change in the variables, the participant occupying the position of legislator would be the one to effect it. Nevertheless, it should be noted that the control the CBN has is limited. While they can indeed change collateral laws, with regards to debt recovery laws, it is more likely they make recommendations to a higher body of legislature, rather than effect actual change itself.³¹¹

The final variable is the costs and benefits assigned to actions and outcomes. This ties into the need to have sanctions attached, to influence the desired behaviour of participants in the arena. As noted already, Ostrom submits that rewards and/or sanctions maybe be distributed to participants in positions depending on the path taken to achieve a particular outcome.³¹² If the benefits of an easy flow of finance and an adequate loan recovery system is to be created these sanctions can either be positive or negative. Positive in the sense that it comes in form of an incentive to encourage better behaviour among participants, and negative in that it excludes rule breaking participants from attaining benefits under the system.

All these above-mentioned elements will have to interact within the action situation, to produce the desired outcomes of a credible lending system, and a system where trust exists between participants in the action arena.

³¹¹ This suggests that perhaps another level of an action situation is needed to effect the necessary changes to the debt recovery laws.

³¹² Ostrom (n 257) 52.

4.9. Is Ostrom's modelling the only approach?

Before moving forward, we must consider if Ostrom's modelling is the only way to approach creating a viable SME sector in Lagos. At the start of this chapter, we began by introducing the reader to Elinor Ostrom. We talked about her work with managing common-pool resources, and the eight principles for governing the commons which she developed through extensive study. We then proceeded to lay foundations to discuss her efforts to understand institutional diversity. At this point, before immersing ourselves fully in Ostrom's theory and applying it, it seems prudent to ask if 'Ostrom's modelling is the only way to approach financing of SMEs in Lagos?' The direct answer to the preceding question is no. Tackling the problem of identifying legal, cultural and market impediments to SMEs in Lagos can be approached in numerous ways. A suggested alternative way could be through the theory of 'Mechanism Design'. It should be noted that mechanism design is another subset of the game theory. It however plays the game in reverse. By this we mean that rather than starting at the lowest level and working up through an institution as with Ostrom, in mechanism design theory we imagine the outcome we want to achieve, and working backwards, we create mechanisms and rules which enable us to achieve the desired outcome. As we know, with game theory we have players (individuals) who are working with existing rules to play a game and see how it ends, however with mechanism design, we start at the end of the game, playing backwards. Thus, with game theory, we have the existing set of rules, and players can choose from different strategies and attain an outcome. Depending on what rules they play by, we can then predict what the outcome will be.

In mechanism design however, Maskin³¹³ states that “we begin by identifying our desired outcome or social goal. We then ask whether or not an appropriate institution (mechanism) could be designed to attain that goal”. Maskin believes that mechanism design is directed at answering three questions. These questions are: When is it possible to design incentive-compatible mechanisms for attaining social goals; what form might these mechanisms take when they exist; when is finding such mechanisms ruled out theoretically? It is suggested that mechanism design examines the hypothetical space in which our desired outcome can be realised, given the right incentives.

Maskin further identifies constraints that impede the playing of ‘the game’. These constraints being the moral hazard problem³¹⁴ and adverse selection. Adverse selection is the problem of getting people to share information honestly. He nevertheless states that such constraints can be overcome by designing incentive-compatible mechanisms. It has been concluded that individuals will naturally not share information, unless there is an incentive to do so, or there is a benefit attached to sharing this information. The plan or incentives created, must give people a reason to share information honestly. It is suggested that a purpose of mechanism design is to add sharing information honestly to the list of possible strategies available to a participant in a game.

Mechanism design operates to find a balance between participants needs, for example, it can do this using a mediator. Using this equilibrium, the mediator

³¹³ Maskin, E.S ‘Mechanism Design: How to implement social goals’ (2007) Available at < http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/2007/maskin_lecture.pdf > Accessed on 20th November, 2016.

³¹⁴ Moral hazard occurs where a person’s incentives do not align with his duty, in an ideal situation a person would ordinarily carry out his duty, but the moral hazard occurs when it is in my interest not to do my duty, and because there is a possibility that you cannot know everything I do, I take advantage of this fact.

finds a match or price which satisfies both participants. This price is found by splitting the difference between the participant's best price, and where no match can be found, they are free to walk away. This theory assumes that the mediator is not behaving strategically. For example, if we assume the government is the mediator wanting to balance the needs of lenders and borrowers. They do this by creating policies which help to either assure lenders that they will recover loans or assure borrowers that they won't be taken advantage of by the lenders. But is a government ever truly unbiased, we must acknowledge the possibility of lobbying occurring, and swaying government policy to the side of the better lobbyist. We find that in a situation like this, the difference cannot be split fairly. If we take the market to be the mediator, it has been suggested already that the market does not work in the circumstances under investigation. If we also factor in other transaction costs that come with operating within a market, there is always a high likelihood that the best price for each participant will not be met, and where it is impossible to generate the outcomes that we want, mechanism design theory suggests that we stop trying.³¹⁵

It has been stated above that mechanism design operates in a hypothetical possibility space. The goal is to design mechanisms or possibility space, where the only activities that are possible will be the ones that produce socially productive outcomes. This maps quite closely to the challenges of the small-medium enterprise we are trying to resolve, because we are looking at that social space in which lenders and borrowers interact, and we want their interactions to produce the outcomes of secured lending and honest borrowing and loan

³¹⁵ See Maskins third question of 'When is finding such mechanisms ruled out theoretically?'

repayment. This suggests that there is a natural alignment between mechanism design and what we are trying to achieve. However, Ostrom's model and mechanism design are trying to do it at different levels of precision. This precision is rooted in the difference in approach taken by both theories.

Both theories are aligned in so far as they seek to pinpoint what variables will determine the strategy chosen by participants, which will produce the outcome we desire. They also share the same constraints about information sharing and how to get participants to honestly share information, thereby adding 'honest communication' as part of the possible strategies that can be selected when playing the game. If you recall our hypothesized snatch game about SME lending in Lagos discussed above, it was questioned under the first possible move that participants could play whether or not a lender would be able to get credible information about the borrower.

But the approaches differ thus, Ostrom does not start with an outcome and go to a design. She states that we must start with a description of the situation, then work out if there are problems.³¹⁶ After this, we then examine if the problem can be remedied. Ostrom's theory offers a more thorough analysis of the problem of financing SMEs in Lagos, she does not start with a blank piece of paper and work out if X and Y can be solved by altering D and E variables. Ostrom's type of mapping is useful because it allows us to generate information and truly understand the reasons why the successive SMEs schemes have failed.

It is suggested that from reflecting on the history of SMEs in Nigeria, the different administrations have simply pictured an outcome they wanted, created schemes

³¹⁶ Thus, the approach of this thesis to identifying legal market and cultural impediments

in which they assumed would produce the desired outcome. A somewhat mechanism design approach, they assumed by introducing different schemes in the hopes of creating a certain outcome, the problem would be solved. But as history has shown, from 1960 to date, the sector still faces high loan defaults rates, mistrust between participants within the sector, and an overall failure. Obviously, there have been speculations as to why the schemes failed, and on this speculation, counter measures have been proposed.³¹⁷ However, with these new proposed counter measures, things are not where they should be. So, the question now is, why? What did the previous research into the area miss? How concrete are these speculations? Using Ostrom's modelling gives us the opportunity to perhaps answer these questions, rather than playing a guessing game, hope we achieve the desired outcome, and walk away when we cannot.

Furthermore, as mechanism design postulates its constraints on a blank piece of paper, Ostrom develops her constraints through a thorough analysis of the situation, taking cognizance of the rules³¹⁸ currently being followed. Ostrom allows us to take into account the role of norms when we alter rules, because her game takes cognizance of the role norms play in influencing participant decision making and includes it as part of her strategy. Mechanism design predicts outcomes from an economic rational standpoint but fails to highlight the role of norms in influencing human decision making.

If we look at laws in real world situations, we see they are not always obeyed even with the threat of sanctions. Sometimes sanctions from an above authority

³¹⁷As we shall note during our analysis, the creation of a collateral registry, Central bank of Nigeria stepping in to guarantee loans etc.

³¹⁸ Keep in mind by rules, we also include norms, regulation, and instructions.

are ineffective. Governments change rules all the time, but they do not always have the desired effect. Ostrom allows us to investigate why, she suggests it is because of the role our existing norms play. Legislation is drafted to affect everyone, but whether or not a person will adhere to it depends on their personal norms. For example, the American prohibition of alcohol in 1920.³¹⁹ This prevented the manufacturing, sale, and transportation of alcoholic beverages in America. Despite the legislation, millions of American still drank alcohol illegally, giving rise to bootlegging and speakeasies (illegal, secretive drinking establishments), both of which were capitalized upon by organized crime. As a result, the Prohibition era is also remembered as a period of gangsterism, characterized by competition and violent turf battles between criminal gangs.³²⁰ What this shows is that sometimes where there is a conflict between norms and legislation, people are more likely to adhere to their norms.

However, this is not always the case. Rules can influence norms, and it is where this overlap can happen that Ostrom capitalizes. She suggests that legal and other policies can affect normative actions, and therefore shift strategic behaviour. But what does it mean to change those norms in the real world? A classic example would be the end of segregation in America, and the civil rights movement. In *Brown v Board of Education Topeka*³²¹ the U.S. Supreme Court ruled unanimously (9–0) that racial segregation in public schools violated the Fourteenth Amendment to the Constitution, which prohibits the states from

³¹⁹ 'Prohibition, United States History [1920–1933]' Available at < <https://www.britannica.com/event/Prohibition-United-States-history-1920-1933> > Accessed on 8th December, 2016.

³²⁰ Prohibition, United States History (n 314).

³²¹ (1954) 347 U.S. 483. Also available at < <https://www.britannica.com/event/Brown-v-Board-of-Education-of-Topeka#ref135870> > Accessed on 8th December, 2016.

denying equal protection of the laws to any person within their jurisdictions.³²² With the end of segregation, racial integration began, and today it is frowned upon to be overtly racist, when previously open racism was the norm. It should be stated that norms cannot always be changed completely, even in modern society racism still does exist. The key thing is reversal in the amount of people who regard such behaviour as being the norm. For example, if we have a country with a population of one thousand, eight hundred believe that being corrupt is the status quo and two hundred do not. We would have a society similar to America during the prohibition era, and any anti-corruption laws may prove abortive. To remedy this, the target becomes influencing the normative value of enough people to flip the numbers, so that being corrupt isn't the order of the day. But the question is, how?

While mechanism design suggests that we change rules to affect outcomes, it does not clearly answer the question of how. Neither does it take into consideration, the influence of norms on participants when selecting strategies. Mechanism design was rejected as a possible tool for analysing the problem of financing SMEs in Lagos, because it does not give us the opportunity to explore what will actually be effective in terms of policy making. What policy response will be effective in terms of rule changing, lies in the description we generate by using Ostrom model.

Ostrom is a response to what's happening in the world. Remember above, we briefly noted the concept of how rules subsist in society to become norms; this happens in the overlap where laws and norms interact. This goes back to

³²² *Ibid*

Ostrom's suggestion that following a particular rule may become a 'social habit', and that as individuals consciously adopt different rules over time, their behaviour changes and conforms to the rule.³²³ The key thing about Ostrom's model is that it generates her rule from within the system, rather than an above authority generating these policies.³²⁴

Norms feed into law, it determines what laws are practical. Laws generated by the people who are within the situation are more likely to be effective. I would presume that if you can enrich yourself without being corrupt, that would be the preferred way of life. The current perception in Nigeria is that everyone is corrupt; if I don't act that way, someone else will swindle me. It's a relationship of "get the other person before they get me". But corruption undermines economic activity and increases transaction costs. It means less deals take place, but if business can be done in Lagos without being corrupt, it creates a better, stable economic environment.

4.10. Conclusion

In this chapter, the model to be used to diagnose the problems of the SME sector in Lagos was elaborated on. The chapter began with a discussion of Ostrom's earlier work which formed the basis of her need to understand the diversity of institutions. The chapter then proceeded to discuss Ostrom's IAD framework and the different components that must interact to produce outcomes. Following this, the chapter drew a distinction between an action arena and the action situation,

³²³Ostrom (n 257) 19.

³²⁴ See previous discussion on common-pool resources and how when rules are generated internally, they are more likely to be obeyed than when it is imposed by an outside body

and we noted that different situations can be nested in one arena. The chapter noted the important role rules and norms play as part of the institutions and how they influence actions and decisions. After this, it became relevant to illustrate what the action situation within our SME context would possibly look like. The chapter further considered whether Ostrom's modelling was the only way to diagnose the legal, market and cultural impediments to financing business, thus another method, mechanism design was considered. While it was agreed that Ostrom's framework was not the only approach, it was nevertheless asserted that the use of Ostrom's type of mapping is more desirable because it allows us to generate our own information and truly understand the reasons why the successive SMEs schemes have failed. Having discussed the model to be applied in the thesis, it now becomes important to consider some theoretical ideas that inform us on how the actors in our arena will select their actions and strategies as we simulate the Lagos SME action situation.

Chapter Five: Conceptual Underpinnings and the Nigerian Debt Recovery Environment

5.1 Introduction.

In the previous chapter, we discussed the work of Elinor Ostrom and her development of the IAD framework. An attempt to unpack the complex model was done and initial connections between her framework and the subject matter of the thesis were made. We noted that IAD framework is viewed as “a way of decomposing institutional context into component parts as a prelude to understanding how each part affects the other and shapes outcomes, with a view of diagnosing, changing or designing the institution”.³²⁵ Given that this work will focus on investigating the institutional aspects of legal, cultural, market impediments to financing SMEs, it is asserted that the framework will allow us to conduct an analysis of these institutions with the aim of diagnosing the weakness inherent in them.

From chapter four, we can note that Ostrom as an economist uses several economic theoretical concepts within her model, given the more legal background of this thesis, it would be prudent to expound on these concepts further as they play important foundational roles in our analysis. During our elucidation of Ostrom’s work, we could observe that her framing relied on concepts from game theory and the behavioural study behind rational actions.³²⁶ Even Maskin’s mechanism design³²⁷ is subject to the rules of game theory. Given that this theory

³²⁵ McGinnis (n 229) 170.

³²⁶ An area she has written extensively on.

³²⁷ Which we discussed in the previous chapter as an alternative to investigating legal, market and cultural impediments to financing SMEs.

forms a foundation of our analysis, it becomes pertinent to explore it further below.

5.2. How does Game Theory Work?

Game theory is a method to study a system of self-interested agents in conditions of strategic interaction.³²⁸ Alternatively, *game theory* is the study of cooperative and non-cooperative behaviour of individuals within a competitive situation i.e. our action arena discussed in the previous chapter. Game theory takes the rules of the game as given, and makes predictions about the behaviour of strategic players.³²⁹ It has been stated that in a cooperative game, players are able to form binding commitments.³³⁰ However, in non-cooperative games, players cannot form agreements without an enforcement mechanism,³³¹ this is because in non-cooperative games players make choices to achieve their own interest,³³² so without an inducement, players will follow the rational choice of self-interest.

Rational choice theory as we have seen, forms the basis of game theory. With rational choice, we are looking at why individuals act the way they do. According to rational choice, an individual will only act if in their view, the benefits are greater than the cost, if it is not then they would not act.³³³ Yoshimichi in his

³²⁸ Classic Mechanism Design, available at < <http://www.eecs.harvard.edu/~parkes/pubs/ch2.pdf> > Accessed on 18th November, 2016, 25.

³²⁹ Borghers, T 'An Introduction to the Theory of Mechanism Design' (2008) available at < <http://www.econ.yale.edu/~dirkb/teach/521b-08-09/reading/2008-mechanismdesign.pdf> > Accessed on 18th November, 2016, 2.

³³⁰ Cooperative game theory investigates such coalitional games with respect to the relative amounts of power held by various players, or how a successful coalition should divide its proceeds. Theodore L. Turocy, and Bernhard Von Stengel, 'Game Theory' (2001) Available at < <http://www.cdam.lse.ac.uk/Reports/Files/cdam-2001-09.pdf> > Accessed 22nd November, 2016, 6.

³³¹ This seems to reflect the Nigerian environment where the players cannot form agreements, and even enforcement mechanisms don't work as we shall see when we populate our action arena with variables from the Lagos SME sector.

³³² Turocy (n 330)

³³³ Andre Blais., *To Vote or Not to Vote: The Merits and Limits of Rational Choice Theory* (University of Pittsburgh Press 2000) 1

article states this as follows; "an actor chooses an alternative that he/she believes brings about a social outcome that maximizes his/her utility (payoff) under subjectively conceived constraints".³³⁴ He further goes on to identify that his proposed definition is in five parts: constraints; alternatives; social outcomes; utility and belief.³³⁵ Sato believes that constraints make some of the possible alternatives impossible and constraints change costs and benefits of alternatives.³³⁶ This view of constraint is based on the belief of the individual, thus it is subjective.³³⁷

As noted already, beyond constraints, the set of alternatives available to an individual also influences the decisions they make. Consequently, if an individual chooses one of the alternatives, a social outcome is realized.³³⁸ The basis of choosing an alternative is based on the utility that is received. In game theory, these alternatives and outcomes are set up by the rules of the game, and the game is played according to those rules. The rules define who the players are, what actions each player can make are created, possible strategies that a player can choose from are designed, and the payoffs of a game produced. To achieve this payoff, a player will use one or more strategies, also called the '*Nash equilibrium*'. This *Nash equilibrium* is a list of strategies, one for each player, which has the property that no player can unilaterally change his strategy and get a better payoff.³³⁹

³³⁴ Sato Yoshimichi., 'Rational choice theory' (2013) Sociopedia.isa. Pages 1, 1.

³³⁵ *Ibid*

³³⁶ In our action situation which we shall discuss in the next chapter, we shall explore how barriers to accessing information i.e. a constraint can exclude certain borrowers and influence the decisions they make.

³³⁷ For Sato, social resources such as money, assets, prestige, privilege, authority and power affect the formation of subjective constraints with the help of frames through which the actor views rational choice theory. Yoshimichi (n 334) 1. As we shall see in the next chapter, the exogenous variable of education (literacy) can influence a participant's decision to remain in the action arena.

³³⁸ Yoshimichi (n 334) 2

³³⁹ Turocy (n 330) 3.

There are generally two ways in which game theory is applied, the first being the laboratory experiment in which we present people with choices to see how they react. The other is the mathematical model based upon the payoffs of the different choices, the classic prisoners' dilemma game developed by Merrill Flood and Melvin Dresher.³⁴⁰ The prisoner's dilemma is simply a hypothetical situation where two prisoners are separated and given the chance to cooperate with the authorities by confessing.³⁴¹ The finite strategies available to them are; both can confess; both can remain silent; or one can confesses while the other keeps quiet.³⁴² If both refuse to talk, then they both go free; if one confesses while the other doesn't, then the co-operator gets off lightly and the non-co-operator gets a heavy penalty.³⁴³ The worst mutual outcome is if both confess, and both get sentenced.³⁴⁴ It has been suggested that if a rational prisoner had full information and trusted the other party, they would realize that the obvious choice with the best overall outcome is to remain quiet.³⁴⁵

However in the absence of such information and trust, and with the realization that the other prisoner also has choices, the decision moves from maximizing benefit to minimizing harm, in which case they should confess quickly.³⁴⁶ Classic Prisoners dilemma states as a rational person you should never cooperate, thus

³⁴⁰ We highlight what this game is in chapter four, during our exposition of what common pool resources are on page 68, there we note that with this game, people working for their own benefit when pursuing a course of action do not create optimal results. Also, Tom De Herdt 'Cooperation and fairness: the flood-Dresher experiment revisited' (2010) 62 Review of Social Economy 183.

³⁴¹ Kevin Gibson 'Games Students Play: Incorporating the Prisoner's Dilemma in Teaching Business Ethics' (2003) 48 Journal of Business Ethics 53, 53

³⁴² *Ibid*

³⁴³ *Ibid*

³⁴⁴ Gibson (n 341) 54

³⁴⁵ *Ibid*

³⁴⁶ *Ibid*

Nash equilibrium means that everyone defects at some point, because where you don't defect, you get cheated.

An attempt to mathematize the decision making process will not be made in this thesis, rather game theory and games like the 'Prisoner's Dilemma' are being used to develop the thinking process and generate nuanced insights into the Lagos SME sector without applying an empirical approach.³⁴⁷ As stated above already, the prisoner's dilemma game is made in such a way that you should never cooperate if you are a rational person. Therefore, we can assume that many people are irrational because behaviourally, they do not want to be the type of person that cheats other people - people would sometimes say why don't we split the gain.³⁴⁸

It is believed that the prisoner's dilemma game and reaching the *Nash equilibrium* where defection occurs is closer to the Nigerian state of mind. Again, because of corruption, a more rational mind-set (as described by game theory) has been adopted, because no one wants to be taken advantage of. Speaking as a Nigerian, it is asserted that the Nigerian mind-set has been shaped by corruption in such a way that every individual is always on guard because they feel the next person is out to cheat them. Thus, exploring game theory has informed this work by highlighting the ways in which a corrupt system degrades the quality of interaction and degrades the ability of building cooperation.³⁴⁹ The working

³⁴⁷ We are not conducting an empirical approach like that done in the LSEFT survey mention in chapter two and discussed more fully in chapter eight.

³⁴⁸ Peter M. Blau 'On Limitations of Rational Choice Theory for Sociology' (1997) 28 *The American Sociologist* 16 – In this article, Blau makes the point that rational theory should be criticised and indeed it has been, he addresses the issue of how rational choice theory ignores the fact that human behaviour is also influenced by emotional, moral and pathological influences. This criticism addresses the above point, and it can be stated that moral considerations may stop a person from cheating another.

³⁴⁹ We shall see this degraded interaction when we synthesize our information in Ostrom's action arena in chapter six and chapter seven.

hypothesis carried forward in this thesis, is that within the Nigerian context, people are closer to the rational maximiser, not because Nigeria is a particularly rational society, but because in Nigeria this is one of the effects of corruption upon society, hence people are more cynical. This explains the importance of building normative and structural institutions which support people in the absence of trust. Ostrom talks about this, hence again, her relevance to this discourse. It is asserted that people's rationality is not constructed in the same way as the mathematical understanding of the prisoner's dilemma because they have norms. Ostrom is important because within our action arena, her framework allows us to consider these norms.

5.3. Establishing Trust in Nigeria, why is it important?

During the introduction to this work, we noted that Nigeria currently has an infamous reputation. There are endless reports regarding the difficulty of conducting business in Nigeria,³⁵⁰ and allegations of corrupt practices within the government have become the norm. It was asserted that Nigeria's poor reputation affects the country economically, especially with regards to investments and loans. Thus, there is a need to change this perception, but the question of how this can be achieved remains? As we shall see below, it has been suggested that the key element that must present in an economy before it develops, is the establishment of trust. Trust plays this fundamental role because it determines how much people would be willing to risk of their finances. In

³⁵⁰ For example, reports like The World Bank 'Doing Business Reports' (2018) Available at < <https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2018-Full-Report.pdf> > and The World Bank 'Doing Business Report' (2017) Available at < <https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB17-Report.pdf> >

Chapter Four, we discussed the concept of CPRs and the idea that degradation occurs whenever people come in contact with it, we noted that this is known as the tragedy of the commons. The idea underpinning this degradation becomes useful to think about and keep in mind as we discuss the subsequent topics of trust and the rule of law. What we must understand is that trust and the rule of law are similar to CPRs in that they must be managed collectively, and if not managed and monitored closely, the resource can be depleted by opportunistic use since neither trust or the rule of law are pure public goods.³⁵¹

The aim of this section is to analyse Nigeria's deficiency in establishing trust in the financial market, explore how trust can be created and determine the overall long-term benefits of establishing trust.

