Governance Challenges in Nigerian Small Medium Enterprises (SMEs): *A Regulatory Comparative Analysis and Prospects for Reform*

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A thesis submitted for the degree of Ph.D.

September 2021

Lancaster University

DECLARATION

I declare that the work presented in this thesis is my own. Any information originating from other work has been referenced. This work has not been submitted in substantially the same form for the award of a higher degree elsewhere.

DEDICATION

I dedicate this thesis to my parents of blessed memory; Sir Ohiolei Styne Ehimiaghe and Deaconess Mojisola Abigail Olasebikan. I also dedicate this thesis to my little cousin Olohiye Ehimiaghe, who we lost on the 10th of August 2021. May the souls of the departed, through the mercy of God, rest in peace. Amen

ACKNOWLEDGMENT

First and foremost, my eternal gratitude goes to my heavenly father, Jesus Christ, for preserving and for seeing me through this PhD journey; thank you, Abba!

My sincere appreciation and gratitude to Dr. Kayode Akintola for guiding me through this journey. It has been one of self-discovery, learning, unlearning, and relearning. I remain grateful to you for your expert guidance, critical comments, and valuable suggestions. To Phil Lawton, who was also my supervisor before his retirement, I am very grateful to you for all the support you provided me from my LLB degree to the third year of my PhD research. Phil and Kayode's patience, knowledge, wealth of wisdom and technical abilities allowed me to learn tremendously over the years.

I remain grateful to the Faculty of Law and Social Sciences at Lancaster University for the generous scholarship that covered my tuition fees and made this thesis a reality. To the entire academic and non-academic staff at the Law School and Lancaster University at large, I say a big thank you; it has been an incredible seven years at Lancaster University - right from the moment I drove into campus for my LLB degree in September 2014, to the morning I drove out in June 2021. For all the theoretical aspects of Law I learnt, my teaching experience and the soft skills I have acquired and honed over the years - thank you, Lancaster University.

To Honourable Adeyemi Ikuforiji, - you made my dream become a reality; you gave me hope when I thought all hope was lost. Thank you for bearing the cost of my tuition & accommodation fees and your generous financial support towards my PhD programme and for being a father figure. I am forever indebted to you. God bless you richly, and I promise to always make you proud.

To my other sponsors, Mr & Mrs Emmanuel Imafidon, thank you for taking me under your wings and ensuring I received the support I needed. Mr Idawari Ogolo, I am forever grateful to you for all the financial support you provided me during this project and for believing in me. God bless you all.

To my paternal family - Uncle Joe and Uncle Ohimai I am forever indebted to you for paving the way for me and for being father figures. To Aunty Olohigbe, Uncle Oisaye, Ikuemehe, Oisawemi and the entire Ehimiaghe family, I say a big thank you to you all for everything.

To my maternal family, thank you is an understatement; I will be nowhere close to where I am today without all your support – Mr & Mrs C.F Awosika, Aunty Bukky, Aunty Tola, Aunty Kike and to all my cousins, I love you all so much, and I say a big thank you.

To my brother Lolu, thank you so much for your love and support over the course of my research. To my sister, Oluwatemilorun and her young family, thank you for being a mother figure and for making sure I was okay every step of the way. My little nephew and niece (Joel

and Jemimah Peterside), thank you for being a constant source of joy. Thankfully, neither of you spoilt my laptop along the way.

To my best friend, sister, and everything Eseohe Imafidon, thank you for being a pillar of support through the rollercoaster of emotions. You were there for me throughout this journey and this thesis is just as much yours as it is mine. Thank you for being the best friend I could ever ask for.

To Sodienye Ogolo, my surest friend & sister, thank you for being a constant source of support, encouragement, and a shoulder to lean on. You have been there for me right from my foundation days up until this very moment. I am forever blessed knowing that I always have you in my corner.

To Ayotelemi Ikuforiji, my sister! I say thank you for everything; right from my Undergraduate days, you have always been there for me and forever a shoulder to lean on. Your desire to see me achieve my heart's desires made this journey possible, and for that, I remain grateful and indebted to you.

To Osiyemi Osipitan, from the depth of my heart, I say a very big thank you. You have been there for me right from my foundation days and undergraduate degree to the entire course of my PhD and my Training Contract hunt. You have always been there for me, Yemi, and I remain indebted to you.

To my mentor, Dr. Adeayo Sotayo, my big brother, thank you so much for your advice and support. I remember the day in 2015 when you spoke to me and said, 'Tiffany, please make me proud'. That statement stuck with me, and I promised myself to make you proud. I am glad I was able to make you proud at Undergraduate level. I hope I have been able to make you proud with this too.

To my 'boys' as I call them – Sage, Destiny and Faith, thank you so much for your constant support and encouragement. I have learnt so much about a career in Law from you all, I remain grateful to you, and I will never trade our friendship for anything.