5.3.1. The Nature of a Lack of Trust.

Finance must be understood as being predicated on risk,³⁵² so it must be stated that there is no investment or financial transaction that will be completely risk free. Knowing this, how then can we establish enough trust within a society where even though an investment is not completely risk free, investors and lenders are willing to part with their money? The answer to this lies in mitigation of the perceivable risk. If lenders can be reassured that when they give out money, there will be an effective system in place to help recover the whole debt or at least a significant amount of the debt, then they will be more willing to lend. It is pertinent then at this point to ask how this can be achieved. Trust in the

³⁵¹ In Chapter Four we discussed what public good are and how they differ from CPRs, we said their difference lies in that a pure public good is non-rivalrous and their consumption and non-excludable, but with CPRs they are subtractable and can be excluded. See page 69 for fuller discussion.

³⁵² Alastair Hudson., *The Law of Finance* (2nd Ed Sweet & Maxwell 2013) 6

system in which they operate plays a significant role to achieving this. As part of the social construct of society, trust has been a topic discussed by numerous authors.³⁵³ In their discourse, many have theorised on how the establishment of trust in the government and its establishment, and trust between members of society can enhance an economy of a country.

As an illustration, during the course of this work, the example of lending will be used as a reference. It is suggested that the issue of trust with regards to lending is three-pronged. The first prong deals with the relationship between the formal institutions lending the money and the borrower. This proposes that the lender must trust that the borrower will pay or will be able to pay if the debt is called in. The second, is the relationship between the borrower and the lender (be it the government, informal lenders and formal lender). This suggests that the borrowers must trust who they obtain the money from. A current example, in Lagos, Nigeria where a microfinance bank was alleged to have fraudulently collected money from no fewer than 200 women.³⁵⁴ The agreement was that they deposit money ranging from various sums, and at the end of three months, they would be granted a loan higher than the sum deposited. At the end of the expected time, the women turned up at the bank premises hoping to get their loans but discovered that the building had been abandoned and the banking premises closed. Finally, there is the relationship that exists when a guarantor (third party) is involved. Here, the lender must trust in the ability of the guarantor to hold up his end of the deal and pay the borrowers' debt should it be called in.

³⁵³ We shall subsequently examine Francis Fukuyama's work on trust.

³⁵⁴ Danielle Ogbeche, 'Microfinance Bank Defrauds over 200 Market Women in Lagos *Daily Post Nigeria*' (November 2015) < http://dailypost.ng/2015/11/23/microfinance-bank-defrauds-over-200-market-women-in-lagos/?utm_source=divr.it&utm_medium=twitter > Accessed 11th December 2015.

The issue of establishing trust becomes problematic when people live in a society like Nigeria. As stated above, corruption is not a new phenomenon in Nigeria. It can be safely assumed that the people rarely trust the government and many of its institutions. Given the scenario of the sham microfinance bank above, it can be stated that acts such as these, can if unchecked, slowly erode the trust people place in financial institutions as well. The implication of a lack of trust in society was aptly stated when it was said that; "Trust between citizens and their government officials and elected representatives is a vital element of a well governed society. In the absence of trust, citizens become cynical about their political system and disaffected with the existing order".³⁵⁵ Applying this to investments and lending, it can be stated that a lack of trust will breed cynicism with regards to lending, borrowing or investing, hence stifling economic development.

As a reference point to establishing trust in society, Fukuyama's *Trust: The Social Virtues and The Creation of Prosperity* provides compelling insights. Fukuyama in his work breaks down the issue of trust into categories. He talks about low trust societies and high trusts societies. To him, in low trust societies the people are less inclined to trust people outside their family or clan, and in doing so they make it difficult for large industrial growth. He stated that state intervention was often the only avenue by which they could build large scale industries,³⁵⁶

³⁵⁵ Larry Diamond, 'Building Trust in Government by Improving governance' Available at < <https://www.hitpages.com/doc/4645543062011904/12/> > Accessed 11th December 2015.

³⁵⁶ Francis Fukuyama., *Trust: The Social Virtues and the Creation of Prosperity* (Penguin Books 1996) 17.

"If a low-trust, familistic society wants to have large scale businesses, the state must step in to help create them through subsidies, guidance or even outright ownership".

The above reflects the opposite in societies with high degree of trust, it was stated that such societies can create large organisations without state support.³⁵⁷

It must be stated that ethnicity plays a vital role in Nigeria as a whole. This is a country with diverse ethnic groups, and with the multiplicity of groups people tend to develop closer affinity with members of their own tribe, i.e. more often than not, they are more willing to trust or help their own tribesman.

To Fukuyama, the social problem of lack of trust lies in the fact that:

"People who do not trust one another will end up cooperating only under a system of formal rules and regulations, which have to be negotiated, agreed to, litigated and enforced, sometimes by coercive means."³⁵⁸

A study of Fukuyama, hints that for Nigeria which has a low trust to develop economically, state intervention is the logical path. But we must also consider that apart from the lack of trust between peoples, the historic corruption of the Nigerian government presents the conundrum of whether the people can trust their devised intervention. With this in mind, we must then ask ourselves 'how can trust be created?'

³⁵⁷ *Ibid*

³⁵⁸ Fukuyama (n 356) 27. This is on parallel with Ostrom's approach.

5.3.2 The Concept of Calculative Trust.

As stated above, people who do not trust each other can only cooperate under a system of rules and regulation.³⁵⁹ Flowing from this, it would seem a straightforward concept that regulation should be able to solve Nigeria's trust issue. However, Nigeria presents a situation where there is not only a low trust degree between individuals, but also a low trust degree in the government. This indicates that even if regulations and checks are put in place, there will be suspicion as to whether they will actually be enforced or be effective. Speaking generally, without consideration of the Nigerian predicament, the rule of law plays an instrumental role in developing trust. In the financial sector, this rule plays its part by the construct of institutional devices. In this regard,

"in France...., public authorities also participate in the protection of lenders through penal punishment of failing borrowers".³⁶⁰

In creating penal punishments for failing borrowers, France has created an environment where formal institutions are more willing to lend to borrowers, because they believe that the rules set in place offers them remedy when a borrower fails. It can be stated that trust is embedded in the rule of law, flowing from the part which emphasises that no individual or entity be they economically or politically or militarily powerful, are able to act outside the reach of legal

³⁵⁹ *Ibid*

³⁶⁰ Michel Ferrary., 'Trust and social capital in the regulation of lending activities' (2003) 31 Journal of Socio-Economics, 673, 677

remedy.³⁶¹ Where the rule of law is not undermined, it can be used as an effective tool in building trust between the government and its citizens.

Douglas C. North is convinced that law, rules and processes, are a vital feature of the institutional structure of successful economies.³⁶² North also concludes that too much uncertainty hinders investment.³⁶³ If we are persuaded by this line of reasoning, it then becomes incumbent on the Nigerian government to show they can be trusted if a viable SME sector is to be established. The current administration has recognised that the current institutions within the country are in need of repair.³⁶⁴ It is a fact that the rule of law needs to be reinforced. With its reinforcement, trust between the people and government can slowly be built.

Beyond the type of trust created through the rule of law, which is established over time, another aspect of trust must be considered because as most financial transactions are based on taking, it is this type of trust that influences the decision to take risks. This is called 'Calculative Trust', it is this type of trust that would be particularly relevant in the analysis of our action situation to be conducted in subsequent chapters. By calculative trust, we refer to a situation where the expected gain from placing oneself at risk to another is positive, but not otherwise.³⁶⁵ This links to our earlier point of financing business being based

³⁶¹ Graham Ferris 'The Path-dependent Problem of Exporting the Rule of Law' (2012) 4 The Round Table 363, 364

³⁶² *Ibid* 366

³⁶³ Ferris (n 361) 366

³⁶⁴ Speaking particularly about the judiciary, President Muhammadu Buhari stated that "our justice system currently has a reputation for delays...this situation is a huge disincentive for businesses. It is not surprising therefore that Nigeria ranks near the bottom on the ease of doing business index. We are currently ranked 143 out of 189 countries by the World Bank Group's Enforcing Contracts Indicator. According to World Bank, it takes about 510 days on average to enforce a contract at the level of a court of first instance in Nigeria. In Singapore, the top ranked country on the index, it takes 150 days on average to enforce a similar contract. The ability to enforce contractual obligations and resolve disputes is an essential consideration for intending investors, both local and foreign, in deciding where to put their money." See 'Buhari laments delay in justice delivery' (2015) *SUN Newspaper* Available at <<http://sunnewsonline.com/new/buhari-laments-delay-in-justice-delivery/>> Accessed on 13th December 2015 .

³⁶⁵ Oliver E. Williamson., 'Calculativeness, Trust and Economic Organisation' (1993) 36 The Journal of Law & Economics 453, 463. This calculative trust shall be examined again in chapter six when we conduct our analysis of the Borrower-Lender Action Situation.

on risk. While we cannot effectively remove all risks from the system, the perceived benefit of agreeing to finance should outweigh the perceived risks.

Summarily, we observed that trust plays a fundamental role in any economy. We observed that a lack of trust will breed cynicism with regards to lending, borrowing or investing, hence stifling economic development. We noted that Fukuyama provided compelling insights to the nature of trust, and it was acknowledged that people who do not trust each other can only cooperate under a system of rules and regulation. It was illustrated that France uses public authorities to participate in the protection of lenders through penal punishment of failing borrowers. However, it was pointed out that due to the flagrant reign of corruption in Nigeria,³⁶⁶ even if regulations and checks are put in place, there will be suspicion as to whether they will actually be enforced or be effective.

To tackle this problem, it was suggested that the need to reinforce the rule of law in society was of paramount importance. In doing so, only then can trust be slowly established in society. It can be argued that within this context, trust and law could be substituted for one another as well as the fact that they complement each other in the sense that if it is believed that enforcement mechanisms such as the courts can be relied upon, and are timely and effective then we begin to see more willingness to transact.

The answer to why this is important has been indicated throughout this piece.

Succinctly put, the establishment of trust creates an environment where lenders

³⁶⁶ Bernard C. Chine, & Obiajulu, A.U. Nnedum 'Corruption in Nigeria: A Solution through Application of Organisational Development Perspective' (2018) 4 Social Science Research 31. This article provides an illustrative insight on the trend of corruption in Nigeria, tracing it from after Nigeria's independence during the First Republic in Nigeria. The article notes how even the first election in 1961 suffered major rigging by the Northern People's Congress. See page 35

and investors are more willing to part with money, because the risk of total loss will have been mitigated.

5.4. Debt Recovery in Nigeria, Some Considerations.

Beyond the issue of trust as part of the way in which loss can be mitigated, we must also consider what the legal environment in terms of enforcement of court judgements and the debt recovery procedure is like. In chapter two, when considering all the various schemes aimed at financing SMEs, we noted that most of them failed as a result of the inability to recover debts.³⁶⁷ While these failures apply to past schemes, it is relevant to note that a 2016 World Bank study still presents this inability to recover debts as a problem. In 2016, a new Bankruptcy and Insolvency Bill was proposed to help alleviate the debt recovery problems.³⁶⁸ Research has shown that Nigeria suffers from poor institutional infrastructure, thus there is a substantial challenge in enforcing contracts, collateral agreements, security registration in the legal and judicial process.³⁶⁹ Even in 2018, the World Bank Doing Business Report reaffirms that this is still a problem.³⁷⁰ Based on this, it becomes relevant to consider the bankruptcy and insolvency regime in Nigeria. In Nigeria, the term bankruptcy is limited to the individual alone while insolvency covers corporations. We noted in chapter two that CAMA is currently being

³⁶⁷ For example, the Microfinance Banks

³⁶⁸ The provisions of this Bill shall be considered subsequently, note that it has not been passed into law.

³⁶⁹ World Bank Group 'Nigerian Development Finance Study' (2016) Available at < <http://documents.worldbank.org/curated/en/365141527009626947/pdf/126401-WP-P146319-PUBLIC-Nigeria-Development-Finance-Study.pdf> > Accessed 2nd April 2019, 16.

³⁷⁰ In the Doing Business Report released in 2018 Nigeria is ranked 145th out of 190 countries in terms of doing business. The report also records poor improvement between 2016 -2017 in the strengthening of legal institutions, reduction of regulatory complexity and cost with regards to enforcing contracts and resolving insolvency issues. See World Bank Group 'Doing Business 2018 Reforming to Create Jobs' (2018) Available at < <http://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2018-Full-Report.pdf> > Accessed on 2nd April 2019, 38

reviewed, but as we stated already, it is not Law yet. Interestingly, this Bill also proposes to include a framework on resolving the existing insolvency issues incorporating concepts like business rescue.³⁷¹ Also, being reviewed is the still applicable Bankruptcy Act discussed below. The proposed new Act is now called the Bankruptcy and Insolvency (Repeal and Re-enactment) Bill. An example of a key highlight from the Bill includes the addition of corporate and unincorporated bodies.³⁷² As this is not law yet and there is no indication on when it will be, it still remains pertinent to review the position as the law stands under the extant Act, even if it may be redundant soon.

It is the writers' view that under Nigerian Bankruptcy and Insolvency laws, the rights of debtors are given more prominence in the debtor's indebtedness is discharged whether or not the creditor is fully satisfied. A brief summary of bankruptcy and insolvency law in Nigeria is given below. The preceding sub-headings will not offer a comprehensive analysis of the Bankruptcy and Insolvency Laws, but rather highlight some of its important features.

5.4.1. Bankruptcy in Nigeria

Bankruptcy has been stated to mean an inability to pay debts. It has been described as the process to which an individual is subject to when their debt is so overwhelming as to be incapable of being paid in full as and when they are due.³⁷³ The Nigerian Bankruptcy Act of 1992 applies to any person who cannot pay his/her debts of a specified amount and serves to disqualify said person from

³⁷¹ See Companies and Allied Matters Act (Repeal and Re-enactment) Bill, 2018 Section 402

³⁷² See **S.3(1)** of the Bankruptcy and Insolvency (Repeal and Re-enactment) Bill 2016

³⁷³ Andrew Keay and Peter Walton., *Insolvency Law* (Jordan Publishing Limited 2012) 45

holding certain elective and other public offices or from practising any regulated profession (except as an employee).³⁷⁴ This position is reflected in the opening preamble of the Bankruptcy Act, and it suggests that Nigerian Bankruptcy law is punitive in nature. The preamble also suggests that bankruptcy law in Nigeria is only applicable to individuals, however further examination reveals that this is not the case. It should be noted that bankruptcy can either be instituted by the debtor or by the creditor.³⁷⁵ Furthermore, **Section 4** of the Acts states that:

(1) Subject to the provisions of section 7, a creditor shall not be entitled to present a bankruptcy petition against a debtor unless -

(a) the debt owing by the debtor to the petitioning creditor, or if two or more creditors join in the petition, the aggregate amount of debts owing to the several petitioning creditors, is not less than N2,000;³⁷⁶

(b) the debt is a liquidated sum, payable either immediately or at some certain future time;

(c) the act of bankruptcy on which the petition is grounded has occurred within three months before the presentation of the petition;³⁷⁷ and

(d) the debtor is ordinarily resident in Nigeria, or within a year before the date of the presentation of the petition, has ordinarily resided or had a dwelling-house or place of business in Nigeria, or has carried on business in Nigeria, personally or by means of an agent or manager, or is or within the said period has been a

³⁷⁴ Bankruptcy (Amendment) Decree No 109 of 1992, Cap B2, LFN 2004

³⁷⁵ See **Section 1** of the Act

³⁷⁶ The 2016 Bill under **S.5 (a)** changed this to N1 Million.

³⁷⁷ **S.5 (b)** changes this to 6 months

member of a firm or partnership of persons which has carried on business in Nigeria by means of a partner or partners or an agent or manager.

The Act sets out a series of steps which must be followed in order for a person to be officially declared bankrupt. They are: an act of bankruptcy must have been committed;³⁷⁸ a petition based on an available act of bankruptcy may then be presented by a creditor or group of creditors (or the debtor may present a petition against himself to be declared bankrupt); A receiving order making the official receiver, the receiver of the debtor's property will be made, if the petition is proved to the satisfaction of the court;³⁷⁹ a statement of affairs will be drawn up by the debtor;³⁸⁰ a meeting of creditors shall be held to discuss the statement and decide whether to proceed with the bankruptcy or accept any composition or scheme of arrangement which the debtor may offer.³⁸¹ The law states that the scheme of arrangement should be structured in such a way that it provides reasonable security for the payment of not less than twenty-five (25) per cent on all the unsecured debts provable against the debtor's estate, and if it fails to do so the court can reject it.³⁸²

³⁷⁸ See **Section 1** of the Act

³⁷⁹ **Section 3**

³⁸⁰ **Section 6 (2)**

³⁸¹ **Section 15 (1)**

³⁸² **Section 18(10)**. Note also that in the distribution of property, the Government and employees have priority before other debtors. The government is paid first, followed by employees' wages accrued during four months before the date of the receiving order, not exceeding N300. See **Section 36 (b)**. Under subsection **(2)** it goes further to say that these debts shall be paid in full unless the property is insufficient in which case they shall abate in equal portions. In the proposed new bill, it could be a failure on the part of this writer to understand the intention of the draftsman, but the bill under **S.24** states that the priorities in distribution of the debtor's property by the receiver shall be done with reference to "Division 3 of Part IV of the Companies Act". On examination of Part IV of "**CAMA**", this part provides for the members of a company, the register of members, the power to close register, liability of members etc. This raises the question of the accuracy of the bill. Perhaps the draftsman intended to make reference to **S.494** (Now 496 under the new bill) which is under Part XV of CAMA. Here the preferential payments are listed, and like the Bankruptcy Act, ranks the government i.e. payment of taxes and employees first, before other creditors.

Despite the above preamble suggesting that the Bankruptcy Act applies to individuals, **Section 5** nevertheless states that the following provisions shall have effect in the case of a firm carrying on business in Nigeria:

(a) a creditor of the firm shall be entitled to present a bankruptcy petition against the firm, and a receiving order may be made against the firm in respect of an act of bankruptcy committed in reference to the business of the firm by any partner of the firm or by any person having control or management of the business of the firm. An act of bankruptcy shall be deemed to be committed in reference to the business of the firm in all cases in which the act relates to the property or creditors of the firm and would be an act of bankruptcy by such partner or person as aforesaid if it related to his property or creditors;

(b) it shall be sufficient that a receiving order against the firm be made in the firm's name, without mentioning the names of the partners, and such receiving order shall affect the joint and separate property of all the partners.

(c) the right of a creditor to present a bankruptcy petition against the firm, and the jurisdiction of the court to make a receiving order or an adjudication of bankruptcy against the firm, shall not be affected by the fact, if it is so, that all or any of the partners of the firm are not citizens of Nigeria or are not resident in Nigeria.

This therefore suggests that bankruptcy applications can also be brought against firms. A bankrupt individual may, at any time after being adjudged bankrupt apply to the court for an order of discharge, and the court shall appoint a day for hearing the application.³⁸³ It should be noted that the application shall not be

³⁸³ See **Section 28**

heard until the public examination of the bankrupt is concluded. The application shall, except when the court in accordance with rules under this Act otherwise directs, be heard in open court. **Section 28 (2)** states that where the bankrupt does not of their own accord, within such time as the court may deem reasonable, apply for their discharge the court may of its own motion or on the application of the official Receiver or the trustee or any creditor who has proved, make an order calling upon the bankrupt to come up for their discharge on a day to be fixed by the court. On due service of the order, if the bankrupt does not appear on the day fixed thereby, the court may make such order as it thinks fit, subject to the provisions of this section, and the debtor shall, in addition to any other punishment to which he may be subject, be guilty of a contempt of court and may be punished accordingly.

Section 28 (3) provides that on the hearing of the application, or on the day on which the bankrupt has been ordered to come up for his discharge or any subsequent day, the court shall take into consideration a report of the Official Receiver as to the bankrupt's conduct and affairs (including a report as to the bankrupt's conduct during the proceedings under his bankruptcy) and may either grant or refuse an absolute order of discharge, or suspend the operation of the order for a specified time, or grant an order of discharge subject to any conditions with respect to any earnings or income which may afterwards become due to the bankrupt or with respect to his after acquired property. Under the Bankruptcy law, an order of discharge effectively releases the bankrupt from all other debts provable in bankruptcy.³⁸⁴ While the above does not present a comprehensive

³⁸⁴ Section 29 (2)

examination of the Bankruptcy Law in Nigeria, it does however try to highlight the fact that the law aims to provide relief to the debtor, even though it comes with a punitive measure, and it also provides a means to distribute the debtor's assets.

5.4.2. The Winding-Up of a Company

The life of a company can be brought to an end through the process of winding up.³⁸⁵ As with bankruptcy, this is usually because of the company's inability to pay debts. Winding up is usually accompanied by the process of liquidation, i.e. selling all of a company's assets, paying outstanding debts, and distributing the remainder to the shareholders, and then going out of business.³⁸⁶ In Nigeria, the process of winding up is set out in CAMA.³⁸⁷ The scope of winding up a company is very broad, and cannot be covered fully, nevertheless, **Section 408** of CAMA provides that a company can be wound up if: the company can by a special resolution resolve that the company be wound up by the court; default is made in delivering the statutory report to the Commission or in holding the statutory meeting; the number of members is reduced below two; the company is unable to pay its debt; the court is of the opinion that it is just and equitable to be wound up. For the purpose of this work, we are concerned with the aspect that involves the corporations' inability to pay their debts.

³⁸⁵ Note that the New CAMA Bill now includes a framework for rescuing insolvent companies under S.402.

³⁸⁶ Leonard C. Opara, Livinus I. Okere and Chinwendu O. Opara "The Legal Regime of Bankruptcy and Winding up Proceedings as a Tool for Debt Recovery in Nigeria: An Appraisal" Available at < http://www.cscanada.net/index.php/css/article/view/4151/pdf_106 > Accessed on 15th March 2016, 66.

³⁸⁷ Cap C20, LFN 2004

Section 409 states that a company shall be deemed to be unable to pay its debts if:

(a) a creditor, by assignment or otherwise, to whom the company is indebted in a sum exceeding N2, 000³⁸⁸, then due, has served on the company, by leaving it at its registered office or head office, a demand under his hand requiring the company to pay the sum so due, and the company has for three weeks thereafter neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor; or

(b) execution or other process issued on a judgment, Act or order of any court in favour of a creditor of the company is returned unsatisfied in whole or in part; or

(c) the court, after taking into account any contingent or prospective liability of the company, is satisfied that the company is unable to pay its debts

It has been stated that by its very nature, a winding up order in effect is for all the creditors of the company, regardless of the amount owed to each creditor, and they must be given notice and invited to claim against the company being wound up as the assets of the company will be shared amongst them.³⁸⁹

It has been suggested that from the entire provisions of the Act dealing with winding up, it is not intended to be used as a vehicle for debt recovery.³⁹⁰ In the case of ***Oriental Airlines Ltd. vs. Air via Ltd***³⁹¹, it was held per Musdapher, JCA (as he then was) that “The machinery of a winding up petition should not be

³⁸⁸ S.11 of the CAMA Bill Changes this to N200,000

³⁸⁹ Idris, D.B (Justice) “Insolvency and Judicial Capacity: Challenges of the African Courts”. Available at < <https://www.insol.org/files/Africa%20Round%20Table/2015/Papers/INSOLVENCY%20AND%20JUDICIAL%20CAPACITY%20PAPER%20BY%20JUSTICE%20M%20B%20%20IDRIS%20NIGERIA.pdf> > Accessed on 14th March, 2016 at page 8

³⁹⁰ Opara (n 386) 67.

³⁹¹ (1998) 12 NWLR (Pt. 577) 271 at 230-281.

converted to an engine for debt collection in circumvention of the established legal procedure for instituting action in appropriate courts for collection of debts.” Nevertheless, the process has been used by creditors as a means to recover debts owed to them by debtor companies, and many creditors have succeeded in having their debts paid using the winding up proceeding.³⁹² Finally, it should be noted that the primary function of a Liquidator during the winding up process is to administer the assets of the company under liquidation. He sells the assets and distributes them amongst various creditors and shareholders before finally dissolving the company.³⁹³

5.4.3. The Law of the Books and the Law in Action

When it comes to debt recovery, several options may be available in terms of procedure.³⁹⁴ Generally, if the contract or agreement allows for it, an option would be Alternative Dispute Resolution (ADR), either through arbitration or mediation. Usually this is initiated by sending a letter of demand. It has been stated that the letter must be sent by means which would ensure delivery, and a copy of acknowledgement of receipt or such other evidence of the receipt must be obtained and kept.³⁹⁵ It should be noted that claimants can apply for ADR at the Lagos Multi-Door Courthouse (LMDC) located at the Lagos Division of the High Court.³⁹⁶

³⁹² Opara (n 386)

³⁹³ Opara (n 386) 69

³⁹⁴ As the author has no practical experience with regards to debt recovery, information from Law Firms practicing in Lagos will be relied on. Also, on The High Court of Lagos State (Civil Procedure) Rules of 2012 and 2019; The Federal High Court (Civil Procedure) Rules of 2009; The National Industrial Court of Nigeria (Civil Procedure) Rules of 2017.

³⁹⁵ Law Salvatores: Advocates, Solicitors and Consultants ‘Procedures available to Creditors for Recovery of Debts in Nigeria’ Available at <<https://lawsalvatores.com/procedures-available-to-creditors-for-recovery-of-debts-in-nigeria/>> Accessed 21st August 2019.

³⁹⁶ *Ibid*

In terms of litigation, the Federal High Court rules are applicable where one party is the Federal Government or an agency of the Government, while the High Court rules apply where there is no affiliation with the Federal Government. When it comes to the recovery of liquidated damages, the High Court of Lagos State (Civil Procedure) Rules 2012 provides for this. **Order 10, Rule 3** states that where the claim is a liquidated demand and the defendant or all of several defendants fail to appear, a claimant may apply to a Judge for judgment for the claim on the originating process or such lesser sum and interest as a Judge may order. **Order 10 Rule 4** further provides that where there are several defendants of whom one or more appear to the process and another or others fail to appear, a claim may apply to a Judge for judgment against those who have not appeared and may execute the judgment without prejudice to his right to proceed with the action against those who have appeared. It should be noted that the 2012 civil procedure law has now been amended, and an addition has been made regarding claims for liquidated damages. Under the new law,³⁹⁷ **Order 59(2)** stipulates that a suit will be automatically qualified (without any application) for a fast track procedure where the action is for a liquidated monetary relief of one hundred million Naira (N100, 000,000).³⁹⁸ Also, an action that involves a mortgage transaction, charge or security will also be automatically qualified for fast tracking.

The Magistrate Courts of Lagos State also make provision for summary judgement procedures for quick debt recovery process. **Order 3** of the Magistrate Court of Lagos State (Civil Procedure) Rules 2009, provides that a

³⁹⁷ The High Court of Lagos State (Civil Procedure) Rules 2019

³⁹⁸ As at the exchange rate on the 21st of August 2019, that is about £225,000

summary summons can be issued for claims for debt or liquidated money demand. Also, in 2018, a small claims court was established within the Magistrate Court. **Article 1** of the Magistrate Court Law of Lagos State Practice Direction of 2018 sets out when a small claim can be instituted. **Article 2 (1) (d)** provides that the claim for liquidated money demand should not exceed five million Naira (N5, 000,000).³⁹⁹ **Article 12 (2)** further provides that the entire period of proceedings from filing to judgement must not exceed sixty (60) days.⁴⁰⁰

In the Federal High Court, for liquidated sums, **Order 12** of the Federal High Court (Civil Procedure) Rules 2009 provides that a claimant may apply summarily to recover a liquidated sum and the application will be accompanied with an affidavit stating the grounds upon which the claim is based and that the defendant has no defence on the merit to the claim. The Court would enter the claim in the "*undefended list*" if it is satisfied that the defendant has no defence to the claim. Furthermore, **Order 30** provides that where the claimant feels that the defendant may obstruct or delay the execution of any order that may be passed against them by disposing or removing his property from the jurisdiction of the Court, the claimant may apply to the Court at the time of instituting the suit, to make the defendant deposit sufficient security to fulfil the order or for their moveable or immovable property within jurisdiction to be attached until the order of Court is delivered.

Despite the above developments to ease the debt recovery process, a distinction must be made between the laws of the books and the law in action. As a Nigerian,

³⁹⁹ As at the exchange rate on the 21st of August 2019, that is about £11,000

⁴⁰⁰ As this is a relatively new court, not much is known about its effectiveness, however communications from practicing lawyers in Nigeria say the courts exceed the 60 days limit.

it is common knowledge that recovery of debt is not often done through the courts. The dysfunctions of the system, i.e. the delay in the court system⁴⁰¹ and a corruptible police force, enable aggressive creditors, who take advantage of this dysfunction. People are often arrested for failure to pay up debts, in order to put pressure on the family members to pay debts, and this has proved more effective than the courts. In ***Economic and Financial Crimes Commission vs. Diamond Bank Plc & Ors.*** (2018) LPELR 44217 (SC), J.S.C Baje speaking; identified and condemned this practice of using police to enforce civil debts through misuse of the criminal justice system. In the course of condemning the police, he stated that our security agencies particularly the police are not debt recovery agents but have allowed themselves to be used as such. He stated that the police should focus on their statutory duties of investigation and crime prevention rather than being overzealous and unscrupulous characters for debt recovery arising from contracts and loan or purely civil transactions.

This straddles the issues of lack of trust and absence of the rule of law. McMillan and Woodruff explain this as private order under a dysfunctional public order. They state that where the legal system may not always be available to provide contractual assurance and when the law is dysfunctional and machinery for enforcing them is inadequate, private order might arise to take its place.⁴⁰² The author's establish that private order can arise through shared communal norms, trade associations, bilateral relationships etc. As we have seen creditors in Nigeria

⁴⁰¹ Given the recent strides taking by Lagos State to ease the debt recovery process, this may now be a perceived delay. People are generally used to the idea that the Nigerian courts are to slow in dispensing justice, so it may take some time before the effectiveness (if any) of the new laws are seen.

⁴⁰² John McMillan and Christopher Woodruff 'Private Order under Dysfunctional Public Order' (2000) 98 Michigan Law Review 2421, 2421

have adopted a private order approached to resolving their contractual issues,⁴⁰³ because there is an inability (perceived or otherwise) of the courts to function properly or because the transaction costs associated with going to the courts are high. What is novel in the application of this insight to this Nigerian practice is that a public institution (police) is being adapted by private actors (creditors) as a means of generating private order (debt recovery). This idea of private order is pertinent to this work, especially the idea that it can arise through norms, as we shall see in Chapter Six when we conduct our analysis, we take corruption to be a shared norm within Nigeria, it is this corruption that has enabled the use of the police force as agents for debt recovery.⁴⁰⁴

5.4.4. Asset Managing Company of Nigeria (AMCON)

Another important aspect of the debt recovery process is the role AMCON plays in it. AMCON was created in 2010, after the 2009 financial crises in Nigeria. It was set up by the AMCON Act of 2010 (amended in 2015), and **Section 5** states the objectives as being to acquire eligible bank assets from financial institutions, purchase or otherwise invest in eligible equities, hold and dispose of eligible bank assets including the collection of interest, principal and capital due and the taking over of collateral securing such assets. In short, AMCON purchases non-performing loans from banks and bears the responsibility of debt collection. Amongst its powers, under **Section 6,**⁴⁰⁵ **sub (2)** gives it the ability to exercise

⁴⁰³ What is novel in the application of this insight to this Nigerian practice is that a public institution (police) is being adapted by private actors (creditors) as a means of generating private order (debt recovery)

⁴⁰⁴ Beyond allowing for the use of the police as an enforcement mechanism, we shall also explore the role this norm plays in the degradation of interaction between people.

⁴⁰⁵ For example, entering into contracts; enforcing any security, guarantee or indemnity; compromising any claim, forgiving any debt; selling and disposing any asset

its power anywhere inside and out of Nigeria.⁴⁰⁶ It is interesting to note that since its inception in 2010, AMCON has acquired over 12,000 non-performing loans, of these over 5, 000 were unsecured and over 2, 000 secured with mortgages.⁴⁰⁷

Commencing proceeding is governed by the Federal High Court Asset Management (AMCON) Proceedings Rule of 2018. **Order 10 (1)** of the rules provides that where the claimant believes there is no defence to the claim, he may sue for recovery of debt or a liquidated money demand or any other claim by summary judgement. **Order 12** states that the courts may grant interim orders with respect to the proceedings. Such interim orders may include; freezing accounts; detention or preservation of the relevant property; sale of the property; payments of income from the relevant property into a designated account, until such time as the case is decided; and restraining the party from moving assets outside the jurisdiction of the courts etc. **Order 15** covers foreclosure and redemption and states that persons entitled to the property whether through a legal or equitable charge may claim the following reliefs; payment of moneys secured by the mortgage or charge; sale; foreclosure; redemption; re-conveyance; delivery of possession by the mortgagee etc.⁴⁰⁸

In terms of approach and performance, it was said that the enforcement approach jettisons restructuring plans and focuses on enforcing the security by

⁴⁰⁶ Interestingly, Nigeria has no existing legal framework in respect to cross-border insolvency and has not adopted the UNCITRAL Model Law on Cross-Border Insolvency 1997 or is a signatory to any insolvency treaties See INSOL International 'Collection of Practical Issues Important to Small Practitioners-Nigeria' (2017) Small Practice Issues Technical Series. Available at < <https://www.insol.org/library#> > Accessed 3rd April 2019.

⁴⁰⁷ AMCON Achievements, Available at < <http://amcon.com.ng/achievements.php> > Accessed 3rd April 2019. Bloomberg notes that the acquisition is worth 1.7 trillion Naira. Emele Onu., 'Bloomberg: Nigeria's AMCON Expects to Return to Profit as Losses Narrow (2018)' Available at < <https://www.bloomberg.com/news/articles/2018-06-01/nigeria-s-amcon-narrows-loss-by-90-in-2017-as-economy-improves> > Accessed 3rd April 2019. This same article also reports that in 2016 AMCON suffered a loss of 164.9 billion Naira, but this has been attributed to the recession that occurred during that year.

⁴⁰⁸ The list is not exhaustive; thus, a full reading of the Order would be necessary. It is interesting to note that **Order 14** covers the possibility of the defendant absconding or selling the property while the suit is ongoing, thus, the court may make an order that the defendant provide security if there is a likelihood of this happening.

sale of the underlying assets because the majority of debtors may be unable or unwilling to repay their debts.⁴⁰⁹ It has been stated that despite AMCON's enormous powers it has struggled to discharge its duty. *"Figures bandied in the media suggest that AMCON's attempts to recover value from non-performing loans stands at a paltry 19 to 20 per cent or thereabouts of the NPLs on AMCON's docket".*⁴¹⁰ In over eight years, AMCON has only been able to hit an annual recovery rate of less than 2.5 per cent.⁴¹¹ Although no official records reflect this, personal information reveals within the legal service market within Lagos, firms were competing for debt recovery work which was being subcontracted out by AMCON which appeared to be due to the difficulty faced in recovering debt.

Given what has been said above, this somewhat reaffirms the World Bank's stance that debt recovery still presents a problem in Nigeria, and without a strong debt recovery system, lending or getting institutions to lend will always be problematic.

5.5. Conclusion.

In this chapter, we explored more fully the theoretical concepts of game theory and rational choice theory that would inform our understanding of the analysis to be conducted in chapters five and six. The chapter also explored the issue of trust in society and how it relates to whether individuals would agree to transact with each other. On this concept, we asserted that what was required was not

⁴⁰⁹ Collins Nweze, 'AMCON's debt recovery challenges' (2018) Available at < <http://thenationonlineng.net/amcons-debt-recovery-challenges/> > Accessed 3rd April 2019.

⁴¹⁰ *Ibid*

⁴¹¹ *Ibid*

the ordinary understanding of trust between friends and family, but the calculative trust which enabled individuals to take risks.

The chapter also considered the Nigerian legal environment, examining the laws which guided bankruptcy and insolvency procedures. We noted that these laws were currently being changed, although there was no effective date as to when it would happen. We noted some of the changes the proposed new law sought to make. Nevertheless, we concluded, based on the World Bank reports, that debt recovery still presented as a problem in Nigeria. When these new laws finally come into effect, it will be interesting to review how successful they are in tackling the debt recovery problem.

Chapter Six: Investigating a Borrower – Intermediary Action Situation

6.1. Introduction

In the previous chapter, we discussed theoretical concepts that would influence our application of Ostrom's IAD framework. The concepts of game theory, rational choice theory and calculative trust were discussed in an attempt to fully grasp the complex layers of the model which is about to be utilised. We also examined the Nigerian legal environment and noted from the World Bank study in 2016, that enforcement of contracts, realisation of securities and insolvency was still a problem. With this information in mind, in this chapter we shall attempt an application of the IAD framework. The key feature of the IAD framework is that it allows for the focused integration of different concepts using the action arena, creating the opportunity to carry out a multi-level analysis.

It is pertinent to note at this point that the use of the model presents several possible applications. The first application being to carry out an empirical analysis which involves observing the pattern of interactions within a community and measuring these interactions against evaluative criteria to note when outcomes change or do not change.⁴¹² This empirical analysis can be likened to game theory⁴¹³ and conducting a game analysis.⁴¹⁴ The second application would be a theoretical analysis, that is, a conceptual community is created where

⁴¹² This empirical study can be seen in her observations of how common pool resources were managed in her book 'Governing the commons' discussed in chapter four

⁴¹³ As we know from chapters four and five, with game theory we have players (individuals) who are working with existing rules to play a game and see how it ends. With game theory, we have the existing set of rules, and players can choose from different strategies and attain an outcome, depending on what rules they play by, we can then presume what the outcome will be.

⁴¹⁴ Again, in chapter four, we discussed the concept of the snatch game, prisoners' dilemma and mechanism design.

assumptions are made about the rational and irrational strategies available to the participants, and predicted interactions and outcomes are made. These interactions, like an empirical analysis, are measured against the evaluative criteria which we assume, in a real world running of the action arena, will inform on where a change can occur. This work will adopt the latter of the applications. While the ultimate motivation should be policy design, the pertinent problem now is diagnosing and identifying questions that needs to be asked and considered when attempting to create policy, and where changes within the arena would be possible. Therefore, our conceptual focus is on the operational and collective action arena,⁴¹⁵ rather than the constitutional action arena.⁴¹⁶ What follows is a population of Ostrom's framework with our own terms and factors, to observe what pattern of interactions will be generated.

6.2. The IAD Framework and the Lagos SME Sector

To begin our analysis, we must first create the stage, identifying as clearly as possible all necessary factors that could impact on the action arena and situation. Such factors are according to Ostrom, the biophysical/ material conditions, the attributes of the community and the rules in use. Before delving into what these attributes are,⁴¹⁷ it is necessary to first determine what evaluative criteria the arena will be examined with, if change is to occur.⁴¹⁸ The relevance of identifying these criteria early on, is that it helps streamline and eliminate unnecessary

⁴¹⁵ The operational level looks at the decisions by participants and the consequences of those decisions, while the collective level is the process through which institutions are constructed by be actors. See chapter four, Ostrom (n 257) 25

⁴¹⁶ The collective arena looks at the legitimization of the policy generated at the collective level and the actions on the operational level.

⁴¹⁷ Because by doing so, it would mean that the analysis of the arena has started.

⁴¹⁸ If you recall, in chapter four, we briefly listed what these criteria will be, but did not go into a full discussion on them, Here, we shall now attempt to expatiate on them further

factors that have no bearing on our proposed arena. Ostrom identifies several evaluative criteria⁴¹⁹ which act as the lens with which the arena is evaluated. They are:⁴²⁰ Economic efficiency; Equity; Adaptability, Resilience and Robustness; Accountability and Conformance to general morality.⁴²¹

6.2.1. The Concept of Efficiency

Ostrom in her work places a lot of emphasis on economic efficiency, however, it has been suggested that efficiency can be viewed in many ways.⁴²² With regards to allocation and reallocation of resources i.e. the resource being funding, we have noted that there are institutional arrangements⁴²³ set up by the government to fund SMEs. These schemes represent administrative efficiency, but what must be examined here is how well they are being managed. Again, administrative efficiency can be satisfied by the delivery of the scheme's mandate. The economic efficiency looks at the net benefit to be gained by funding SMEs.

Economic efficiency within our arena looks at the way in which the system functions, examining whether sufficient funding is getting to the SMEs by focusing on whether there is an alignment in the demand for finance and the supply to meet that demand. Our analysis of economic efficiency does not seek to determine what the level of funding to SMEs should be capped at, but rather a

⁴¹⁹ McGinnis (n 229) 176, McGinnis in his work analysing Ostrom's IAD framework further extends these criteria to also include Legitimacy and Participation Level.

⁴²⁰ Ostrom (n 257) 266

⁴²¹ Ostrom concludes that the number of potential evaluative criteria is large, but in her book, she focuses on the five indicated above.

⁴²² Economic and Administrative efficiency. By economic efficiency it means the degree of difference in the flow of net benefits associated in the allocation or reallocation of resources, and administrative efficiency concerns government and public interventions. See Kalim U. Shah, and Keron Niles., 'Energy Policy in the Caribbean green economy context and the Institutional Analysis and Design (IAD) framework as a proposed tool for its development' (2016) 98 Energy Policy 768, 775

⁴²³ The different schemes created by the government to finance SMEs.

submission that more money is needed. This is justifiable in that it aligns with the perspective of the Nigerian Government, as we have seen in chapter two, more recently different funds were being created to fund the SMEs, for example the N200 Billion fund provided by the CBN to refinance and restructure the different bank's existing portfolio.⁴²⁴

It must be noted that this proposed concept of efficiency being used for my analysis of my action arena does not align with Ostrom's use. In other words, a proxy view for the concept of efficiency is being used. This view is simply that through policy interventions, more funds should be received by SMEs. Whereas Ostrom might try to investigate optimum allocative efficiency using her model, this is beyond our ambition, we are merely seeking a model which can increase the allocation to SMEs.

6.2.2. The Concept of Equity

Equity here looks at the distribution outcomes and processes.⁴²⁵ With regards to processes, in our arena, this would examine the criteria used to assess whether or not a loan should be granted, in other words, procedural fairness. With regards to outcomes, this would mean that the funding is getting to the most effective and successful businesses. It should be noted that predicting successful business is a problematic area, and sometimes there are clear indications that a business will not be successful. However, the majority of the interactions with SMEs will

⁴²⁴ See chapter two, page 40 (last paragraph).

⁴²⁵ Ostrom (n 257) 66

involve having a risk analysis process, but again even this is not a guarantee. What ultimately determines the success of a business is the market.

6.2.3. The Concept of Accountability

Without accountability, actors can engage in various opportunistic, strategic behaviours.⁴²⁶ Ostrom evaluates accountability on the collective-choice or constitutional choice level of her action arena.⁴²⁷ Accountability within our arena can be approached from two perspectives, the first being systemic accountability which has to do with generating publicly viewable justifications as to why specific actions were taken and overall monitoring. This suggests that there must be checks in place to make sure the loans are granted efficiently and based on merit after having done their due diligence.

The second is individual accountability which deals with whether the loans and interest on the loans have been paid back by the SMEs. This also extends to what mechanisms are available, how well the SMEs granted loans can be monitored, and if they can produce accurate reports on their business to ensure accountability. This is obviously hinged on the information system within Lagos and enforcement procedures granted by law.⁴²⁸

Accountability also has an underlying enforcement implication, and what resources are available to the officials to carry out their monitoring duties if so required, etc.

⁴²⁶ Ostrom (n 257) 67

⁴²⁷ *Ibid*

⁴²⁸ By this we mean the remedies available in the event of bankruptcy or insolvency; how creditors can claim; which creditors can claim first etc.

6.2.4. Conformance to General Morality and Legitimacy

With conformance to general morality,⁴²⁹ Ostrom seeks to find out whether those who can cheat and go undetected are able to obtain very high payoffs. This criterion looks at whether those who keep promises are more likely to be rewarded and advance in their careers, and how those within the institutional arrangement learn to relate with each other over a period of time.

McGinnis when discussing Ostrom's work, adds the extra criteria of legitimacy.⁴³⁰ It is suggested that legitimacy comes into play within our situation where the substantive laws are viewed as fair, and there is an alignment between the norms and the formal rules as written down. For example, in our arena when dealing with how land is used as collateral. As we shall see when we explore this further in chapter six, banks in Nigeria are clear as to what form of title is acceptable when it comes to accepting land as collateral. The title (certificate of occupancy) issued by the Governor of a state is viewed on paper as the most superior claim to land you can hold.⁴³¹ But despite having a Certificate of Occupancy from the Governor, a title which ordinarily should allow for peaceful enjoyment of the property, if the community is not in support, then it brings about a host of trouble for anyone seeking to claim the land in question.⁴³²

⁴²⁹ Ostrom (n 257) 67

⁴³⁰ McGinnis (n 229) 176

⁴³¹ When we look at this in more detail in chapter six, we shall observe that before the Land Use Act of 1978, land was seen as communal property and even when alienation occurs this view does not change, and this creates problems for the new owners. Banks are always wary of the fact that the community may not be in support of the transactions and tend to avoid accepting such forms of collateral or if they do accept, they discount heavily on its value.

⁴³² "The various chiefs or heads of communities still regard themselves as trustees of community land for the management and control of the land in total disregard of the rights of occupancy system.... They still allocate, partition, and sell land without reference to the appropriate authorities designated under the Act" See Ehi P. Osho, 'The Indigenous Land Tenure and Nationalization of Land in Nigeria' (1990) 10 Boston College Third World Law

6.2.5. The Concept of Adaptability, Resilience and Robustness

This reflects how the institutions set up can respond to changing environments and information.⁴³³ For Ostrom, this specifically examines how the system changes, and also how the behaviour of the participants changes over time and adapts itself to inefficiencies. Whether or not the participants learn from experience within the action situation, and if they adapt to new circumstances as they arise or become rigid in their responses over time.⁴³⁴

It is suggested that these concepts are linked to the participation level within the arena, because participation level comes into play when examining the adaptability of the systems. We have noted that there is a shared common interest between the Government lenders, the bankers and the borrowers all working together to develop the SME sector, a robust system will be able to sustain the participation of all the key players, and where there is a deficiency, correct itself in order to maintain the participation level.

6.3. The Exogenous Variables and Preliminary Observations

Now that our evaluative criteria have been identified and expanded upon, it is relevant to examine what our exogenous variables are, and how they play into

Journal 43, 56. This point is reiterated in more recent studies done in 2012 and 2014. See Butler (n 522) and Ghebru (n 533).

⁴³³ Shah (n 420) 775. This goes to the issue of the feedback loop within the action arena i.e. outcomes feedback onto the participants and the arena and transform both over time. This has been discussed in our exposition in chapter four

⁴³⁴ Ostrom (n 257) 67

our arena. As stated previously, the exogenous variables include the biophysical or material conditions⁴³⁵ that affect the arena, for example, the issue of collateral, transportation, education,⁴³⁶ power supply, flooding and security are factors which can be considered under this heading. For attributes of the community, an examination of factors such as: the issues of corruption; issues of security and education; access to credit information; problems of trust; inflation affecting interest rates; business registration culture, specifically important in Lagos; entrepreneurial spirit; the problem of infrastructure; a working robust property registration system; border trading, the ease of accessing business permits; type of family or community support available, etc.

The rules in use, as noted previously, are an incorporation of both formal and informal rules. We noted that the formal rules are the existing regulations within the country (fully discussed in chapter 2), whilst informal rules are cultural or societal norms inherent in a community (for example the registration culture in Lagos). It has been observed that sometimes these societal norms may conflict with the formal rules. This was observed above when we discussed how land is held in Nigeria, and the obvious conflict between the indigenous tenure system and the formal system that was established with the introduction of the Land Use Act in 1978.