To all my lovely friends, I say a massive thank you for your love, support, and encouragement during the course of this thesis. I would have attempted an exhaustive list, but I fear I might miss mentioning someone's name. You all remain my OGs.

Indeed, it takes a village to raise a child, and I am grateful to you all.

ABBREVIATIONS

BCCI - Bank of Credit and Commercial International

BI - Bank of Industry

BIS - Business Incentive Strategy

CAC - Corporate Affairs Commission

CBILS - Coronavirus Business Interruption Loan Scheme

CBN - Central Bank of Nigeria

CGS - Credit Guarantee Scheme

CIT- Company Income Tax

CRD - Credit Risk Databases

CVL - Creditors' Voluntary Liquidation

ECODA - European Confederation of Directors Associations

EDP - Entrepreneurship Development Policy

FCA - Financial Conduct Authority

FG - Federal Government

FRCN - Financial Reporting Council of Nigeria

FSMA - Financial Services and Markets Act

GDP - Gross Domestic Product

IDC - Industrial Development Centres

IFC - International Finance Corporation

LFN- Laws of the Federation of Nigeria

LSE – London Stock Exchange

MVL- Members' Voluntary Liquidation

NACRDB - Nigeria Agricultural Co-operative and Rural Development Bank

NBCI - Nigerian Bank for Commerce and Industry

NCCG – Nigerian Code of Corporate Governance

NDE - National Directorate of Employment

NEPD - Nigerian Enterprises Promotion Decree

NERFUND - National Economic Reconstruction Fund

NITEL - Nigerian Telecommunications Limited

NTP - National Tax Policy

PHCN - Power Holding Company of Nigeria

SMEDAN - Small and Medium Enterprises Development Agency of Nigeria

SMEEIS - Small and Medium Enterprises Equity Investment Scheme

SMEs - Small and Medium Sized Enterprises

UBN – Union Bank of Nigeria

UK - United Kingdom

UNODC - United Nations Office for Drugs and Crime

US – United States

ABSTRACT

Small to medium size enterprises (SMEs) contribute significantly to economic development. They are the lifeblood of economies as they constitute the bulk of business organisations. However, particularly in Nigeria, they are plagued with several challenges, including poor governance practices, lack of access to finance and inadequate rescue provisions for financially distressed SMEs. These challenges limit the ability of Nigerian SMEs to thrive and compete in the local and global business environment. However, although SMEs are fraught with challenges in the United Kingdom (UK), they have been comparably successful, with steady growth and contribution to the country's economic development. Given the critical role that SMEs play in the Nigerian economy, it is imperative that policies are designed to cater for the typical needs of SMEs adequately.

Accordingly, this thesis considers the corporate governance, finance and insolvency issues that SMEs face. This thesis adopts a combination of doctrinal and comparative analysis of the UK and Nigeria laws and evaluates the current Nigerian regulatory regime to deal with governance challenges of SMEs. The thesis argues the need to bolster policies that address specific issues facing SMEs in Nigeria. Further, it considers that while policy changes have been made in recent years to ease doing business and boost Nigeria's global competitiveness, extant legal frameworks need to be brought in line with the modern needs of Nigerian SMEs, to enhance their potential to contribute to the development of the Nigerian economy.

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Chapter 1

1. Introduction to SMEs in Nigeria

1.1. Introduction

When examining an economy, it is important to consider who the stakeholders are and their interests. This is because an economy is an amalgamation of interests. Some of these interests could be connected to a business vehicle, a company, a sole trading business, a partnership, among others.[1] The divergence in economic interests presents unique challenges, much of which corporate law seeks to address.[2] One of the most important interests in any given economy and in particular a developing country like Nigeria is the interests of Small to Medium Sized Enterprises (SMEs) and their stakeholders.

Within the Nigerian context, the National Policy on Micro, Small and Medium Enterprises (MSMEs) describes small businesses as having an asset value (excluding land and buildings) of N5million to less than N50milllion and medium businesses as having an asset value of N50 to less than N500 million, and employee number of 10 – 49 for small business and 50 – 199 for medium businesses;[3] however, the Companies and Allied Matters Act 2020 (CAMA) defines a small company as a private company with not more than N120 million in turnover and N60 million in net assets value, with none of its members being an alien, government, government corporation/agency or nominee; and in the case of a company with share capital, the directors hold at least 51% of its equity share capital.[4] Igwe records (based on extensive studies carried out by the International Finance Corporation) that about 96% of Nigerian

[1] Companies and Allied Matters Act 2020 (CAMA) has introduced Limited Liability Partnerships and Limited Partnerships in Nigeria; see s. 795 & s 746 respectively.
[2] R. Kraakman et al, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd Edition, Oxford University Press, 2017) 27.
[3] SMEDAN, 'National Policy on Micro, Small and Medium Enterprises' <https://www.smedan.gov.ng/images/PDF/MSME-National-Policy.pdf >accessed 6 March 2021
[4] CAMA 2020, s. 394(3).

businesses are SMEs.[5] This figure stands in contrast to some countries such as the US and Europe where the proportion of SMEs is 53% and 65%.[6] However, in the UK, an SME is defined as one that employs less than 250 employees (between 0-249 people).[7] SMEs are said to account for over 99% of UK businesses.[8] It can be argued that the UK is similar to Nigeria, in that SMEs constitute the bulk of economic activity in both countries. Therefore, it might be apt to state that the proportion of SMEs in Nigeria and the UK is considerably high.