Some formal rules that would impact our arena include the Small Medium Enterprise Development Agency of Nigeria Act (SMEDAN), The Asset

⁴³⁵ Chapter four offers a fuller discussion and explanation of this concept.

⁴³⁶ Which according to Yoshimichi, is a social resource and can influence what individuals see as a perceived constraint. This was discussed in chapter five when looking at 'Rational Choice Theory'

Management Company of Nigeria Act (AMCON), Collateral Registry Regulation,⁴³⁷ and obtaining business permits and enforcements of contracts.

Below, we shall now consider some preliminary points on the exogenous variables that will be used within our action arena.

6.3.1. Collateral:

It was noted that some variables can fit in two or more categories. Thinking about the issue of collateral, it can be an attribute of biophysical, attribute of the community and the rules in use. Biophysical, depending on the nature of the goods produced or if the collateral has a physical life span. For example, cars, machinery etc. depreciate over time, while something like land appreciates. Under the rules in use, it is relevant to have that classification because of what is recognised as collateral under the law. With attributes of the community, it is one thing to state under regulation what is legally acceptable as collateral, but another for it to be what is commonly used as collateral. In Nigeria, the use of land or real property is the most acceptable form of collateral. While the biophysical attributes of collateral may not be particularly relevant to the action situation⁴³⁸ being analysed, it is however relevant to be aware of their existence.

The existence of collateral under the attributes of the community and rules in use already raises questions within our proposed action situation. It becomes a problem because of the lender's attitude towards the kind of collateral being used, and what type of collaterals the borrowers actually hold. Also, if we have

⁴³⁷ Companies and Allied Matters Act (CAMA); Companies Tax Act; Personal Income Tax Act; Bank and other Financial Institutions Act (BAOFIA), Relevant CBN Guidelines; Bankruptcy Act.

⁴³⁸ Not relevant because of the level of abstractness being dealt with. The biophysical nature becomes relevant if basing the analysis more industry specific areas where perhaps perishable goods can be put up as collateral.

progressive legislature which creates a wide variety of legislation on acceptable forms of collateral in line with international standards, for example, the use of patents to secure debt, but the legislation exists within a community who neither understands what patents are or their value. We again have that disparity in what is accepted and what the law says. The use of collateral only functions if the borrowers hold what the lenders want. If a lender exists within a community where the value of patent is not recognized and they have no understanding of how attain value for it should they need to exercise their right over it, then they would be unwilling to accept it as a form of collateral.

6.3.2. Corruption and Norms:

Corruption as an attribute of the community can have both positive and negative effects. Positive in that if you are willing to offer kickbacks, you find that business can be achieved more quickly. There have been debates around the fact that bribes are useful tools within the business environment.⁴³⁹ For example, a few thousand naira's here and there can get you that permit more quickly or make your registration of business faster. Such bribes can be calculated as part of the transaction costs. But the negative effect of allowing corruption undermines trust within that system. If bribes can be taken to falsify documents to acquire a loan, then we have lenders no longer willing to participate within that environment.

Corruption can be viewed from three perspectives; the agent perspective who may feel it is better to pay because it expedites achieving their end goal; the systemic perspective which has wider negative impact because it raises

⁴³⁹ This was talked about extensively by Adeyeye in his article. See Adefolake Adeyeye., 'Bribery: cost of doing business in Africa' (2017) 24 Journal of Financial Crime 56

uncertainty and transaction costs; and a cultural perspective created because of the wide spread acceptance of corruption in every sphere of life in Nigeria, that paying of bribes is the normal way of functioning within Nigerian society, and not engaging is an aberration.

It is suggested that corruption in Nigeria lies between reluctant acceptance and the need to fight it.⁴⁴⁰ But while it might be useful from the agent's perspective, the systemic consequences of engaging are more alarming, and it is from this systemic perspective that it will be considered in our arena.

6.3.3. Cultural Norms and Communal Support:

Again, within the attribute of the community category and the rules in use, we can observe another interaction between cultural norms and family or communal support. Culturally speaking, it is generally frowned upon within the family unit and ethnic group not to assist your "brother/sister", this is reflected in the NBS survey carried out in 2013 in which family loans ranked third when it came to sources of finance.⁴⁴¹

6.3.4. Cultural Norms and Rules in Use:

At this point, it would be relevant to examine that interface between acceptance of legislation,⁴⁴² and accepted cultural norms. There is often a disparity between institutional laws and what is culturally acceptable within society. This can be examined from two points: a total rejection of the rule because it is at variance with the norm as illustrated by the American prohibition of alcohol in 1920

⁴⁴⁰ This need is reflected in the fact that the selling point of most political platform is the fight against corruption. This platform is attractive because political leaders recognise the people's desire to see change in the system.

⁴⁴¹ SMEDAN and National Bureau of Statistics collaborative survey, (2013) 44

⁴⁴² Which would be primarily in line with western policy.

discussed in chapter three, or we see a situation where over time the rule can change norms as seen in the *Brown v Board of Education Topeka* case.⁴⁴³

6.4. Actors, Positions and Outcomes

Under this section we shall begin to fully **synthesise** our terms and information from the Lagos SME sector within Ostrom's framework. Mainly, our Action Arena would be the 'Financing of SMEs'. Given the functions of SMEDAN, as specified by the SMEDAN Act,⁴⁴⁴ within our first action situation, the participants would be the SMEs (borrowers) and SMEDAN.⁴⁴⁵ Working with this situation, we would have an arena like the one set out below:

- We can take the participants here to be SMEs who are assigned the position of borrowers.
- SMEDAN are assigned the position of linking small scale industries to sources of finance, technology, technical skill development and management.⁴⁴⁶

The aim of SMEDAN as set out in its functions is to bring the borrower and lender together in a fruitful enterprise.⁴⁴⁷ SMEDAN plays an important role to both lender and borrower, even if different. The first relationship is between SMEDAN and the borrower, while the second is the relationship between SMEDAN and the lender. In the interest of the arena, we may assume that the actors within the

⁴⁴³ See chapter four on page 110 where this case was discussed.

⁴⁴⁴ Said functions will be discussed subsequently.

⁴⁴⁵ Any other situation can include lenders (be it public, private and the Federal Government).

⁴⁴⁶ A function of the agency as set out in **Section 8 (I)** of the SMEDAN Act of 2003

⁴⁴⁷ At this stage in our situation, the interactions that will happen occur at the operational level which looks at the day-to-day decision-making process.

arena are self-interested⁴⁴⁸ with the aim of maximizing benefits important to them. Within our action situation, for SMEDAN, a clear distinction must be made between the formally stated functions or motivations of the organisations and the actual motivations of the individuals who run the organisation. We must be careful not to make false assumptions that SMEDAN as an organisation will be filled with people who would naturally be motivated by the functions of SMEDAN as set out in the Act.

So far, we have identified who our actors are within our situation, and what position they occupy. The next step would be to determine what possible outcomes can arise from the interactions between SMEDAN and the SMEs. In setting up the action situation, it is helpful to identify the desired outcome. For example, we can decide that in our action situation efficient lending to SMEs is a desired outcome, and by efficient lending we mean that lenders can identify and ally with genuine borrowers with bona fide businesses.⁴⁴⁹ Again, we can also say our desired outcome can be an efficient debt recovery process,⁴⁵⁰ or solving an information gap problem, giving potential lenders adequate access to information on borrowers to make informed choices or vice versa. Broadly, when conceptualizing outcomes, these are what will be potentially considered. However, this conceptualized outcome should not be confused with the actual outcomes generated by the situation; this actual outcome stems from the pattern of interactions that occur in the action situation. Here, reference must be made to the mechanism design literature, discussed in chapter three, where it was

⁴⁴⁸ Reflecting the rational choice theory discussed in chapter four.

⁴⁴⁹ This implies legitimate businesses with the potential to succeed. The question of if it actually succeeds is a market question.

⁴⁵⁰ Particularly relevant if we're looking at a lender focused action situation

noted that in the theory, “we begin by identifying our desired outcome or social goal”.⁴⁵¹ This is not what we are doing here.

When this theory was compared with Ostrom’s model, it was identified that with Ostrom’s framework we have actors who are working with existing rules to select strategies and make decisions. It is at this point the outcomes are produced. However, with mechanism design we start at the end – determining the outcome we want, then running it backwards, designing a situation that will produce the outcome and often ignoring the existing social context. Thus, these generalized outcomes must be distinguished from the outcomes produced in the arena, because the aim is not to create a design to meet our outcomes. Rather, the point of the arena is to uncover what outcomes may arise as a result of the restricted choices the participants make within the action situation, given all we can surmise about the attributes of the community, the rules in use, the biophysical and material conditions.⁴⁵²

6.5. Action, Information and Incentives

Under this section, our knowledge of the biophysical/material conditions, attributes of the community and rules-in-use will prove useful. Previously, we considered these concepts and drew firm conclusions on what they mean within the Lagos SME sector. These factors all influence what actions the participants may take, resulting in outcomes. When the constraints presented by these factors

⁴⁵¹ Maskin, E.S ‘Mechanism Design: How to implement social goals’ (2007) Available at < http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/2007/maskin_lecture.pdf > Accessed on 1st March, 2017.

⁴⁵² This would be explored more fully as we discuss the arena in more detail.

and the incentive structures are considered, it becomes easier to predict and observe the patterns of behaviour.

Given who the participants are, we can assume that the actions-outcome can be broadly categorized into two: the borrower will be linked to a lender or not. The question at this juncture now becomes what circumstances will lead to these outcomes. To answer this, first we must consider the incentive structures which are made up of the costs and benefits to be suffered or gained by the actors. The incentives underpin the motivations of the actors and influence what actions or strategies will be used. The task of developing an incentive structure that aligns with the actor's interest is fundamental to the situation. If done correctly, it may be able to some extent overcome the free-rider problem⁴⁵³ and build an internal monitoring system within the situation.

6.5.1. The Borrower's Costs and Benefits

If we begin to consider the incentives, we can observe that an obvious benefit of a borrower working with the SMEDAN would be to take advantage of their connections to lenders.⁴⁵⁴ Further incentives to work with SMEDAN can be identified through its functions under **Section 8 (c)** of the SMEDAN Act of 2003.⁴⁵⁵ It has also been stated that SMEDAN provides training and capacity building in areas such as book keeping and accounts management, preparation

⁴⁵³ The 'free rider' was considered in chapter four. Within our action situation, from the perspective of SMEDAN a properly designed incentive structure will foster competition among employees and encourage monitoring. Thus, recalcitrant employees would not benefit but rather only compliant employees.

⁴⁵⁴ In March 2017, SMEDAN unveiled a credit information portal which provides information on available credit by various institutions. It has been observed that to access these loans a SMEDAN identification number along with other requirements are needed. This suggests there is a prerequisite to be a registered SMEDAN member.

⁴⁵⁵ Promoting and facilitating development programmes, instruments and support services to accelerate development, modernisation, networking and linkage of small and medium scale industries.

of business plans, quality control, computer or IT appreciation.⁴⁵⁶ This is valuable knowledge to any business owner, and acts as a reassurance to creditors that the borrower is equipped with the relevant skills to run the business. Again, a potential benefit to be considered would be whether the borrower who goes through SMEDAN with all the required documents,⁴⁵⁷ gets priority over a borrower who approaches the bank or lending institution directly.

But we must also examine the costs of working with SMEDAN,⁴⁵⁸ for example, a borrower's potential cost could be time, expense, the possibility of humiliation, expectation that they may have to pay a bribe etc. Now we must consider this individually in light of the exogenous variables. If we consider the concept of time under the variable of attribute of the community, we can note several observations. Time can be viewed from several perspectives, the first is how much of it is spent accessing information at the physical offices, and the second is how much time is spent accessing information through the online platform. If the expectation of the borrower is that they are going to spend an inordinate amount of time which could put towards doing other productive things at the SMEDAN office, we can assume that some borrowers will be discouraged. Experience has shown that Nigerian government offices are time wasting black holes unless you have the advantage of knowing a top-level member of staff or you have deep pockets.⁴⁵⁹ This leads us to the second cost of 'expense'. We can

⁴⁵⁶ Nigerian Investment Hub "Small and Medium Enterprises Development Agency of Nigeria (SMEDAN)" (2013) available at < <http://investor.ng/resource/small-and-medium-enterprises-development-agency-of-nigeria-smedan/> > Accessed on 25th January, 2018.

⁴⁵⁷ A point worth considering would be standardization of what would be required across lending institutions. For example, the type of Identification used; some institutions require the Nation Identity card (which is difficult to acquire) and others are laxer with the ID needed.

⁴⁵⁸ Here we can identify the constraints as defined by Yoshimichi in chapter four which influences the rational choice an individual will make.

⁴⁵⁹ The problem of government offices is well known and has been discussed in academic literature. See John O. Magbadelo, 'Reforming Nigeria's Federal Civil Service: Problems and Prospects' (2016) 72 (1) *India Quarterly: A Journal of International Affairs* 75.

view this in light of whether or not there is the expectation to pay bribes.⁴⁶⁰ If this is an added expenditure to be undertaken by the borrower who is seeking money, you may find again that some borrowers will be discouraged.

As stated above already, the second consideration would be how much time is spent accessing information through the online portal. Here again, we must consider the expense spent in getting the information, and the usefulness of the information. Viewing this under the attribute of the community, for expense we must consider the money spent on internet data subscription or going to cyber cafés for those who do not readily have a mobile phone with internet capabilities. Also, we must consider the practicality of accessing the information via the internet if you are not literate.⁴⁶¹ So, do we then assume that the uneducated are excluded from the use of the online platform? This raises questions about its accessibility for the older demographic who may not be proficient in using computers.

Additionally, we must consider the usefulness of the information on the platform. The SMEDAN platform offers access to a credit information portal where the names of various institutions offering loans, their requirements etc. are specified, and an SME toolkit website which hosts short videos explaining various concepts, like how to apply for loans, what a balance sheet is, how to create business plans etc. It must be noted that the concept of usefulness is highly subjective and dependent on the individual seeking information. Nevertheless, the videos seemed too general and not specific to the Nigerian context.⁴⁶²

⁴⁶⁰ The concept of corruption has been considered previously.

⁴⁶¹ When considering the attributes of the community, a low level of education was discussed.

⁴⁶² A noticeable problem was the continued use of US dollars as the form of currency, rather than the Nigerian Naira. This suggests that the video was not designed originally for a Nigerian audience.

6.5.2. SMEDAN's Benefits and Costs

Formally, we can assume that since SMEDAN is a government institution, their motivation would be in line with the policies of the administration in power. But this official motivation is subject to whether or not the individuals within the organisations believe in it and execute it. As noted previously, we must distinguish between the incentives of the organisation as a body and the personnel within the organisation. While their formal mandate is connecting borrowers and lenders together, we may nevertheless assume that some of the personnel of SMEDAN may be self-interested actors seeking their own personal benefit. Not much is understood as to how benefits accrue to employees of the organisation. **Section 6** and **Section 11 (2)**⁴⁶³ of the Act does specify that emoluments would be paid, so we can conclude that there is a salary scheme, but what is not clear is whether or not salaries are paid, or bonuses offered if a specific target⁴⁶⁴ is met or exceeded. So, we must ask ourselves what type of remunerations the employees are paid and is there a difference if they do not fulfil their mandate within that year.

For the individual employee within SMEDAN, there could be the possible added benefit of receiving bribes from the borrower in return for services or preferential treatment. We may assume that some employees might not be satisfied with the salary scheme and won't diligently carry-out their functions. We can also assume that others will be selflessly motivated to carry out the functions as set out by

⁴⁶³ This deals specifically with allowances and remunerations for employees, while **Section 12 (1)** provides that; '..... employees of the Agency shall be entitled to pensions, gratuities and other retirement benefits as are' prescribed under the Pensions Act'.

⁴⁶⁴ By set target we mean how well they did their job, for example, how many workshops or training sessions were organised within that year; how many borrowers were successfully linked to lenders

SMEDAN without any other form of compensation, outside their fixed salary paid by the organisation. Again, we must also consider the possibility that since the organisation receives funds from the government, and aid from agencies to carry out their functions, these monies could be diverted by staff for their personal use⁴⁶⁵ rather than using it to fulfil their mandate.⁴⁶⁶

As with the borrower, we must also consider SMEDAN's cost, are there any sanctions if their obligations are not fulfilled? **Section 16** of the Act provides that the Agency shall prepare and submit an annual report to the Federal Executive Council, through the Minister, not later than six months after the end of each year., However, the last annual report available to be viewed on their website is dated 2012. While it is obvious that corruption cases will be prosecuted as with the former Director General Alhaji Bature Umar Masari,⁴⁶⁷ what about the day-to-day mismanagement? For example, failure to turn up for work, condescending attitude towards borrowers resulting in humiliation. It is relevant to note whether there are sanctions for these, and whether there are rewards for enthusiastic, helpful behaviour. Is there some form of service review mechanism in place where borrowers can assess the staff's performance? if so, how seriously is it taken, and is it a ground for termination of employment?⁴⁶⁸

⁴⁶⁵ This is considered a benefit for them.

⁴⁶⁶ On the 8th of December 2017, the previous Director General of SMEDAN Alhaji Bature Umar Masari was arrested by the Independent Corrupt practices and other related offences Commission on charges of corruption, he allegedly demanded and received bribes from contractors and awarded contracts on behalf of the agencies to his cronies who were neither experienced or qualified to execute them. See The Nation Newspaper 'ICPC arrests former SMEDAN DG for alleged corruption in contract awards' Available at < <http://thenationonline.net/icpc-arrests-former-smedan-dg-alleged-corruption-contract-awards/> > Accessed 16th February 2018.

⁴⁶⁷ *Ibid*

⁴⁶⁸ Here we're looking at the concept of developing rules which with time become part of the Norms of the Institution

6.6. Analysing Patterns of Interactions

The next step within the action situation would be to proceed towards the prediction of likely behaviour. This will be influenced by the rules in use, which determine what the actors must, must not and may do.⁴⁶⁹ We must note that individual borrowers may have their own motivation for coming to seek help from SMEDAN. As simplistically as possible, if we were to imagine three borrowers X, Y, Z who approach SMEDAN with different expectations, X expectation might be to receiving training; Y might be finding the right lender to meet a need, and Z might have an information need.

If we begin to elaborate further, given what we know about the structure of the situation, we can begin to identify what interactions may occur. Given Z's need for information they are faced with two possibilities, physically going to the nearest SMEDAN office to get this information or accessing what is available online.⁴⁷⁰ Z opts to physically go to the SMEDAN office because Z is not computer literate, but Z's physical attendance will require a consideration of the distance to the office, time and money to be spent getting there. In Lagos, there is only one SMEDAN zonal office⁴⁷¹ and there is a high likelihood of being stuck in traffic, thus getting there will take time. Two choices are before Z at this juncture: Z forgoes going, at which point it can be said Z has exited the action situation; or Z decides to undertake the journey despite the possibility of time-wasting traffic. On getting to the office, Z is confronted again with several possibilities: Z's time could be wasted further by self-interested SMEDAN employee, but Z receives the

⁴⁶⁹ Previously, we identified that the rules in use are made up of the authority rules, boundary rules, information rules...etc.

⁴⁷⁰ This will be considered again as a separate point.

⁴⁷¹ The office is in the Oshodi area of Lagos state, if one is familiar with Lagos, the expectation to get to Oshodi is that depending on the start point of the journey there is a very high likelihood of being stuck in traffic for hours.

information required; Z could be attended to quickly with no problem; Z could be asked to pay a bribe by the employee; Z could receive the information after suffering some form of humiliation from condescending staff; Z receives information, but it is not useful to Z; Z receives no information at all.

If, on the other hand, Z decides to access the information online, again Z is confronted with several possibilities. Z may find it difficult to navigate through the online portal; Z may successfully navigate the portal and get the desired information; Z may encounter barriers which limits Z's access to information. Such barriers could include that fact that there is a limit to how much information an individual can access from the SMEDAN credit information portal without a SMEDAN identification number.⁴⁷² In the portal there are the basic details of the lender, such as who is lending, how much the loan is, interest rates and some lenders even specify what documentation is needed. However, to get more information you need to use the SMEDAN identification number.⁴⁷³ While one can assume a function of this identification number may be to keep track of the number of SMEs or act as some form of monitoring tool in proving SMEDAN is carrying out its functions, this nevertheless acts as a barrier to the information they are supposed to make accessible.⁴⁷⁴

⁴⁷² The SME Toolkit portal does not require a SMEDAN identification number, but the information there is too general and does not reflect the Nigerian experience.

⁴⁷³ Online, the process to acquire this number is an initial registration of which there is no cost, after which you fill in the required form which requests for information such as your CAC registration number. Registration with the CAC incurs cost. This implies that to be part of SMEDAN your business needs to have gone through the formal registration at the companies' house.

⁴⁷⁴ Using a friend's CAC details for her business name to complete a registration on the platform, I was able to start the registration process. However, upon completing the form and attempting a submission, an error message kept repeating, after several attempts, I stopped trying. However, while filling in the registration form, it was noticed from the options provided for the description of business that the range of business SMEDAN is interested in, is limited. The CAC details were for a Law Consultancy firm, so the category of "women owned enterprise was selected" as opposed to the other options of food processing; arts and crafts; oil and gas related goods and services; construction etc. The form requires the business owner to identify their needs, that is, what complaints they had with regards to their business. The form also asked for an indication as to whether the business owner required

For Z's interaction, if we begin to make action-outcome linkages we can begin to conclude on what the final outcomes will be if the actors decide to participate. For example, where the interaction pattern between Z and a SMEDAN employee can be Z undertaking to go to the office despite initial constraints, and Z encounters an employee who asks for a bribe. Z can either exit the situation; Z can refuse to pay the bribe but nevertheless wait to be attended to; or Z can pay the bribe for preferential treatment and receive the information in time. While we may want Z to get the information needed, we do not want Z to engage in bribing within the action situation, as this is not a strategy that we want to encourage. The question here now is what incentive structures can be set up to discourage the expectation of receiving bribe from the SMEDAN employee or the paying of bribes by the borrower.

6.7. Designing Incentives

According to Ostrom, "perceived rewards and punishments can motivate individuals to take actions that are genuinely productive for all involved".⁴⁷⁵ Within our arena, we must now begin to consider what rewards can motivate the individual actors. Not much is understood about the incentive structure of SMEDAN, while we do know that employees are entitled to remuneration, beyond that it is not clear how promotions are made.⁴⁷⁶ So, in our arena given what we understand about the community (Nigeria, specifically Lagos), we can make

entrepreneurship training. Other questions included whether the business owner had accessed any loans, if not, why not; the initial start-up capital of the firm; and the current assets of the firm excluding lands and building.

⁴⁷⁵ Daniel H. Cole and Michael D. McGinnis *Elinor Ostrom and the Bloomington School of Political Economy: A Framework for Policy Analysis*, Volume 3 (Lexington Books 2017) 229

⁴⁷⁶ Generally, what is known about civil service is that exams are written for promotion. In 2013 there was a move to scrap this system, arguing that promotion should be based on customer satisfaction and services rendered, but this has not been put into effect.

assumptions about the valuations that will be placed on the incentives. The basic need for the average Nigerian centres on transportation,⁴⁷⁷ health care, education, food, and power. For our action arena, we shall consider the first three. It must be noted that we are working from the premise that an employee during the course of the working day will want to do as little work as possible, and still earn their pay, thus it is vital that employees are aware of the incentive structures in place to encourage them.

Again, we must note that given that Nigeria is well known for corruption, thus we can assume that a high value will be placed on financial rewards. As stated previously, not much is known about the salary structure for SMEDAN employees other than they are entitled to remuneration. But judging by the salary scale of the Federal service commission, which is reputed to be one of the highest paying government organisations, but realistically they barely pay a living wage, and with SMEDAN being a Federal agency, one cannot expect too much from them. The current minimum wage level per month for Federal employees in Nigeria is about N18, 000.⁴⁷⁸ Civil servants in Nigeria, are paid according to their level. For example, Level 1 is a staff with no formal education who gets the minimum wage.⁴⁷⁹ Considering other forms of incentive structures is important, but one

⁴⁷⁷This is very important in Lagos because of the heavy traffic the city experiences. Practice has shown that where there is fuel scarcity, flooding (which Lagos is prone to), or any form of hindrance to easy movement beyond what is normally expected, fares go up for the regular buses. Thus, getting to and from work becomes a difficult process. The alternative to taking the regular buses, will be to use the BRT buses. Which on the average day, the queues to get in is not worth the lower fare, and because of frequency problems if you miss the first bus, you have a long wait for the one after.

⁴⁷⁸ At the current exchange rate on 28th February 2018 that is about £36 a month. Given the current state of the economy there has been a lot of agitation for it to be increased. In March 2019 a bill was passed by the Senate to increase the minimum wage to N30, 000, but this is not law yet as it requires presidential assent.

⁴⁷⁹ This scale is based on the Federal Civil Service commission. See Federal Civil Service Commission Salary Structure Available at < <https://www.currentschoolnews.com/articles/federal-civil-service-commission-salary-structure/> > Accessed 28th February 2018. The level 4 salary – This is the secondary school certificate holder, and the wage for this N20, 000 (£40). The level 8 who is a person that has completed their university education earns N81,000 (£161). Note that in 2011, SMEDAN applied to the National Salaries, Incomes and Wages Commission (NSIWC) to have a special salary structure for its staff, but the application was rejected. See, The Daily Trust, available at < <http://allafrica.com/stories/201109010764.html> > Accessed, 28th February 2018.

must first begin by addressing the salary issue. Perhaps revisiting the idea of increasing the salary structure should be considered again.

Aside from the salary, we can also consider other non-monetary incentives, that is, performance-based incentives. For example, we can look at promotion and job security based on successfully connecting a borrower. At this juncture we assume successful connection is not simply putting information on a web page, but rather, where possible, supporting and guiding the borrower to meet the requirements set by the lender. This will require the employee to be conversant with relevant policies. Generally, most government offices in Nigeria provide a staff bus for transportation.⁴⁸⁰ If this is applicable in SMEDAN offices, it can be used as a privilege based on performance and can be withdrawn if it can be shown that employees are underperforming.

Also, Nigeria currently has a National Health Insurance Scheme,⁴⁸¹ so health benefits are also something that can be considered for employees of SMEDAN. Access to different benefit packages⁴⁸² under the scheme can be based on hierarchy within the organisation. This can foster competition amongst employees to be promoted to attain these benefits. Where an employee underperforms, perhaps the responsibility for paying the premium for that month, quarter or year can be shifted from the organisation to the employee for that

⁴⁸⁰ If this is not in use, then it can be something to consider.

⁴⁸¹ **Section 16** of the NHIS Act of 1999 makes participation voluntary (Note that the Act was established in 1999, but only became functional in 2005). There has been a recent agitation to make participation compulsory. However, if employers do decide to participate, both the employer and employee are obliged to make contributions to the scheme (See **Section 16 (2)** of the Act)

⁴⁸² Some benefits offered by the NHIS include: Accessing medical care for spouse and four (4) biological children; Referral for specialised investigations or care; and more dependants or children above the age of 18 can be added to a cover when additional payment is made.

period, and should performance pick up again, the organisation shoulders the responsibility.

Another incentive worth considering in addition to revisiting an increase in salary, could be extra allowances. Extra remunerations can be paid to deserving employees. Also, sponsoring their education based on performance. Generally, one of the quickest ways to move up in the civil service is through education. Depending on the level which you entered, acquiring the required certificates can put you in line for promotion. Scholarships could be awarded to diligent employees to further their education, to further their chances of promotion.

6.8. Processing information

Above, we have previously considered the benefits the borrower can get⁴⁸³ and noted some of the costs attached to engaging with SMEDAN. Putting all this information together, we will look at the interaction of our actor 'Z' who approaches SMEDAN for help. Given the incentive structure,⁴⁸⁴ we can assume now that the individuals will be in competition with each other for the benefits. Ostrom states that "as an initial information condition, we can assume that actors know the shape of the function linking actions to outcomes".⁴⁸⁵ This implies that they know what strategies produce which outcome. In our situation, we also assume that the SMEDAN operatives may not communicate with each other regarding strategies they adopt.⁴⁸⁶ Ostrom further states that each actor will

⁴⁸³ Where we looked at training possibility etc.

⁴⁸⁴ Potential of using the staff bus, attaining scholarships, the possibility of health care.

⁴⁸⁵ Ostrom (n 252) 81

⁴⁸⁶ Between the borrowing actors, this is a given considering they may likely be in competition for the same source of finance.

assume that all other actors are rational and will adopt the best response⁴⁸⁷ to their own actions.⁴⁸⁸ Within our situation, the best response we want to encourage would be strategies which allow for the work to be done and also attain the benefit.

6.9. Analysing Outcomes

6.9.1. Efficiency

As noted, this must be done in line with the evaluative criteria discussed above. The first step will be to look at efficiency. For an interaction to be efficient within our situation, there must be an alignment between SMEDAN and the borrower, by this we mean a borrower is either connected to a potential lender or some form of knowledge is gained. What happens beyond this connection falls within the purview of a borrower-lender situation which we shall examine in the next chapter. The SMEDAN role is to act as facilitator and educator.⁴⁸⁹ We have noted cultural and social factors often hindered the process of connecting these SMEs. In our pattern of interaction, we made inferences that this cultural or social factor could be the possibility of time wasting, humiliation, demand for bribes etc. Given what we know about the Nigeria context, we deduced that this behaviour is often overlooked by their co-workers and for the most part encouraged. To do this successfully, a form of collusive relationship exists among them, but this collusion is the sort we want to discourage rather than reinforce. To resolve this, we identified the possibility of using incentives or creating a monitoring structure.

⁴⁸⁷ This best response should lead all actors to over harvest from the resource.

⁴⁸⁸ Ostrom (n 252) 81

⁴⁸⁹ Their mandate of equipping SMEs with tools to survive and thrive, e.g. provision of bookkeeping workshops etc. Also, this can simply be solving an information gap.

With incentives, we are designing tools which ultimately encourage the kind of behaviour that will achieve efficient outcomes.

6.9.2. Equity

We noted that the question of how the decisions were reached was a question of equity. In our situation, it is suggested that equity must look at the fairness of the decision-making process. It has been observed that SMEDAN carries out an evaluation of SMEs before passing them on to the financial institution who may carry out further evaluation.⁴⁹⁰ One must consider whether this process of evaluation is seen as fair. Writing on procedural fairness, Professor Macdonald states that this must encompass the two features of any decision-making process: the quality of the participation which should be afforded to persons affected by a decision; and the kinds of reasons which properly may be offered in support of the decision which results.⁴⁹¹ While contextually McDonald in his article was reviewing legal decision making process, it is submitted that these two principles are applicable within our situation. For example, how clearly the defined criteria of SMEDAN linked business to potential lenders. Clearly defined criteria ensure on the face of it, those who meet the requirements already know that they will likely get access to the services provided by SMEDAN. Where they are denied access, the reason for the denial must be justified.

We have also suggested above that there is a possibility of SMEDAN playing an active role in streamlining the requirements from lenders, this should be done to

⁴⁹⁰ Nigerian Investment Hub "<https://investor.ng/resource/small-and-medium-enterprises-development-agency-of-nigeria-smedan/>" accessed 22nd October, 2018. SMEDAN indicates that evaluation of the projects takes less than a week if all the appropriate details are included.

⁴⁹¹ Roderick A. McDonald, 'A Theory of Procedural Fairness' (1981) 1 Windsor Yearbook of Access to Justice 3, 5.

aid procedural fairness. From what was observed on the credit information portal, the means of identification varied from financial institution to financial institution, some required National IDs,⁴⁹² others passport or any form of valid ID. Streamlining the identification requirement can make it easier for SMEs to meet the requirements of lenders.

In terms of fiscal equivalence, we must note what financial burden is shared between the SME and SMEDAN. If we use the evaluation conducted, are specialists involved in reviewing the business plan of the SME? Do the SMEs pay a fee before the evaluation is carried out? From our research, this information is not made clear. Again, the training programs hosted by SMEDAN, what is the selection criteria of those participating, is there a fee involved? We know that most of the programs hosted by SMEDAN are done in collaboration with other organisations,⁴⁹³ is there a requirement to pay registration fees? The equity in our situation, is that everyone is treated fairly. In our situation, if rejection occurs it will be done on valid grounds.

6.9.3. Accountability

Further considerations within the situation, especially in terms of how sustainable it is, will include whether the incentive structure within SMEDAN was strong enough to allow the individual actors to act in the desired way. This focuses on the accountability method within the system. Here we focus on 'hierarchical accountability' within SMEDAN, where the person in charge (e.g. a director or the

⁴⁹² Officially it is stated that it takes 12 months after issuance of National Identification number to get the ID. But it has been reported in complaints by people that four years later they have still not received their ID.

⁴⁹³ The CBN sometimes works with SMEDAN to educate SMEs. Community Awareness on Development Network (CAWAN) in 2015 collaborating with SMEDAN hosted a two-week training program

branch manager) holds other staff members responsible for your actions and decisions. Did the SMEDAN actors receive the benefits for engaging in the correct behaviour? The granting of benefits must also be examined alongside whether those who cheated were caught and sanctioned, or whether it went undetected.⁴⁹⁴ It must be understood that monitoring is expensive especially where employee self-interest cannot be aligned. We noted above when considering incentive structure, it must address the basic need of transportation, health care,⁴⁹⁵ education,⁴⁹⁶ and since SMEDAN is a government agency, the government could easily take advantage by arranging a collaboration between the agencies.

Alternatively, we must also consider how the use of a complaints system might contribute to the sustainability of the situation. Where an SME encounters an actor within the situation who requires them to pay bribe, a confidential reporting mechanism might prove to be a useful tool, especially where there are assurances that complaints will be taken seriously.

Without the criteria of accountability, actors can engage in the various opportunistic behaviours. It must be noted that accountability can be approached from two perspectives, the first being systemic accountability which has to do with generating publicly viewable justifications as to why specific actions were taken. This is linked to legitimacy and whether there is a public perception that the evaluation process is fair and transparent, and that the SMEs are not

⁴⁹⁴ By undetected, it is meant that within the organisation the individual monitoring is not working but outside reports show that there is a problem.

⁴⁹⁵ We noted above that the government currently has a National Health Insurance Scheme, and health benefits is something that can be considered for employees of SMEDAN. Access to different benefit packages under the scheme can be based on hierarchy within the organisation, with access being given by performance.

⁴⁹⁶ Education or training sponsored by the agency, gives them the opportunity to attain promotions

overcharged to attain training from SMEDAN. The second being individual accountability, the evaluation here would be whether the bonus mechanism has been able to encourage individual accountability.

6.9.4. Adaptability, Resilience, and Robustness.

We noted above that this is a reflection of how the institutions set up can respond to changing environments, specifically how the system reshapes itself and also the behaviour of the participants, changing it over time.⁴⁹⁷ Whether or not the participants learn from experiences within the action situation, and if they adapt to new circumstances as they arise or become rigid in their responses over time.⁴⁹⁸ Thus, we must examine again how effective our incentives are in moulding the type of behaviour we require in the situation. We must contemplate the resilience with which the players can change level i.e. change the way in which the game is played and survive that change. Since we have/are designing the incentive structure to foster competition for benefits, we must reflect back on our study of game theory and determine at what point actors would begin to act on their self-interested impulse.

It must be understood that our action situation is definitely a repeat game, in that SMEDAN acts to continually evaluate and provide training for SMEs, and the SMEs wishing to gain access to SMEDAN's services or information base must engage with them either physically through their offices or via their online platform. Since there is no control over the number of times the game can be repeated, what we may have is a potentially infinite number of repeat situations,

⁴⁹⁷ How rules can shape norms over time. This was explored in chapter four.

⁴⁹⁸ Ostrom (n 257) 67

and potentially a one-shot game for each set of players.⁴⁹⁹ The reality is that if the situation works well, only then can there be repeated play. To qualify, working well does not simply mean a connection to potential lender, but also includes where SMEDAN offers an opportunity to develop a skill or correct a deficiency. This highlights the concept of adaptability, resilience and robustness currently being explored, because what matters is that the system keeps repeating.

Furthermore, it is suggested that adaptability is specifically linked to the level of participation engaged in by the actors. The more actors that are motivated to engage in the situation, the more barriers to participation within the arena we can identify. A robust system will be able to sustain the participation of all the key players, and where there is a deficiency correct itself in order to maintain the participation level.

6.9.5. Conformance to General Morality

With this criterion, Ostrom seeks to find out whether those “who can cheat and go undetected are able to obtain high payoffs, and whether those who keep promises are more likely to be rewarded and how those within the institutional arrangement learn to relate with each other over a period of time”.⁵⁰⁰ Again, this would be a reflection of how benefits are awarded, and if, despite engaging in undesirable behaviour, the SMEDAN actors are still able to obtain these benefits. Beyond attaining benefits, it also examines whether evaluations made by SMEDAN are done fairly and transparently, and whether SMEs that are

⁴⁹⁹ One-shot because they may choose to exit the situation where they feel SMEDAN has no useful knowledge to offer, or they experience humiliation/ they feel their time has been wasted. For SMEDAN it can be a one-shot game where they feel that the SME has no viable business or does not meet the requirements to be linked to a potential lender.

⁵⁰⁰ Ostrom (n 257) 67.

successfully connected to potential lenders are linked honestly. As noted previously, the distortive effect of corruption is that most decisions taken by government agencies are viewed with suspicion. As we noted with some of the government schemes examined in chapter two, decisions on who to grant loans to were based on familial relationships. It would not be too farfetched for SME actors to assume that they were rejected based on the fact that they could not take advantage of such connections.

Aside from familial relationships, we must also look at bribery. In our discussions above, we noted that there may be a possibility of SME actors being asked to pay bribes in exchange for preferential treatment, and as a matter of practicality, people will compromise and engage to attain their ends. Both practices are generally accepted behaviours within Nigerian society, but these are not the behaviours we want to encourage, but rather one where merit attracts the reward. This criterion enables us to understand the catalyst behind the behaviours/actions and generates ways to change the behaviour. Again, a way of doing this could be through the incentive structure and monitoring mechanisms.

6.10. Conclusion

In this chapter we conducted the first synthesis of our concepts with Ostrom's IAD framework. Before conducting the synthesis, we began the chapter by expounding on Ostrom's evaluative criteria hinted on in chapter three. Following this, we made preliminary observations on what exogenous variables will be considered throughout our analysis. With the exogenous variables in mind, we

then considered who our actors were (SMEDAN and the Borrowers), what potential action-outcome linkages would arise from their interactions and how they matched against our evaluative criteria. The process undergone in this chapter allowed for a firmer understanding of the reasons as to why the SME financing sector is not viable.

The chapter teased out these reasons and also made preliminary suggestions on how to potentially begin resolving them. But this chapter is just the beginning, and forms only a part of our analysis. Here, some limited empirical investigation was undertaken, using publicly available resources. If resources permitted, the next stage would be a more structured investigation of the question in the Lagos SMEDAN office through data gathering. Using desk-based methods, the most we have been able to do is identify salient points, pertinent questions and potential means for addressing system failures. In our next chapter, we shall now delve a bit further into the legal, market and cultural impediments to financing SMEs in Lagos.

Chapter Seven: A Borrower-Lender Action Situation

7.1. Introduction

In the last chapter, we began to populate Ostrom's model with our own terms and in doing so we made preliminary observations on what value actors within the SMEDAN-Borrower action situation placed on actions. We made some preliminary conclusions that if SMEDAN's intermediary role was to be improved, the incentive structure⁵⁰¹ needed to be changed, we also mentioned what some of these possible changes could look like. Now, having used the SMEDAN-Borrower action situation as a foundation to begin illustrating the use of the model, in this chapter, we must now begin to consider what a borrower-lender action situation would be like. This is the heart of this thesis in that we now begin the journey of identifying legal, market and cultural impediments to financing SMEs in Lagos, thus creating a foundation for a more viable SME sector.

Note that this action situation will be analogous to the SMEDAN-Borrower action situation. Again, from the pattern of interactions we would be using the model to identify relevant questions that need to be asked if the sector is to improve and thrive. It is important to remember that the framework is acting as a lens to view different elements that can affect a situation. Therefore, from the interactions within the situation, we can then make valuations on what incentive structures would be most relevant to the actors, what actions may occur, what possible situations will give rise to lending and borrowing, and when it would not.

⁵⁰¹ The cost and benefits of doing or not doing a particular action, as explained in chapter four.

7.2. Legal, Market and Cultural Impediments to Financing SMEs in Lagos

As noted previously, largely our “Action Arena” is the financing of SMEs in Lagos. Within this situation, we must now consider the interactions between the borrower and a lender. Here, our exogenous variables⁵⁰² considered in the previous chapter will be utilised more fully. Like the application of the model done in the previous chapter, this chapter will be broken down into two sections; ‘Actions-Information-Incentives’ and; ‘An analysis of the patterns of interactions’. But before proceeding, it is relevant to consider the nature of banks and their functions. This is necessary because, in our action situation banks will act as the embodiment of the various types of lenders.⁵⁰³

It can be stated that a major feature of a bank in addition to acting for depositors is to maximise their profits. They often do this by providing loans to businesses, which have interest on top of the principal sum loaned. Shelagh Heffernan in her book, notes that banks are strategically placed to offer this service as opposed to the individual lender because their core activity is to act as intermediaries between depositors⁵⁰⁴ and borrowers. Also, because of the wealth of information available to them through access to privileged information on current and potential borrowers with accounts at the bank.⁵⁰⁵ It was suggested that provided

⁵⁰² In the previous chapter, we looked at the issues of collateral, education, corruption, issues of security, access to credit information, problems of trust, inflation, business registration culture etc. and categorised them under the headings of attributes of the community, rules in use and the biophysical and material conditions. Note that the confines of this work would not allow for each variable to be treated individually, the key idea of this elaboration is to see how the model itself can be used to identify barriers within the sector.

⁵⁰³ It would be nearly impossible to consider every potential type of lender and conduct an analysis of them within this piece of work.

⁵⁰⁴ Who are seen in the context of lending as suppliers of capital. Shelagh Heffernan, *‘Modern Banking’* (John Wiley & Sons Ltd 2005) 1

⁵⁰⁵ Heffernan (n 504) 3

a bank can act as intermediary at the lowest possible cost, there will be a demand for its services.⁵⁰⁶ However, this condition of acting “at the lowest possible cost” presents a problem in Nigeria. This is because the interest rates at which the loans are taken are often prohibitive. In 2016, the CBN reported that the interest rate for different banks ranged from 20% to a maximum of 31%.⁵⁰⁷ It is asserted that high interest rates may be as a result of two possible factors; the perceived risks of lending within the current system or due to inflation.⁵⁰⁸

Robert Shiller in his book explains that high nominal rates of interests are in part a reflection of high rates of inflation, and real interest rates tend to be lower.⁵⁰⁹ The real interest is the nominal rate minus inflation, and generally, people will likely not borrow when nominal rate is high. In the Nigerian system, many relatively unsophisticated small business owners will be subject to a concept called money illusion.⁵¹⁰ The high nominal rate will be off putting even though the real interest rate might be reasonable, thus with interest rates being high, despite there being a market demand for loans in Nigeria and by implication, Lagos, the demand is often not met.

⁵⁰⁶ Heffernan (n 504) 3

⁵⁰⁷ THISDAY Newspaper ‘CBN Unveils Banks with Lowest, Highest Lending Rates’ (October 2016) *THISDAY NEWSPAPER* Available at < <https://www.thisdaylive.com/index.php/2016/10/20/cbn-unveils-banks-with-lowest-highest-lending-rates/> > Accessed 23rd March 2018. . It is interesting to note that Agricultural loans were in single digits

⁵⁰⁸ In chapter one we note that Nigeria just experienced a recession and is now classified as the poverty capital of the world. As at February 2019 the National Bureau of Statistics recorded that the inflation rate was at 11.31% see NBS ‘Consumer Price Index February 2019 Report’ March 2019 available at < file:///C:/Users/N0657569/Downloads/CPI_REPORT_FEB_2019.pdf > Accessed 19th March 2019.

⁵⁰⁹ Robert Shiller, *Irrational Exuberance* (3rd. Ed. Princeton University Press 2016) 55-56

⁵¹⁰ Ernst Fehr discusses this concept extensively, and how the money illusion means that people behave differently when the same objective situation is represented in nominal terms rather than in real terms. See Ernst Fehr and Jean-Robert Tyran, ‘Does Money Illusion Matter?’ (2002) 91 *American Economic Review* 1239

7.2.1. Action, Information and Incentives

In this Borrower-Lender situation, using the format from chapter five, we will take the participants here to be SMEs who are designated to the position of borrowers and banks⁵¹¹ who will take the position of lenders. Again, we must accept that these participants may have incomplete information about each other as our default position.⁵¹² Given who the participants are, we can assume that the action-outcome can be broadly categorized into two: the borrower will receive the loan, or the borrower does not receive the loan. The question now becomes what circumstances will lead to these outcomes, that is, the action-outcome linkage. Here, we must consider what the banks require from borrowers in order to grant loans. To answer this question, it was relevant to look at some bank profiles in Nigeria and identify what (if any) conditions would be attached to a loan request. In First Bank of Nigeria Plc,⁵¹³ the bank can offer a secured loan of N40, 000, 000 (Forty Million Naira)⁵¹⁴ with a maximum term of 36 months.⁵¹⁵ The conditions for receiving this loan includes providing six months bank statement; current utility bills; latest audited accounts; company profile; application letter and other 'know your customer'⁵¹⁶ information. The borrower also needs to

⁵¹¹ Again, not that the use of banks represents various lenders, be it individual or government because they will be faced with the same problem.

⁵¹² For banks despite there being an awareness of the borrower's financial information through their role as depositors, it is still possible not to have perfect complete information on borrowers.

⁵¹³ The banks considered in this section beyond the criteria of popularity were chosen randomly. First Bank itself is one of the biggest banks in Nigeria, with International offices in Africa, Europe, Middle East and Asia. It was founded in 1894 as The Bank for British West Africa and was one of the first banking institution to be established on the African continent. See First Bank < <https://www.firstbanknigeria.com/about-us/> > Accessed 7th March 2019

⁵¹⁴ With the exchange rate of today -23rd March 2018, that is about £79, 000

⁵¹⁵ First Bank Nigeria 'Secured Loans' Available at < <https://www.firstbanknigeria.com/business-banking/loans/secured-term-loans/#1457947296685-89b04a4b-7441ca15-0bdf> > Accessed 23 March, 2018.

⁵¹⁶ The 'know your customer (KYC)' information was a policy released by the CBN to gather information on customers when opening accounts. It usually includes information such as the customers address, photograph of the customer etc.

provide as collateral, landed property in a First Bank approved location,⁵¹⁷ or treasury bills or a fixed term deposit.⁵¹⁸

To receive a loan facility from the Bank of Industry (BOI)⁵¹⁹ of about N5, 000,000 (Five Million Naira),⁵²⁰ aside the usual documentations,⁵²¹ the collateral requirements include the option of landed property with a Certificate of Occupancy; debentures⁵²² on assets of the company; bank guarantee; external guarantors with notarized statement of net worth for loans below N10 million.⁵²³

From the above, the issue of collateral raises questions within our proposed action situation. We must consider the lender's attitude towards the kind of collateral used, and what type of collaterals the borrowers actually hold. We can note from the two banks above, there is a range of options to choose from when it comes to collateral. Based on the requirement of using land because this is the most popularly accepted and used collateral, we must now briefly consider the nature of property rights and view them within the Lagos context.

To expand on this, we note that the BOI requires a Certificate of Occupancy. Under the new land tenure system brought in by the Land Use Act of 1977,⁵²⁴ this vested ownership of Land in the hands of the state government, to hold in

⁵¹⁷ This shall be discussed further under the lender's cost and benefit

⁵¹⁸ First Bank (n 513).

⁵¹⁹ This was discussed in chapter two. The Bank targets businesses that engage in manufacturing and processing activities. It only finances enterprises or companies and not an individual person or group of persons. The company / enterprise must register, and you will be required to provide the registration number for a Limited Liability Company or business name for an enterprise.

⁵²⁰ As at the 23rd of March 2018, N5 million is about £10,000

⁵²¹ That is, identification documents, application form etc.

⁵²² By debenture, we take the meaning to be a secured loan document. **Section 173. (1)** Of CAMA states that a debenture may either be secured by a charge over the company's property or may be unsecured by any charge (Floating or fixed).

⁵²³ Bank of Industry Loan Centre, Available at < <https://www.boi.ng/apply/register> > Accessed 23rd March 2018

⁵²⁴ Previously in the southern region, that Lagos is a part of, land was held under customary laws, which emphasised collective community or family ownership with the head of the family or chief of the community vested with the authority to part with land. This parting was not a true divestiture of interest, but rather a lease to the individual or family to hold at the convenience of the chief so long as tributes were paid. See Stephen Butler, 'Nigerian Land Markets and the Land Use Law of 1978' 2012 Available at < https://landportal.org/sites/default/files/nigeria_land_markets_nov2012.pdf > Accessed on 23rd March 2018.

trust for the people. The provisions of the Act require that the Governor's consent must be sought for alienation of land.⁵²⁵ For a sale to be complete, the Governor would issue a Certificate of Occupancy⁵²⁶ which represented the title and ownership of the land. Generally, getting consent is often an arduous process and attracts a fee in every state. It was noted that Lagos was among one of the states that had the highest land consent fees.⁵²⁷ Currently, fees⁵²⁸ for mortgage transactions range between N2, 500 to N1, 000,000 for consent and a registration fee of 0.25% of the value of the land, that is from N 5, 000 to N1, 000,000.⁵²⁹ At this point we begin to see that should a borrower be inclined to use their land as collateral, they have already begun to incur costs. This is because for most people, without the need for alienation or some pressing purpose, they will not usually obtain a Certificate of Occupancy. It is relevant at this juncture to consider the costs and benefits to the borrower should they decide to use landed property.

7.2.2. The Borrower's Cost and Benefits.

It becomes relevant to consider the costs of engaging with a lender and using land as collateral. A report from 2012, finds that the main obstacle to accessing finance for SMEs is the collateral requirements stipulated by financial institutions.⁵³⁰ Using the IAD framework to understand what these 'requirements'

⁵²⁵ Whether an outright sale or creating a mortgage.

⁵²⁶ Section 5 (1) Land Use Act 1977

⁵²⁷ Note 522 above at page 3

⁵²⁸ Other fees include capital gains tax at 2% and a stamp duty fee of 2%.

⁵²⁹ Lagos State Land Government Bureau. Available at < <https://landsbureau.lagosstate.gov.ng/2017/05/17/governors-consent/> > Accessed 23rd March, 2018.

⁵³⁰ The report also notes that the absence of a functioning personal identification system, and the high costs of realizing collateral in the case of default contributes to the inability to access finance. See Note 141 above.

are, we can see that the borrower already has very high transaction fees just to mortgage the property.

Aside from the consent fees, during the term of the loan, since the property is in Lagos, the borrower also bears the land use charges. Recently, on the 28th of January 2018, the Lagos State House of Assembly repealed the 2001 Land Use Law and replaced it with a new Act 'Land Use Charge Law of Lagos State, 2018 (LUC)'. Under this new Act, land use charges were greatly increased.⁵³¹ **Section 10**⁵³² provides that the new rate payable on any property will be arrived at by multiplying the market value of the house⁵³³ by the relief rate⁵³⁴ and annual charge. If a borrower wants to take a loan and considers the transactions fees too high at this point, they may drop out of the action situation. It must be stated that the Land Use Charge may or may not influence the decision to collateralize the property. It may not influence the decision because whether or not the borrower uses the property to take a loan, they still pay the land use charge. As the charge for private and commercial properties are different, with commercial being higher.⁵³⁵ However, the borrower must also consider whether, in addition to the land use charge, they can afford to pay the extra fees to perfect the mortgage.

⁵³¹ This increment sparked several protests across Lagos state. The Guardian Newspaper 'Protests, concerns trail new Lagos land use charge' 5th March 2018 Available at < <https://guardian.ng/property/protests-concerns-trail-new-lagos-land-use-charge/> > Accessed on 7th March 2019.

⁵³² Land Use Charge Law 2018

⁵³³ The market value is arrived at by adding the value of the land to the value of the building developments.

⁵³⁴ Some properties are entitled to relief, for example **Section 3** provides that the status of the owner will be considered, i.e. if they have reached the age of retirement, whether or not they are physically challenged, the depreciation rate of the property etc.

⁵³⁵ With this charge being higher, it is possible that people will fail to declare that their premises is used for business, thus a distortive effect is caused when it comes to business surveys. Also, it can keep people in the informal markets due to the fraud being perpetuated, they may not want to use the property as collateral.

Additionally, we must consider what type of title the borrower has. If they own property but do not have a Certificate of Occupancy, then they find themselves in the position of having to apply for one.⁵³⁶ After going through the arduous time-wasting procedure, they still have to pay the fees to mortgage the property as consent fees for this new transaction, as it is different from obtaining the Certificate of Occupancy. Contextually, it is possible to own land without having the Certificate of Occupancy as prescribed by the Land Use Act. Again, this is a reflection of the tenure system before the enactment of the Land Use Act. It has been noted that *"since various chiefs or heads of communities still regard themselves as trustees of community land, they disregard the current right of occupancy system. These chiefs are still allocating, partitioning, and selling land without reference to the appropriate authorities designated under the Act. Where written documents are used for this purpose, they are back-dated to any period before the Land Use Act came into force"*.⁵³⁷ Furthermore, in a 2012 study it was revealed that 35 years after the enactment of the Act, alienation of land still occurred through contractual documents without the application for Government consent or registration.⁵³⁸

Further considerations also include the cost of engaging a lawyer: additional fees to be added to the transaction. Given the rise in fees, one must consider the amount being loaned and how it may affect the borrower's view of the worth of

⁵³⁶ In a working paper published in 2014, it was identified that the national-average of those who had a Certificate of Occupancy was less than 3% See Hosaena H. Ghebru et al "Tenure security and demand for land tenure regularization in Nigeria: Empirical evidence from Ondo and Kano states" Nigeria Strategy Support Programme II Working Paper (2014) at page 15 Available at < <http://www.ifpri.org/publication/tenure-security-and-demand-land-tenure-regularization-nigeria-empirical-evidence-ondo> > Accessed 8th March 2019

⁵³⁷ Osho (n 422) Also see working paper of 2014 where it was reaffirmed that this still happens "Although the Land Use Act" does not allow sales of land without authorization, this practice still continues. In some cases, documents confirming transfers are fraudulently backdated to appear legal" Ghebru (n 536) 6.

⁵³⁸Ghebru (n 536) 2.

the final balance. We can safely assume that the borrower requires a loan facility because they may not be financially buoyant to shoulder their current responsibility. Weighing this lack of finance and how much of the loan they will actually end up with, because of the above transaction costs, it may not be worth it to engage within the action situation, and they may decide to drop out rather than add the extra cost lawyer services.

Furthermore, we must also consider other variables such as corruption.⁵³⁹ Is there an expectation to bribe the loan officer⁵⁴⁰ for the application to be processed and granted? One would assume that granting the loan especially when it can be collateralised would be in the best interest of the bank, but like the distinction we drew with the SMEDAN action situation on the motives of the individuals in the organisation, and the organisation as its own entity, we must also do that within this situation. It must be recognised that the 'loan officer' may not be motivated by the interests of the organisation and in such situations may seek to serve their own interests. Additionally, like the SMEDAN situation we must also consider what impact the expectation of the borrower's time being wasted may have on their decision to apply for a loan.⁵⁴¹ Also, the possibility of humiliation,⁵⁴² the problem of high interest rates,⁵⁴³ the need for registration of

⁵³⁹ At this point we note that this is an attribute of the community.

⁵⁴⁰ A report written by Transparency International indicates that SMEs are susceptible to corruption because of the red tape imposed by banks to get loans. The report stated that's the formal requirements and costs on SMEs, may create incentives for engaging in corruption in order to enable, facilitate and speed up the process. See Transparency International Anti-Corruption Resource "Corruption risks and mitigation strategies in Small and Medium Size Enterprise lending" Available at https://www.transparency.org/files/content/corruption/CORRUPTION_RISKS_AND_MITIGATION_STRATEGIES_IN_SME_LENDING_2013.PDF > Accessed 7th March 2019

⁵⁴¹ In the last chapter we explored this concept from the perspective of information sourcing and the actual time spent in the offices.

⁵⁴² We considered this under the SMEDAN-Borrower action arena, and same line of reasoning would apply here.

⁵⁴³ From what has been observed on the SMEDAN Credit information portal interest rates could be as high as 24%, and up to 31%

the company,⁵⁴⁴ and the possibility of the land being sold if they are unable to pay, are all factors that influence the borrower's decision.

But we must also examine the benefits, for example using valuable landed property can give the borrower access to a wider range of lenders than other forms of collateral. Also working within the formal markets affords the possibility of building a strong credit reputation in a situation where the borrower successfully repays the loan.

7.2.3 The Lender's Costs and Benefits

Despite landed property being a prized collateral,⁵⁴⁵ the use of it still presents some potential costs for the lender. We have noted previously under our discussion of legitimacy in chapter six, the banks are always wary of the fact that the community may not be in support of a mortgage transaction and tend to be wary of accepting such forms of collateral, or if they do, they discount heavily on its value. This again is a reflection of the problems within the land tenure system of Nigeria. Despite having a Certificate of Occupancy from the Governor, a title which ordinarily should allow for peaceful enjoyment of the property, if the

⁵⁴⁴ It is suggested that this may not be a crucial factor, given the business registration culture in Nigeria, especially Lagos. It may be safe to assume that the business had already been registered prior to the quest for getting loans. The need for registration is not often synonymous with wanting access to the formal markets, but rather a need to show legitimacy in an environment known for fraud and corruption.

⁵⁴⁵ Although we note for First Bank treasury bills are acceptable, but this calls into question access. It is more probable that a borrower will have landed property, rather than money tied up in treasury bills. Also, it should be noted that the security can be redeemed early although with the forfeiture of some of its cash value. This raises the question of whether the borrower will simply redeem their bills if the return is still high enough rather than be in debt, paying high interest rates. Another consideration is whether the value of the bills will be enough to secure the loan in the first place. The Bank of Industry offers more options, as noted above, they allowed for the use of debentures on assets of the company, bank guarantee, external guarantors etc, but their lending is targeted to manufacturing and processing industries. With regards to the use of assets, this also presents a problem, because assets can depreciate, also to use the movable collateral registry there is also a fee that goes with it, that also adds to the transaction cost.

community is not in support, it brings about a host of trouble for anyone seeking to claim the land in question.

For example, Lagos like any other state, is not free of land grabbers. In Lagos, they are called the ***Omo-Nile*** which loosely translates to 'sons and daughters of the area/community'. When property is bought without community approval, the ***Omo-Nile*** usually turn up at the property claiming to represent the community interests and demand money before the new owners are allowed to enjoy the property. If they are not paid, they usually vandalise the property and prevent the new owners from carrying out works on it. The problem became so rampant that in 2016, the Lagos State Government enacted the 'Lagos State Properties Protection Law 2016' which imposes a fine of N 5 million Naira or a term of imprisonment of 10 -21 years or both on land grabbers. The government also set up a special task force to try and control the problem.

Due to the problems caused by the ***Omo-Nile***, it can be assumed that First Bank through its specification that the 'land should be from a First Bank approved location' that the bank is aware of these tensions and have tried to limit their risk by specifying the location in which the collateral should come from. But then we must ask ourselves what happens to borrowers without collateral from these areas, most likely they will drop out of the action situation and the same would be the case for the lender when the borrower cannot fulfil the requirements.

Again, the education of the borrower must be considered. The lenders must be able to satisfy themselves that the borrower would have sufficient bookkeeping and accounting skills to sustain their business. At this point we can begin to see how this situation can be linked to that of the SMEDAN-Borrower. If we consider

the range of training offered to borrowers in the SMEDAN-Borrower situations,⁵⁴⁶ evidencing this with a certificate from SMEDAN along with the past performances of the borrower, can be seen as a benefit.

Further considerations for the lender in terms of costs can be whether the mortgage agreement can be enforced. This falls into the exogenous variable of the rules in use. In a situation where the borrower has defaulted in their payments, factors such as how effective the legal system is,⁵⁴⁷ the time spent in litigation and the cost of litigation, and what procedures are available to the lender to recover the assets need to be considered. We noted in chapter four that enforcement was still a problem in Nigeria, and in the 2018 Doing Business Report conducted by the World Bank, it was noted that in terms of enforcement of contracts and resolving insolvency, Nigeria had made no improvements.⁵⁴⁸

Also, regarding the benefits to the lender, we must also understand what incentive structure the bank has. Aside from salaries and promotions, are bonuses given,⁵⁴⁹ and on what basis will they be given? In deciding how bonuses should be awarded it is worth considering the use of teams.⁵⁵⁰ Each team would be assigned a set target⁵⁵¹ of granting various loans or processing loan applications, and at the end of the determined period,⁵⁵² a prize is awarded. This can be a useful tool to promote competition between the different actors within

⁵⁴⁶ This reflects Ostrom's position on having different situations nested in one arena.

⁵⁴⁷ We briefly considered the Nigerian Legal environment in chapter four.

⁵⁴⁸ World Bank 'Doing Business Report 2018; Reforming to Create Jobs' Available at < <http://www.doingbusiness.org/~media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB2018-Full-Report.pdf> > Accessed 18th March 2018, 24.

⁵⁴⁹ This could be a monetary reward, or any other form of incentives e.g. paid holiday packages, different types of prizes etc.

⁵⁵⁰ It is understood that in the banking industry teams may be assigned to work on projects.

⁵⁵¹ The use of set targets is an option employed in the marketing department.

⁵⁵² Deciding what this period would be is worth considering. If it is too long, for example when the borrower pays off the loan because the business is successful, this might discourage the employee because this is never guaranteed. If, however, the determined period is at the end of a financial year, this becomes more feasible.

the bank. However, one must be careful of employing such strategies as it may lead to employees making reckless decisions or trying to game the system by lending to family members etc.⁵⁵³ Nevertheless, it is believed that with the adoption of competition as a strategy, this brings about the possibility of monitoring between teams.⁵⁵⁴ As noted in the previous chapters, monitoring plays an important role in the sustainability of the arena. Again, it becomes useful in that it may encourage opposing teams to carry out verification of the other team's loan grants, this plays on their self-interested need to win the competition and attain the benefit. In this kind of situation, we must allow for an open access policy in which records of each team's transactions are available.

For example, if Team A has a potential borrower, the information about the borrower is available on the bank's database, the searches done with regards to verifying the borrower's collateral, and the results of those searches etc. would also be available. Obviously, there would need to be a policy in place prohibiting stealing another team's potential borrower but keeping the information open to all serves two purposes. The first is that the team who puts up the information does so with the perception that the information can be verified, so they are inclined to be truthful. The second is that it allows for monitoring. This in its own way provides check and balances.

7.2.4 Possible Patterns of Interactions

The next step within the action situation would be to proceed towards the prediction of likely behaviour based on the exposition given above. Again, this

⁵⁵³ A very likely outcome because this was done in the Micro-finance banks which we considered in chapter two.

⁵⁵⁴ How well these teams work will always be dependent on effective monitoring and hierarchical structures.

like the SMEDAN action situation, this will be influenced by the rules in use, which determine what the actors must, must not and may do. Again, we must note that individual borrowers may have their own motivation for coming to seek loans. It may be a genuine business activity, or it may not. Like the SMEDAN action situation, we must also not assume that the interest of the individual actors (e.g. loan officer) within the bank would be automatically aligned with the overall motives of the bank, thus the nature of the incentive structure remains important. Less elaborate than the SMEDAN action situation which had varying borrowers with different reasons for approaching SMEDAN,⁵⁵⁵ here we will simply work with two characters X and Y because whatever their underlying intentions, be they genuine or fraudulent, their end goal is the same, accessing a loan. If we assume X has landed property in the appropriate location,⁵⁵⁶ we can predict X's potential for staying in the game is stronger and even playing it out to the end a possibility. Y, on the other hand, does not have land but other movable chattels with their own value,⁵⁵⁷ and as First Bank and BOI have suggested: treasury bills,⁵⁵⁸ a fixed term deposit, assets of the company,⁵⁵⁹ bank guarantee etc. The problem with these forms is that they are not as reliable as land, which presents the problem of giving 'land collateral' more priority. At this juncture, there is a huge possibility that Y may have to exit the game as their position is not as strong as X. Given that these are the possibilities, the potential outcome is either the bank lends, or

⁵⁵⁵ We recall that some could simply be coming to receive training on bookkeeping, others might have bookkeeping knowledge already and were simply there to get information on potential lenders etc.

⁵⁵⁶ Based on the criteria for First Bank of Nigeria

⁵⁵⁷ Going into this action situation, what must be encouraged is dissuading the bank actors from choosing the easy strategy of selecting only those with land within the situation.

⁵⁵⁸ In footnote 42 under 6.1.3 we note the possibility of redeeming the bill rather than take a loan

⁵⁵⁹ It should be noted that tangible assets can depreciate overtime due to wear and tear from fair use.

it does not. The real question here, is what the underlying reasons are as to why the decisions were made.

If we begin to elaborate further, given what we know about the structure of the situation, we can begin to identify what interactions may occur.⁵⁶⁰ X with the land already has some form of guarantee of remaining in the action situation. The interaction that will occur is the verification of information provided by X; this requires an investigation into the title of the land and the type of ownership held. Several possibilities come from this investigation, the first being because of the prohibitive transaction cost involved. For example, verifying information, even if title is established, the interest rates the bank gives might be high.⁵⁶¹ The investigation might reveal a problem with the title which may need to be rectified before moving forward. The outcome of this interaction is either after their investigation they choose to lend, or they do not because of the failure to establish title.

It is also relevant to consider this interaction from the borrower's perspective: that is X's perspective. X may decide to drop out from the situation because of the high interest rate or continue despite it. Should X decide to continue with the situation, X faces another potential problem. It has been noted above that the requirements to be satisfied before a mortgage transaction is complete are arduous, and faced with the possibility of incurring such costs, X at this point may choose to drop out of the situation.

⁵⁶⁰ We can assume for the Y actor the considerations would be the same, going through investigations which will inform a decision.

⁵⁶¹ We noted above that loans have a high interest rate, going as high as 31%. As at 2018, it was recorded that interest rates for all types of loans started from 19%. See Deposits, available at < <https://nigeria.deposits.org/> > Accessed 23rd March 2018.

Other issues that may arise that affect whether or not X will choose to remain in the action situation, include the possibility of being asked to pay bribes, how long it takes for the bank to process the loan application, the time spent waiting in the banking halls, humiliation from the loan assessor, and how quickly X gains information for the loan application either through an online platform or in person. With regards to information gathering, the potential of linking this situation to the SMEDAN-Borrower situation must be considered again. As noted previously, the SMEDAN online platform currently does offer some information on lenders, but this can be an opportunity to standardize lending requirements. While using the online platform we must be careful to address issues of navigation and limit potential barriers to accessing the information.⁵⁶²

Regarding the issue of paying bribes, again several possibilities exist. X may choose to exit the situation at this stage. X may choose to pay the bribe in exchange for preferential treatment and receive the information on time. X may remain in the situation but refuse to pay the bribe. While we may want X to get the information needed, we do not want X to engage in bribing within the action situation, as this is not a strategy that we want to encourage. At this juncture, we must begin to consider how the incentive structure can discourage asking borrowing actors to pay bribes, and even when the borrowers offer to pay, the offer would be rejected. We have already discussed the possibility of using bonuses as incentives for engaging in good behaviour, but we must also consider what sanctions are available for deterring bad behaviour. It is suggested that sanctions may include deducting from the salary of the erring actor, suspension

⁵⁶² In the SMEDAN-Borrower situation, we noted that such barriers included that fact without a SMEDAN identification number there is a limit to how much information an individual can access.

or a dismissal. Here the monitoring effect of the competition structure discussed above becomes a useful tool. Given the incentive structure of attaining bonuses, we can assume that since the individuals will be in competition with each other for the benefits, they are more likely to be vigilant and guard against such practice in the opposing team.

7.3. Analysing Outcomes

7.3.1. Efficiency

As noted previously in chapter six, analysing outcomes must be done in line with the evaluative criteria.⁵⁶³ With regards to efficiency, what we must determine is how well the action situation functioned. Could alignment between the borrower and lender be achieved? We note that alignment is a subpart of efficiency, and within our context, alignment will mean that participants seek the same transaction within the action situation because it is in their interest to do so. An efficient lending system is a field of potential interaction between parties, where each party can/should derive some benefit from the interactions that occur. This benefit can either be receiving a loan/lending to a credible borrower or gaining valuable knowledge or experience if a loan is not given. The point of the interaction is that it must be viewed as worthwhile.⁵⁶⁴ For an interaction to be efficient (worthwhile) within our situation, a loan is either given or some form of knowledge is gained. We note above that banks are often strategically placed to acquire information through access to privileged information from current

⁵⁶³ The criteria here would be efficiency, equity, accountability, legitimacy, adaptability, resilience and robustness, and conformance to general morality

⁵⁶⁴ A rational actor will weigh the value of engaging in a transaction, the primary value of engaging here will be to receive a loan facility at reasonable rate, or lending to an assured borrower. If this does not occur, a secondary value can include the borrower gaining knowledge as to why the loan application was rejected etc. This opens up the possibility of the borrower rectifying the issue and reapplying.

account activity when potential borrowers have accounts at the bank.⁵⁶⁵ Hypothetically perhaps, this strategic position can be extended and further exploited to not only their customers but customers of other banks in order to build a comprehensive report on the borrower.⁵⁶⁶ On the other hand, it would be inefficient if a loan were not given and there were no justifiable reasons for this.⁵⁶⁷

It is suggested that in our borrower-lender action situation, a misalignment of interest can occur because the risk of lending to the borrower outweighs the trust the lender may have for the borrower's ability to pay back. The lender's first concern factoring all risk is to make a profit⁵⁶⁸ and secure their loan by the best possible means in case there is a default. This 'concern to make a profit' is determined by the risk appetite of the institution, willingness to risk is not uniform across institutions, some institutions are more aggressive than others and may choose to overlook certain things where most would not.

Above we discussed the prioritisation of land as the best form of collateral to secure a debt, not just land anywhere, but one in a pre-approved location. This already begins to suggest that the land is viewed to have a varying value depending on its location and the type of title held.⁵⁶⁹ With the use of land brings

⁵⁶⁵ This can be considered as a cheap way of getting information and could potentially eliminate some transaction costs.

⁵⁶⁶ Given that banks tend to be proprietorial with their information, the likelihood of this happening seems inconceivable, but I would assert that there is precedence for this. Currently, in attempt to reduce fraud in the banking system, the "Bank Verification Number (BVN)" was implemented in 2014. The BVN is an 11-digit number and it acts as your universal ID in all deposit money banks in Nigeria and links individuals who have different accounts in different banks. See CBN "Regulatory Framework for Bank Verification Number (BVN) Operations and Watch-List for the Nigerian Banking Industry" Available at < <https://www.cbn.gov.ng/out/2017/bpsd/circular%20on%20the%20regulatory%20framework%20for%20bnv%20%20watchlist%20for%20nigerian%20financial%20system.pdf> > Accessed on 21st March 2019

⁵⁶⁷ The question of how the loan was made, will be dealt with in the subsequent criteria of 'equity'.

⁵⁶⁸ This implies finding a balance between the highest interest rate that can be paid and the lowest rate at which they can lend and still make money.

⁵⁶⁹ The effects of this was explored above under 7.2.2 the borrower's costs and benefits.

in the possibility of the borrower acquiring high transaction costs because of its differentiated nature, or through fees imposed by the state. This high transaction cost may serve to push the borrower out of the action situation; thus, inefficiency is created.⁵⁷⁰

As we stated in chapter four, trust⁵⁷¹ within the situation is central to creating a sustainable and efficient lending system, thus it becomes necessary to explore this concept with relation to lending further. Again, by trust, we refer to the calculative aspect of it, and not the ordinary use of the word. By “ordinary use” we are referring to that long-standing relationship built over a period of time,⁵⁷² where individuals get to know themselves and/or family personally and create a bond. Calculative trust on the other hand occurs where “the expected gain from placing oneself at risk to another is positive, but not otherwise”.⁵⁷³ Simply put, both the lender and borrower are aware of all the potential risks involved in engaging in a transaction but decide to take that risk because the gains or benefits are more than the risks, and certain precautions have been put in place to guard against the rest. This reflects that underlying idea in classical contract law that a contract will only arise where both parties benefit from it, thus this is where the alignment of their interest becomes relevant again in our action situation.⁵⁷⁴

⁵⁷⁰ Markets with lower transaction cost leads to efficiency.

⁵⁷¹ In chapter four we already began to suggest that this concept would play an important role within our arena, now we must begin to fully appreciate how much. To trust can imply many things. It could be trust in the ability of the borrower to keep good books; it could be trust in the borrower’s ability to pay back; it could be the trust that the system allows the lender to acquire the collateralised asset without any form of hindrance or unnecessary expense. The borrower must also trust that the lender will not call in the loan and try to take their assets before it is due; they must also trust that the interest rate being given is fair.

⁵⁷² Also, in chapter five we discussed the type of trust created by a strong enforcement of the rule of the rule of law. This concept was discussed when exploring Fukuyama’s work and that of Douglas North in chapter four

⁵⁷³ Oliver E. Williamson, ‘Calculativeness, Trust and Economic Organisation’ (1993) 36 *The Journal of Law & Economics* 463

⁵⁷⁴ This is the Freedom of Contracts on which Patrick S. Atiyah, extensively writes on in his book *The Rise and Fall of Freedom of Contract* (Oxford Publishers 1985). This also reflects McMillan and Woodruffs point on using private

When it comes to lending, trust becomes necessary for a lender because if they can be reassured that when they give out money, there will be an effective system in place to enable enforcement actions⁵⁷⁵ against the assets of the borrower should the need arise, then they will be more willing to lend. When dealing with risk and trust, the alignment comes in where the level of calculative trust is enough to overcome the risk, so they enter into the voluntary transaction which is of benefit to both. If you have a borrower that is unsuitable, they should be identified quickly and moved out of the situation, again if the bank is exploitive, they should also be identified and kicked out.⁵⁷⁶

It is pertinent then at this point to ask how this can be achieved, Douglas C. North is convinced that law, rules and processes are vital features of the institutional structure of successful economies.⁵⁷⁷ North also concludes that too much uncertainty hinders investment.⁵⁷⁸ In our situation we assume the uncertainty to be that which surrounds the borrower's ability to pay back, and the uncertainty about being able to recover secured assets.⁵⁷⁹ What has been observed from the situation above is that the current policy in place tries to compensate for this lack of trust, but rather than resolve the issue, an imbalance

order as a mechanism, contracts can be an effective use of private order and in our situation over time may be used to establish trust, but this is still subject to the ability to enforce, which we recognise as a main problem in Nigeria. Nevertheless, this is where the mechanisms to foster cooperation become useful in establishing new norms with the aim of countering the effects of corruption.

⁵⁷⁵ Deakin believes that Law/the legal system is an expression of state power and the state is ultimately required to ensure enforcement – (see Simon Deakin, et al “Legal Institutionalism: Capitalism and the constitutive role of law” (2017) 45 *Journal of Comparative Economics* 188, 190). Ostrom believes that enforcement rests in the hand of the participants within the arena, and state/outside intervention is only necessary to sometimes give effect to the enforcement measures decided within the arena. It is suggested that the former view is more compelling, and while within our arena participants should undertake the task of monitoring, ultimately serious enforcement may rest on the State. Thus, there is a need to review the legal mechanism.

⁵⁷⁶ This ordinarily should be a market function, in that the demand for the services of the banks should decline where it is recognised that they are exploitative, but because of the distortive nature of the community (corruption) the market does not operate efficiently.

⁵⁷⁷ Graham Ferris, ‘The Path-dependent Problem of Exporting the Rule of Law’ (2012) 101 *The Round Table* 363, 365

⁵⁷⁸ Ferris (n 577) 366.

⁵⁷⁹ Whether through enforcement in courts (the notion of state intervention), or the community preventing the bank from utilizing the property.

has been created between the borrower and the lender. The current policies seem geared towards protecting the lender from being out of pocket,⁵⁸⁰ thus encouraging more supply of funds. With these policies in place, the Government are confounded as to why more lending is not taking place.

It is suggested that the problem is not only one of supply,⁵⁸¹ but of demand as well. Borrower's may want money but may choose not to borrow on the terms currently being offered. In our situation, to identify where there can be misalignment, we must also draw a distinction between the borrower's need for money and actual demand. Borrower's may need money but demand for it may fall short if the interest rate is not favourable and if this is coupled with the high transaction cost that comes with securing the loan imposed by the government, then at this point again we see an exit from the situation. It is believed that the efficiency problem in this situation must be considered and resolved from a supply and demand perspective.

7.3.2. Accountability

Further considerations within the action situation, especially in terms of how sustainable it is, will include whether the incentive structure within the bank is strong enough to allow the individual actors within the bank to act in the desired way. This focuses on the accountability method within the system. Here, it is

⁵⁸⁰ For example, the establishment of the collateral registry which useful is still lender centric. Other examples include the credit guarantee scheme like the Agricultural Credit Guarantee Scheme Fund (ACGSF), The Commercial Credit Scheme (CACS) set up by the government. These were discussed in chapter two.

⁵⁸¹ It has already been suggested in chapter two that there is currently a block in the flow of money to SMEs. If we consider all the money set aside by the CBN and other Government institutions as intervention funds, or credit guarantee funds we should ordinarily see positive reports reflecting a marked increase in the flow of finance. But in chapter two, what we noted was a failure of the banks to access these funds. We suggested as a reason for this was the lack of trust in the government's ability to actually pay back due to corruption should a default occur. This lack of trust has the potential to undermine the growth of the economy. This assertion is supported by Deakin, he suggests that an economy can only be viable with state involvement (n 575) 198 and if you cannot trust the state, this can potentially undermine the integrity of the economy.

suggested that there would be two forms of accountability, the 'market accountability' where if there is a default in payment, it can be enforced. The second form is 'hierarchical accountability', this can be found, for example, in the government schemes, where the person in charge (e.g. a director) holds staff members responsible for their actions and decisions, or in the bank where managers hold staff members accountable for their decisions.⁵⁸² Thus, within the situation we must ask if the bank actors are actually rewarded for engaging in the correct behaviour. The granting of rewards must also be examined alongside whether those who cheated were caught and sanctioned, or whether it went undetected. While it is understood that monitoring is expensive, especially where employee self-interest cannot be aligned with the interest of the employer, it must nevertheless be enforced. Also, individual accountability must be made paramount, the evaluation here would be whether the bonus mechanism has been able to encourage individual accountability.

Above, we explored the possibility of using managers to oversee the jobs carried out by individual actors and rewarding or sanctioning the manager, based on whether the teams are meeting their targets and how well they do it, and how well the managers were able to detect undesirable behaviour. Alternatively, we must also consider how the use of a complaints system might contribute to the sustainability of the situation. Where a borrower encounters an actor within the situation who requires them to pay a bribe, a confidential reporting mechanism might prove to be a useful tool, especially where there are assurances that complaints will be taken seriously.

⁵⁸² This idea of hierarchical accountability shares a similar theme to that put forward by Alfred Chandler in his text *The Visible Hand: The Managerial Revolution in American Business* (Harvard University Press 1977)

This ties back to our initial discussion of CPR in Chapter Four⁵⁸³ where we discuss exclusion mechanisms being fundamental to overcoming the free rider problem and our analysis in the chapter of accountability within our action arena. However, it is pertinent to consider the role anti-social punishments play in societies that are corrupt. Anti-social punishments take the view that non-cooperators in a group will punish the co-operators within said group as a means of revenge. In a study conducted by Herrmann, Thoni and Gächter⁵⁸⁴ where different societies were observed, some of the initial results confirmed that the ability to punish free riders who did not contribute to the public good increased the cooperative behaviour in most participant pools. Free-riders learned that free-riding doesn't pay off and started contributing to the common pool⁵⁸⁵. This is the prosocial behaviour we want to encourage within our action arena. However, the study took an interesting turn, when it was observed that in some societies, the co-operators were being punished. They note that “the higher antisocial punishment was in a participant pool, the lower was the rate of increase in cooperation”.⁵⁸⁶ The study notes that anti-social punishments are more prevalent in societies with weak rule of law.⁵⁸⁷ This is the situation in Nigeria, thus, within our arena, we must now be aware of the fact that those who monitor may potentially face anti-social punishments, removing the incentive to continue monitoring or reporting. The awareness of this further strengthens the argument

⁵⁸³ See page 72 for this discussion

⁵⁸⁴ Benedikt Herrmann, Christian Thöni and Simon Gächter ‘Antisocial Punishment across Societies’ (2008) *Science, New Series*, 1362

⁵⁸⁵ Note that in some pools it remained the same, the ability to punish did not change the behaviour.

⁵⁸⁶ Herrmann (2008) 1365

⁵⁸⁷ They note that “antisocial punishment is harsher in participant pools from societies with weak norms of civic cooperation and a weak rule of law” Herrmann (2008) 1366

in this thesis for the development of a stronger rule of law to combat the potential of anti-social punishments arising within the action arena.

7.3.3. Equity⁵⁸⁸

Above, we noted that the question of how the decision to lend was reached was a question of equity. In our situation, it is suggested that equity must look at the fairness of the decision-making process. The fiscal equivalence in our situation can only be found in who bears the transaction cost. As it stands, both the lender and borrower share the fiscal burden in some form since they both stand to benefit from the transaction. The borrower's fiscal burden is paying the required consent fees to mortgage the property,⁵⁸⁹ the possibility of paying for a certificate of occupancy, land use charges etc. For the lender, the fiscal burden can come from the money being spent to carry out the required searches at the different registries to verify the information on the borrower.⁵⁹⁰

For re-distributional equity, this can be reflected with the targeted financing of business in particular industries.⁵⁹¹ This is echoed in the Government's renewed zeal for developing the agricultural sector, as opposed to the oil industry, which Nigeria is largely reliant on, but it is suggested that further diversification is needed. Furthermore, it should be stated that for our situation, equity goes beyond these two perspectives of fiscal equivalence and re-distributional equity

⁵⁸⁸ Ostrom views this criterion from the position of fiscal equivalence (which looks at the fact that those who benefit should undertake the cost of financing) and re-distributional equity (which suggests that the poorest receive more resources to improve their condition over time) Ostrom (n 257) 67.

⁵⁸⁹ If a movable property, the required fees for the collateral registry.

⁵⁹⁰ Other costs can come in the form of employing a business analyst to go over the borrower's business plans or a risk manager; or hiring someone to interpret data or information they collected; or even developing a specialised system or algorithm to calculate risks.

⁵⁹¹ Currently the government is focused on financing business in agriculture, and the banks have reassessed their lending focus to reflect this. We noted in chapter four that agricultural loans had lower interest rates compared to businesses in other sectors.

as used when looking at common-pool resources. The equity in our situation, is that everyone is treated fairly. In our situation if rejection occurs it will be done on valid grounds. We illustrated above that different banks require different information and types of collateral.⁵⁹² It is clearly stated on the bank's portal information page (for example First Bank which identified what was needed to secure a loan from them, equity in this situation would be depicted where borrowers who have met these requirements are given the loans, rather than close relatives of the lending officers, as was seen under the previous government schemes.⁵⁹³ There should be transparency when it comes to the decision-making process,⁵⁹⁴ and borrowers should be aware of why their loan application was rejected. If particular sectors have been prioritized by the bank, this information should be known from the outset, rather than a blanket statement of lending being done by that particular institution. This way borrowers are aware of the complete information.

7.3.4. Adaptability, Resilience, and Robustness.

We noted that this is a reflection of how the institutions established can respond to changing environments. For Ostrom, this specifically examines how the system reshapes itself and also the behaviour of the participants, changing it over time.⁵⁹⁵ Also, whether or not the participants learn from experiences within the action situation, and if they adapt to new circumstances as they arise or become

⁵⁹² In chapter six under the SMEDAN-Borrower action situation, we discussed the possibility of standardizing the requirement process, especially of the SMEDAN credit information portal.

⁵⁹³ This was noted in chapter two when discussing the various schemes aimed at financing SMEs.

⁵⁹⁴ This transparency is reinforced under the accountability criterion, thus there may be an overlap between accountability and equity in the action situation. This transparency should show that no tribal or religious bias were at play in the decision-making process, rather it should be a clear indication that you are potentially a bad risk for reasons given.

⁵⁹⁵ At this point we now begin to see how rules can shape norms over time. This was explored in chapter four.

rigid in their responses over time.⁵⁹⁶ We can see this rigidity reflected within the banking system's acceptance of what form collateral should be in. We have understood that land is highly prized as a form, despite innovative policies aimed at diversifying these forms, we have observed a strong adherence to land because it has a tendency to appreciate, and for various other reasons mentioned previously.⁵⁹⁷ Ostrom further notes, that institutional incentives affect the sustainability of an infrastructure. Thus, we must contemplate again how effective our incentives are in moulding the type of behaviour we require in the situation.

Adaptability and robustness have to do with change, and while in the strictest sense resilience does not necessarily embody the concept of change, it must be understood that there is a link between all concepts. Robustness and resilience reflect the facility with which the players can change level i.e. change the way in which the game is played and survive that change. Resilience and robustness are part of the set up that exists for the system to transform itself. By 'transform itself', it means applying Ostrom's concept of moving levels within the action arena to change a particular situation.⁵⁹⁸ As we have noted previously, the action situation is dynamic, it can switch levels or use the same level it is on, to change the situation it is in. Here, the system facilitates change, by facilitating a shift in level to respond to a difficulty which causes a problem. It is suggested that within our action situation currently being examined this may present a difficult problem

⁵⁹⁶ Ostrom (n 257) 67

⁵⁹⁷ In chapter six when discussing 'collateral' under preliminary observations on page 147, we note that broadening the scope of what can be classified as collateral in Nigeria would most likely be ineffective as an appreciation for these other forms has not been fully developed, neither has the infrastructure to support such claims.

⁵⁹⁸ From an operational level to a collective choice level to a constitutional/ meta-constitutional level. See chapter three where the California water basin case was discussed.

because while the Central Bank of Nigeria has taken a leading role in coordinating policy, the study of the history of SME schemes in chapter two has shown that there is still a lot to be achieved in terms of effectiveness.

Again, the adaptability of the borrower-lender situation is tested depending on the type of game being played. Whether it is fixed, or a short run,⁵⁹⁹ i.e. is it a repeat-player game or a one-shot game. It must be understood that our action situation is definitely a repeat game, especially for the lenders (in our situation the banks). From the borrower's perspective, if they are hoping to achieve a successful business growth, then it is a repeat game for them. Now, because there is no control over the number of times the game can be repeated, what we may have is a potentially infinite number of repeat situations,⁶⁰⁰ and potentially a one-shot game for each set of players.⁶⁰¹ The reality is that if the situation works well, only then can there be repeated play. To qualify, working well does not simply mean a loan is made or repaid, but also includes where difficulty arises, participants are able to find solutions to them (moving up levels). This highlights the concept of adaptability, resilience and robustness currently being explored, because what matters is that the system keeps functioning.

Summarily, it is suggested that determining the adaptability is specifically linked to the amount of participation engaged in by the actors. The more actors that are motivated to engage in the situation, the more barriers to participation within the arena we can identify from their experiences. A robust system will be able to

⁵⁹⁹ Ostrom (n 257) 33

⁶⁰⁰ For example, a business takes a loan, it grows and takes another loan. Potentially we may be able to witness the growth from a micro business, to a small business to a large one. As time goes on, we expect the business that keeps growing to be a repeat player. Banks will be repeat players, because this is one of the ways with which they make their money.

⁶⁰¹ One-shot because they may choose to exit the situation where they do not get the first loan.

sustain the participation of all the key players, and where there is a deficiency, correct itself in order to maintain the participation level.

7.3.5. Conformance to General Morality

From our discussion in chapter five we note that McGinnis,⁶⁰² in his exposition of Ostrom terms this evaluative criterion as 'Legitimacy'. If we recall, with this criterion⁶⁰³ Ostrom seeks to find out whether those *"who can cheat and go undetected are able to obtain high payoffs, and whether those who keep promises are more likely to be rewarded and how those within the institutional arrangement learn to relate with each other over a period of time"*.⁶⁰⁴ We know from our account so far that corruption within Nigeria has had a distortive effect on the level of trust within the system. This in effect can lead to a questioning of decisions being made, irrespective of whether they have been fairly made, for example, because of mistrust, a rejected applicant may begin to speculate about the reasons (ignoring their own unsuitability) as to why they were not given the loan. At this point you may begin to hear unfounded statements of how the loan was given to the less qualified 'brother/relative' of the bank's manager.⁶⁰⁵

In determining what this criterion is, we must first understand what the term 'general morality' means. Broadly speaking, morality looks at the values people hold, and this value could be based on religion,⁶⁰⁶ it could be based on education,

⁶⁰² McGinnis (n 229) 176

⁶⁰³ *Ibid*

⁶⁰⁴ Ostrom (n 257) 67

⁶⁰⁵ This is not to say some claims may not be true, building on the premise of what occurred with the MFBs discussed in chapter two. However, it may become difficult to determine this because of set prejudices against the government or other institutions.

⁶⁰⁶ To Etzioni a fundamentalist way of thinking, given the rise of religious fundamentalism in the world. See Amitai Etzioni *The New Golden Rule: Community and Morality in a Democratic Society* (Basic Books 1996) 3

experience⁶⁰⁷ and it could be shared culture values.⁶⁰⁸ We have established that it is generally accepted conduct in Nigeria to engage in bribing in most daily activities, but the question is just because it is a “shared cultural value,” does this make it moral? This must be answered negatively, because we must view morality from the perspective of what is seen as good and bad behaviour.

It is suggested that conformance to general morality/legitimacy comes into play where both the substantive laws and procedures⁶⁰⁹ are viewed as fair, and there is a consensus between the norms (what is good and what is bad) and the formal rules as written down. For example, if we look at bribery again, the formal rules view this a wrong, but on some level⁶¹⁰ it may be appropriate to pay a bribe, because as a matter of practicality people will compromise to attain an end and often this is the only way to achieve that end. In this circumstance, we have a corrupt behavioural norm which is not regarded as ethically normative. As actions stop being normative, they start being behavioural. This suggest that several concepts of morality may be at play within Nigeria. In a situation where bribing may be seen as appropriate it is suggested that some form of corruption norm⁶¹¹ is being exercised. On one level people generally see corruption as something that is bad, on another level people expect corruption and see it as an entitlement of the position/office they may hold.

⁶⁰⁷ Which Etzioni see as the inner source of the moral voice. Etzioni (n 599) 120

⁶⁰⁸ Classified as an external source. *Ibid*

⁶⁰⁹ This indicates an overlap with the criteria of accountability. To McGinnis, he states is as “legitimacy as seen by participants in the decision making-process”

⁶¹⁰ Whether it is right or wrong often depends on the position of the individual. An underprivileged individual paying may view this as wrong when they must pay, but an affluent person may not take the same view, especially if it gets them what they want. The person receiving in Nigeria often views it as their entitlement (especially in public offices), and any individual not respecting this right and conforming to the practice is often met with contempt.

⁶¹¹ For our arena, norms have been grouped into ethical norms with represent good and bad behaviours. Corruption norms- which is a reflection of Nigerian society, and how irrespective of corrupt behaviours been seen as bad, it is still generally accepted as part of everyday life without which society cannot function.

With this criterion, the action arena enables us to understand the catalyst behind the behaviours/actions and generates ways to change the behaviour. One way of doing this could be through sanctions. We noted above that Ostrom requires a consideration of whether those “who cheat and go undetected are able to obtain very high payoffs”. Currently, in Nigeria, this would be answered affirmatively. Under the other criteria discussed above, we considered how we may use incentives to readjust behaviours to a desired standard, but it is also suggested that here we must now consider what appropriate sanctions and enforcement policies should be in place⁶¹². Nigeria is not without its laws and set punishments for engaging in corrupt acts. Nevertheless, one of its key problems lies in enforcement of those laws. If actors cannot trust that those who break rules would be penalised, then they may drop out of the situation or refuse to enter at all.

7.4. Conclusion

In this chapter, we explored the role of banks within the action situation and their possible interactions with borrowers. We noted the requirements of some banks that needed to be met before loans could be granted. In terms of collateral being offered, it was observed that landed property (in an approved location⁶¹³) was the most viable form of collateral. Thus, there was a need to examine the property rights in Lagos. From our observations, we noted that the transaction costs associated with mortgage/selling etc. land was high⁶¹⁴. Additionally, it could

⁶¹² This takes us back to Ostrom’s original work of Governing CPRs and the role of sanctions and monitoring

⁶¹³ We noted that this restriction was because banks were more assured that the title to land would be more authentic as opposed to other areas where clear chain of title could not be established, thus the land may be subject to disputes.

⁶¹⁴ This was reflected in the carrying out searches in the land registry, paying consent fees and taxes for the transactions

be a time-consuming process (obtaining the Governor's consent for every transaction is slow), and these were seen as potential costs to the borrower.

The lender's cost was also considered, while the loan may be secured with landed property it was also necessary to consider what enforcement mechanisms were in place for the lender. We noted from a 2018 Doing Business Report from the World Bank, that enforcing agreements through the courts was still problematic. While analysing the interactions within the arena, it was concluded that misalignment of interests between the borrower and lender could occur if the system was not efficient, again we considered the potential benefits of holding participants accountable and how assigning equal fiscal equivalence between participants can sustain the integrity of the system.

Chapter Eight: Conclusion

8.1. Introduction

During the last four years, the focus of this thesis has been driven by the underlying need to understand why, despite the evidenced commitment of the Nigerian Government to develop the SME sector since the country attained independence as a former colony, this development has not fully been attained. From our chapter one it has been understood that SMEs can play a vital role in economic development, and this development is needed now more than ever as it has been seen that the Nigerian economy has been in and out of recession over the last few years, and currently the country has been ranked as the poverty capital of the world.

The question of why SMEs are seen as the key to meaningful development has already been answered by a plethora of studies, and some of the points of those studies have been reiterated here in this work. But this research's focus was more centred on Nigeria's failures to utilise these SMEs to attain this development. Through this research it was anticipated that meaningful and in-depth insights into the constraints these SMEs faced beyond the surface infrastructural problems would be identified. The thesis proposed a new way of looking at the problems these SMEs faced within the Nigerian context, specifically Lagos, culminating in the utilisation of an 'Institutional Analysis Development Framework' as the lens through which we looked.

Thus, this chapter contains the conclusion of this four-year study. It is divided into four sections. The first section provides an introduction to this final part of

the work. The second section provides a narrative of the process of deciding on the method to tackle the problem of investigating the legal, market and cultural impediments faced by SMEs in Lagos and a reflection from my perspective on the limitations of the use of the framework. The third section contains a discussion of the findings diagnosed through the use of Ostrom's framework and remarks on the possible directions that could be adopted going forward. The fourth section is the final conclusion, and it considers whether the aims and objectives of the thesis discussed in chapter one was met.

8.2. The Narrative

Before the overview of schemes conducted in chapter two, there was a general awareness that the SME sector faced viability problems. The thesis itself started with the belief that to solve this problem, more access to capital was needed to enthrone a robust SME sector in Nigeria. With the decision to further understand the problems faced by these SMEs and the role they played in the economy, it was realised that the world of Law and Development and Development Economics needed to be investigated. As an introduction to this world, that is development economics, and with an appreciation of its breath and scope, William Easterly's "*Tyranny of Experts*" became a foundation on which to undertake this journey⁶¹⁵. While Easterly raised numerous points within his text, what resonated the most was the need to learn from your history rather than hiring so called experts to create solutions to your problems. Easterly stated that "*the blank slate mind-set tends to ignore history and to see each poor society as*

⁶¹⁵ William Easterly, *The Tyranny of Experts: Economists, Dictators, and the Forgotten Rights of the Poor* (Basic Books 2013).

*infinitely malleable for the development expert to apply his technical solutions".*⁶¹⁶

Thus, there was a need to study our own history rather than adopt and transplant solutions. An example of the bad effects of transplantation being that of the Land Use Act which we have discussed within this work, an Act which mostly ignored the pre-existing tenure system of communal ownership of land, thus has produced difficulties in using and alienating land.

With this thought in mind, this became the premise for the work done in chapter two, where a study of different schemes aimed at developing the sector was conducted. From Easterly it was understood that before there could be full engagement with the problem, there was a need to know what had been done and what was currently being done, because both formed a vital part in possibly addressing the problems of the SME sector. History revealed invaluable points, salient among them was the Government's pattern of funding schemes without fully addressing possible incidental issues that would aid in making the scheme a success. At this point, a re-evaluation of the initial position of the thesis became necessary, moving away from the initial mind set of finding new ways to invest more capital into the schemes. It now became necessary to look beyond just creating access to capital, but also into recovering loans, creating trust, and making the schemes self-sufficient to run on their own without further input from the government: a sustainability issue.

Easterly further warned about the dangers of transplanting solutions. Easterly himself is informed by the work of J.B Condliffe who was of the opinion that "*it is too easy a solution to believe that economic development can be achieved*

⁶¹⁶ Easterly (n 615) 25

simply by transplanting some of the mechanical tricks and tools of the west”⁶¹⁷

Concurring with this belief, it was recognised that a comparative methodology, an approach adopted by most law thesis would not be compatible with the intention of this work. As it was important to be wary of borrowing solutions, it became necessary to seek out other methods that would aid in the understanding of the SME problem. This led down the path of seeking authors who appreciated economic and social problems, and the role the law played in providing solutions to them. As seen over the course of this work, prominent authors like Douglas North, Richard Coase, Oliver Williamson and their works have influenced the writing of this thesis in some way. And it is through a consideration of their work which led to Elinor Ostrom who offered within her IAD framework, a way to avoid the problem of transplanting solutions.

In chapter four, we discussed how Ostrom’s framework allowed for a better engagement with the reasons why successive schemes have failed and justified why we settled on her IAD framework as a model to be utilised in this thesis, so it is not necessary to discuss this further here. However, it behoves us to keep Condliffe’s point in mind as we move forward through this conclusion. It must be remembered that the modelling adopted a bottom up approach to investigating the issues, necessitating that the work be situated in the environment of study. This for the thesis, affirmed the potential limitations of it and of the model itself, because as the user needs to know as much of the environment as is possible.

Being Nigerian and growing up within the environment, it was somewhat easier to source information, albeit not every potential source was able to provide

⁶¹⁷ Easterly (n 615) 75; Condliffe, J.B, ‘The Industrial Development of China’ speech given at Chinese National reconstruction Forum at Berkeley on January 24, 1943

credible information or any information at all. But it raises the question of how someone outside an environment can engage with it through the model. Articles, books and your own research can get you so far, but would never really answer why the man from the Bini tribe and the man from the Esan tribe, all grouped as the Edo people, who share similar root language so close enough to understand each other when speaking, who recognise the same traditional authorities and observe the same traditional festivals bore prejudices against each other, which often affected trade between them. Again, the problem of being from the environment requires a check of preconceived bias which needed to be done often, so a balance needed to be struck. Being aware of enough information about the environment, but far removed from it as an analyst so that the bias does not distort the evaluation.

Further limitations during the process was finding the need to be immersed in economic literature, trying to grasp the concepts of market functions, game theory and rational choice theory. Translating an understanding of these concepts and how Ostrom views their interplay within the arena. Also, time became a constraint. Because of this, it was felt that analysis needed to rest solely at the operational level of the action arena where the day-to-day interaction takes place, leaving out the constitutional and meta-constitutional levels. In essence, while recognising that situations could be nested, the analysis did not fully engage in what a nested action arena could look like although it hints at it when references were made to SMEDAN and how their function could fit in our Borrower-Lender situation.

Following this narrative, below a discussion of the findings from the use of the model will be presented. As stated in the introductory section of chapter six, while policy design should be the ultimate goal, the pertinent problem is identifying questions that need to be considered when attempting to create these policies. Thus, this thesis advances current approaches to SME policy making in Nigeria through the utilisation of NIE analysis. It thereby enriches the policy literature and illustrates the potential value of the rather abstract modelling produced by NIE theorists in policy discourse.

8.3. Discussion on Findings

The problems faced by the Lagos SME can be mostly attributed to the exogenous variable of the “attribute of the community” and the “rules in use”. This section will be considered in two sub-headings. The first part focuses on the questions raised from the SMEDAN-Borrower action situation, while the second will discuss that of the Borrower-Lender.

8.3.1. SMEDAN and the Borrower

This situation raised several questions to be addressed. The findings revealed, in no particular order, that there was a need to review the identification process of the borrowers who approached SMEDAN and standardise these requirements along with other lending requirements to make it easier for a borrower to access the loans. We noted that some of these requirements from the lending institutions were not even specified. From the situation, it was observed that the way SMEDAN was designed could possibly set up barriers to entry for the borrowers, especially with the online platform that provided information on

potential lenders. If it is assumed that the online platform could be used as an alternative to the possibility of time wasting at SMEDAN offices (an exogenous attribute of the community that is prevalent), then access to it needs to be easier. We noted that without the SMEDAN ID this would be impossible. Beyond easier access, the information on it also needs to be tailored to Nigerians, for example, the use of the US Dollar rather than the Nigerian Naira is a failure to tailor their information to Nigeria. The practicality of the information to a largely illiterate population is called into question. Usefulness is subjective, and if majority of the individuals who the information is supposed to help, do not understand or cannot access it, then its usefulness must be questioned.

The action arena concept proved apposite for reflection on an intermediary agency. It permitted the opening of the “black box” of state action by compelling a focus on the lowest levels of action, that is, the state employees interacting with potential borrowers. Reflection and analysis of the motives and perceptions of these agents revealed hidden problems of alignment and collaborative purposes.

8.3.2. The Borrower and Lender

This situation proved more instructive on the usefulness of the application of the model, in that the findings could be substantiated by an external source. In this we see that our action situation generated concerns, and these concerns were confirmed by an empirical source. This solidifies our premise of the IAD framework being a practical alternative way of diagnosing problems. In chapter two, we discussed the Lagos State Employment Trust Fund (LSETF) which was created in 2016 and acted in a similar role as SMEDAN, with the underlying

difference between them being that LSETF disburses loans. LSETF have released an impact analysis report⁶¹⁸ within which they carried out a survey of SMEs in Lagos, including those to whom they had disbursed loans. Through a review of the LSETF impact analysis report, we were able to call upon empirical sources, and these both confirmed the theoretical analysis and were themselves susceptible to analysis informed by the theoretical model.

The survey covered a sampling of about 400 SMEs within the state.⁶¹⁹ Interestingly, the survey identified similar problems as our arena, they note issues of transportation,⁶²⁰ interaction with officials – stating “that representatives were rude and communicated ineffectively”.⁶²¹ The survey revealed that the borrowers were charged unnecessary excess fees. For example, they were charged N2, 500 for application forms which are meant to be free by officials.⁶²² The borrowers also noted that where the loans were approved, they still needed to pay an extra fee to get access to the money.⁶²³

From our exercise with the action situation, this report confirms that there is a dissonance with the on-paper motives/functions of the organisation and the individuals that act for them; a problem which we note while discussing the ‘SMEDAN-Borrower situation’ and the ‘Borrower-Lender situation’. It is suggested that this dissonance is not easily recognised by the conductors of the survey.

⁶¹⁸ LSETF ‘Impact Assessment Report’ Available at < <https://www.lsetf.ng/downloads> > Accessed 24th April 2019

⁶¹⁹ LSETF ‘Baseline Study Report 2017’ Available at < <https://www.lsetf.ng/downloads> > Accessed 25th April 2019, 7

⁶²⁰ Within our action arena this was also identified. Overarching, we noted that this forms part of our exogenous variables. It was explored more in the SMEDAN action situation through the perspective of the SMEDAN officials. That is, when we considered that providing a staff bus could be a useful incentive, but as we can see, the borrowers also have transportation concerns.

⁶²¹ In our action situation we discussed how the possibility of humiliation may deter participants from engaging in the situation. Here we can clearly see that this is an actual concern.

⁶²² Within our action situation, we note the possibility of paying bribes to get the necessary information, or service. This survey has shown the added separate issue of being asked to pay for information that should be free.

⁶²³ LSETF (n 618) 38

They know the problem exists, that is, officials working against the interests of the organisation, but it is asserted that they do not understand why it exists. It is argued that without viewing the problem through the lens of the action situation, this question of 'why' may continue to go unanswered. It is only because of the examination of the issues through the arena that it is easily recognisable that the problem is the dissonance.

LSETF also conducted a controlled survey with a smaller sampling of 112 SMEs.⁶²⁴ This survey revealed that LSETF suffered from an awareness problem. The survey showed that word of mouth was the prominent way people heard about the scheme. Having gone through the personal process of using the action situation to diagnose problems in this thesis this raised a question for me of whether the people whose job it is to make the information generally available are deliberately taking this valuable knowledge and refusing to disseminate it. It is possible that this potentially valuable knowledge about accessing loans is being sold, just like the application form, rather than being disseminated publicly. This again goes back to the 'dissonance issue' and the level of impact it can have within an organisation.

The controlled survey also identified that the people whose loan applications were rejected were not informed as to why. Viewing this through the lens of our action arena, it raises Ostrom's question of procedural fairness, under equity. Again, on the equity question, the website shows that to access loans, training was required i.e. bookkeeping. LSETF does their own training before disbursement, on the 'how to' procedure video on their website, borrowers are usually given the option

⁶²⁴ LSETF (n 618) 15

of accessing loans, accessing training, or training alone. With accessing loans, you cannot access a loan without training, but the controlled survey identified an inconsistency, because some borrowers were accessing these loans without training. This was revealed by the borrowers and we know that the knock-on effect of this process not being viewed as fair by participants could lead to them dropping out of the action situation.

Moving away from the survey, there are some additional issues raised by our action situation. In terms of collateral, first we note that the collateral registry which is supposed to be an alternative to immovable collateral is more lender centric. It was asserted by our arena that more protection is being created for the benefit of the lender. The danger of this, as we note, is the probability of borrowers pulling out from the arena where they do not feel that their interest is secure enough. Also, on the issue of collateral, we discussed extensively in chapter six regarding the restrictions placed on the type of collaterals accepted, and the prioritisation of land as the best form of collateral. In that chapter we noted the problems that could arise from the use of land, and broadly conceptualised them as transactions costs, these transaction costs having the effect of keeping participants out of the situation. The importance of having a strong property system cannot be understated, De Soto writes extensively on this. Throughout his text *The Mystery of Capital*, he asserts that without establishing a strong property system, then capital is dead.⁶²⁵ This assertion is given credence within our action situation. As we see from our investigation, that because of the fear of the inability to enforce mortgages due to communal

⁶²⁵ Hernando de Soto *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (Basic Books 2003)

interference, banks have limited their options in what they can accept as collateral. This in turn limits the number of borrowers that can access their loans. Furthermore, since the Land Use Act has not been reviewed since 1977 when it was first created, it is suggested that the time for change is now. This review should take into consideration the old communal system of property rights in place before the Act was enacted. As Easterly suggests, our history should play a part in developing our solutions, if the solution is to be effective. Ostrom considers how our norms determine whether we accept change, this was identified through the discussion of the American Prohibition Era in chapter four. When change is at variance with our held beliefs, there is every likelihood of rejecting this change. This is evidenced by the fact that the LUA 1977 is often ignored when alienating land, creating further problems if it is to be used as collateral. Tom Tyler also writes extensively on this concept of 'why people obey laws'. Tyler asserts that relying on threats and punishment to enforce laws is likely to be ineffective, rather the focus should be on aligning with social values and creating values like legitimacy and morality which underlie voluntary compliance.⁶²⁶

Also, from our action situation, we asserted that the policy climate seemed more designed in favour of the lenders, here the newly established collateral registry⁶²⁷ was cited as an example, as was having a credit information bureau. While these are necessary for the lender's benefit, for the borrower we had consecutive schemes whose focus was on providing finance. It was highlighted that even if

⁶²⁶ Tom Tyler 'Procedural Fairness and Compliance with the Law' (1997) 133 *Swiss Journal of Economics and Statistics* 219, 236.

⁶²⁷ We note this in chapter six when discussing the exogenous variables.

there is an excess supply of finance, if a conducive environment is not provided for the borrower as well, then the demand will not be met.

It was asserted that borrowers may want money but may choose not to borrow on the terms currently being offered, and our action situation illustrates why. Our action situation classified this as a misalignment and attempted to draw a distinction between the borrower's need for money and the actual demand for money. It was asserted that borrowers may need money, but demand for it may fall short if the interest rate is not favourable, or if this is coupled with the high transaction costs that come with securing the loan. It was at this point we identified that an exit from the situation will most likely occur. The key point to be taken away from this, is that for the alignment problem to be resolved in our situation, both the supply and demand problems must be addressed.

8.4. Remarks

This section's main aim is to make visible the way the results from our analysis have informed some considerations when conducting policy reform. Here the focus is on enforcement of contracts, bankruptcy and insolvency procedures and the issue of corruption. On corruption, the need for creating an incentive-based structure was geared mostly towards addressing and curbing the potential corrupt practices which occurred in both situations; thus, it shall be treated as one. A prevalent concern was the possibility of the borrower paying bribes to secure loans. While the discourse on corruption is part of the wider literature, we can nevertheless see its effects within our arena.

As part of the wider discourse on corruption, the Nigeria government have taken preliminary steps to resolve this with their stop gap policy on whistleblowing.⁶²⁸ On the 21st of December 2016, the Federal government released an incentive-based policy on whistleblowing. The policy approved the payment of between 2.5 - 5% of the recovered money to any successful whistle-blower who provides relevant information leading to the recovered funds.⁶²⁹ This policy is supported by an external website and hotline where cases of any wrongdoings in the public sector can be reported.⁶³⁰ The policy itself shows a growing appreciation of the need to curb the menace and recognises the benefits of having an incentive structure in place. While this stop gap mostly focuses on corruption in the public sphere (thus relevant to the workings of SMEDAN), looking at how incentives can promote the right behaviour is something that should also be developed privately. KPMG notes that Nigeria has a culture which places heavy emphasis on benefits and status due to inadequate infrastructure in the country,⁶³¹ because of this they considered what incentive structures could look like and in 2016, conducted a study on the emerging remuneration practices in Nigeria. The study revealed that typical benefits for a managerial role could include a status car, comprehensive insurance, fuel allowance, driver, power generator sets etc., but currently with

⁶²⁸ The discussion on whistleblowing is currently being written as a separate article ancillary to this thesis. In it, a full discussion on the whistleblowing climate in Nigeria is done and the potential impact of the stop gap policy is considered.

⁶²⁹ The Vanguard Newspaper 'Whistle-blower to receive 5% of loot recovered' (December 2016) *The Vanguard Newspaper* Available at < <http://www.vanguardngr.com/2016/12/whistle-blower-receive-5-loot-recovered-fg/> > Accessed 10th March, 2017

⁶³⁰ Due to this policy the Government has begun to recover stolen funds. In 2017, the Economic and Financial Crimes Commission (EFCC) recovered \$9.8 Million from Andrew Yakubu, the former group managing director of Nigeria's state oil company, thanks to whistleblowing. See Quartz Africa, "Nigeria's whistle-blower plan to pay citizens to report corruption is off to a great start" Available at < <https://qz.com/africa/909014/nigerias-new-corruption-whistle-blowing-policy-is-helping-the-government-recover-looted-funds/> > Accessed 21st April 2019.

⁶³¹ A point we considered when discussing our exogenous variables in chapter five.

the recession, these benefits are being monetized.⁶³² In our action arena, for SMEDAN in chapter five, we outlined how we can build on this culture by perhaps providing, health packages and staff bus transportation to work. What this illustrates, is how from building on the culture, we can easily see how better incentives could be used to encourage the right strategies within the arena as discussed in chapter's five and six and if there is a diversion from the strategy, a removal of these benefits as a cost.

Specifically, for SMEs and their payment of bribes to secure loans, it would seem this problem is not limited to the Lagos situation. Transparency International recognises the problem of corruption risk when it comes to loan disbursement, and in a 2013 report considers mitigation strategies that could be used.⁶³³ The report recognises that because of the bureaucratic nature of accessing loans, this creates avenues for bribing,⁶³⁴ we see this in our action situations and in the LSETF report, that this could be an adopted strategy to perhaps save time. The report asserts that bribery to influence selection, nepotism,⁶³⁵ conflict of interest, and fraud are risks present when lending to SMEs⁶³⁶ thus there is a need to ensure effective due diligence and encourage the establishment for integrity in its structure.⁶³⁷ The report considers these strategies from two perspectives, the banks and the SMEs. Regarding the banks, they assert having a "four eyed principle," a mechanism for limiting discretionary powers, is necessary.⁶³⁸ This

⁶³² KPMG 'Emerging Trends in Remuneration Practices in Nigeria' 2016 < <https://assets.kpmg/content/dam/kpmg/ng/pdf/tax/ng-emerging-trends-in-remuneration-practices.pdf> > Accessed 23rd April 2019, 1.

⁶³³ Transparency International Anti-Corruption Resource (n 540)

⁶³⁴ Transparency International Anti-Corruption Resource (n 540) 2.

⁶³⁵ As we observed with the MFB's discussed in Chapter Two

⁶³⁶ Transparency International Anti-Corruption Resource (n 540) 3

⁶³⁷ Transparency International Anti-Corruption Resource (n 540) 5

⁶³⁸ *Ibid*

principle operates by sending credit requests to a separate, independent department of the bank, using standard procedures to approve loans.⁶³⁹ Other considerations could include a staff rotation system to avoid the development of inappropriately close ties between credit agents and SMEs.⁶⁴⁰ On SMEs, the report states that incentives such as reduced service charges, improved banking conditions, easier access to loans or preferential repayment conditions for loans and training can help mitigate corruption risks.⁶⁴¹ On the issue of training, they suggest that this is important to better understand corruption risks and their legal and ethical requirements.⁶⁴² They note that the Global Advice Network, operated through the Anticorruption Business Portal, provides SMEs with training modules in anti-corruption, free anti-bribery and corruption e-learning courses and a business anti-corruption course.⁶⁴³ It is suggested that the view taken by Transparency International on how to mitigate corruption in SME loan disbursement is worth considering when moving forward.

On the issue of enforcement of contracts, we note in the World Bank Doing Business Report 2018 discussed previously, that along with debt recovery, enforcement of contracts is also a problem. Recovery issues led to the establishment of AMCON in 2010, but AMCON itself, despite the resources at its disposal, still faces numerous issues. In chapter six, we stated that for analysis the banks would be representative of lenders as a whole, but this assertion must be diverged from here, as other lenders facing this same problem would not have access to AMCON, therefore being left to tackle their enforcement issues without

⁶³⁹ *Ibid*

⁶⁴⁰ Transparency International Anti-Corruption Resource (n 540) 6

⁶⁴¹ *Ibid*

⁶⁴² Transparency International Anti-Corruption Resource (n 540) 7

⁶⁴³ *Ibid*

access to the benefits and resources of AMCON. The general outcome is that a strengthened legal system is also needed to support recovery efforts, along with improving property rights within the country.

8.5. Conclusion

This thesis was an exercise in finding new ways to think about a problem, and hopefully gain new insights. Through the journey of achieving the aims and objectives set out in chapter one, I found myself immersed in unfamiliar literature, thus broadening the scope of my knowledge beyond my initial foundation. Using the IAD framework developed by Elinor Ostrom, we acknowledged that the framework was designed as a lens to bring different policy elements together while viewing and diagnosing a problem.

As stated in chapter one, the thesis itself set out with the overarching aim of analysing the legal institutions such as the insolvency regime, that play a direct role in developing the SME sector, and the perceived failures of the sector. To do this, the thesis sets off with seven objectives to focus on. The first objective, met in chapter one, was an account of the relevant law of business forms, that is, corporation; the partnership; and the sole trader that businesses in Nigeria could adopt to trade in. The second part of this objective which focused on discussing debt recovery and insolvency law was met in chapter four, while discussing the Nigerian legal environment.

The next objective was to provide a historical narrative of the different initiatives and schemes in Nigeria directed at improving finance to SMEs, this objective was met in chapter two, and the purpose of this was to help contextualise the study. This chapter built into the next objective, which was identifying the perceived

problems that hindered the financing of SMEs, with particular focus on the Lagos business. Through fulfilling this objective, I was able to identify issues such as the low levels of trust, weak rule of law, all this was based on the knowledge derived from the history of past failures. Chapter three then focused on the exposition of the analytical frame to be deployed in investigating the SME sector, and chapter's five and six conducted the analysis using the Ostrom framework. The final chapter considered the results of the analysis, and reflected upon where possible legal reforms could occur, this chapter was also a reflection on the overall development of the thesis.

It is asserted that this thesis has made contributions to knowledge in the following respects. The first being a contribution to the discourse on SME policy in Nigeria. It is asserted that the way our understanding of the Nigerian, specifically, Lagos SME market is better than it was before, we know that simply approaching the problem through established schemes is not the answer, something more than that is needed to develop the SME sector, this is an addition to human knowledge. Also, the elaboration and use of Ostrom's framework within this context is new and hasn't been done before. Ostrom's theory and conceptual modelling is novel in the realm of SME funding in Lagos, thus being an addition to human knowledge.

What this thesis has attempted to do, is draw together different discourses, starting from the perspective of institutional economics which often operates at a high level of abstraction and here it was brought down to a lower and more practical level. To what the Nigerian government has been talking about in terms of policies to develop the sector. Both aspects were merged and examined through Ostrom's framework, producing new insights and knowledge within the

Lagos SME sector. A key insight being the building normative and structural institutions which support people in the absence of trust.

It is attested that the thesis through the discussion of game theory has made an incremental addition to the literature on corruption in Nigeria and how it affects the economic development of the country, identifying how corruption degrades the quality of interaction and degrades the ability to build cooperation within the SME sector in Lagos. It has also made incremental additions to the overall literature of NIE because of the specific context in which the thesis is set. It is asserted that all these contributions in combination resulted in a new synthesis that permitted the exploring in a coherent manner the problems that have proven to be intractable in the past. The different aspects that were combined maintained a necessary breath of factors to be included in the analysis to keep it realistic, whilst allowing a focus on sufficiently precise and limited factors to make the analysis rigorous and potentially repeatable in the future.

As a final point, it must be stated that as much as possible while doing this research, I tried to counter my own prejudices by using theory where possible to avoid my own blinkered bias because I come from Nigeria. In so much as is possible, I have also tried to use the networks that I have, and experiences from living in the country (for example information about the ***Omo-Nile*** and how they interrupt peaceful enjoyment of land, the police acting as debt recovery agents etc) and to bring them to bear within the thesis. This for me adds to the authenticity of the investigation conducted.

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