SMEs and how they are governed have an impact on economic growth.[9] The government relies heavily on SMEs as they serve as a source of government revenue, which in turn contributes to the overall economic growth of a country. Given that SMEs generate income for the masses and the government, contribute to the growth and national development of any given economy as they represent and affect the average individual of a nation, their governance is not trivial.

In the world economy, SMEs account for the largest proportion of the business sector, and their importance is reflected in business policy and legislation. For instance, the enactment of the UK Companies Act 2006 (CA 06) was largely premised on the philosophy of "think small first."[10] Moreover, governments around the world are increasing support measures[11] for SMEs as part of the national development strategy. Notably, government support for SMEs has been more acute in the wake of the COVID-19 pandemic, although it predates it. For instance, in Nigeria, the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) was set up in 2003 to facilitate the growth of SMEs through training, capacity development and

[5] P. Agu Igwe et al, 'Factors Affecting Investment Climate, SMEs Productivity and Entrepreneurship in Nigeria' (2018) 7 European Journal of Sustainable Development 182, 183
[6] C. Rhodes, *Business Statistics*, House of Commons Briefing Paper 06152, 28 December 2017
[7] Department for Business Industrial and Energy Strategy, 'Business Population Estimates for The UK and The Regions 2020' October 2020 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/923565/2020_Business_Population_Estimates_for_the_UK_and_regions_Statistical_Release.pdf> accessed 16 November 2020
[8] ibid.
[9] D. J. Storey, *Understanding the Small Business Sector* (Routledge, London 1994) 4
[10] Department of Trade and Industry, *Company Law Reform* (White Paper, Cm 6456, 2005).
[11] Notably,

funding for SMEs. SMEDAN existed alongside other targeted interventions such as the Bank of Industry Intervention Fund for SMEs. However, in the wake of the pandemic, the Nigerian government launched a $195 business million fund to support ailing SMEs, aid business recovery and bolster the economy. In the UK, HM Treasury set out in 2018 to strengthen SME growth, by increasing SME spend by government departments to 33%. Post-pandemic, the UK government strengthened these efforts through reliefs such as the Furlough Scheme, the Bounce Back Loan Scheme, and the Recovery Loan Scheme – all of which have greatly benefitted SMEs.

Despite these, research suggests that SMEs' contribution to the GDP in Nigeria has remained well below 5%.[12] This illustrates the fact that SMEs currently operate below their potential in the Nigerian economy. Admittedly, creating a policy environment that would enable SMEs to thrive is nuanced. Hence, it is important that an appropriate corporate governance framework must be in place to address these corporate governance challenges SMEs across the country faces.

Historically, the idea of companies and corporate governance were foreign to the indigenous people of Nigeria, and alien to the customary business practices of pre-colonial Nigeria.[13] Pre-colonial business practices lacked the formal structure that underscores business activity in Nigeria today. Agriculture was the dominant activity amongst Nigerians, as there was no system in place for corporations to operate.[14] The first corporations in operation in Nigeria were primarily the British companies chartered in England. These corporations were foreign companies registered in England. The most influential of them was the National African

[12] E. C. Gbandi and G. Amissah, 'Financing Options for Small and Medium Enterprises (SME's) in Nigeria' (2014) 10 European Scientific Journal 329, 331.
[13] J.O Orojo, *Company Law and Practice in Nigeria* (3rd edn, Lagos: Mbeyi & Associates 1992) 10.
[14] This lends proof that SME-like structures have been in place even before colonialism.

Company, which was chartered in 1886 (later renamed the Royal Niger Company).[15] As these companies were British owned, it is unsurprising that they were governed by the British system's law and philosophy.[16] Although the first Company Law provision in Nigeria was enacted in 1912,[17] corporate governance in Nigeria was largely influenced by the British system of corporate governance. This further accounts for using the UK as a comparator in this thesis.

Putting the foregoing discussion in context, this thesis aims to discuss some crucial corporate governance challenges facing SMEs in Nigeria. In doing this, the corporate governance framework in place for SMEs in Nigeria will be compared with the framework in developed countries, particularly the UK. For its analysis, this thesis considers small private companies in both the UK and Nigeria, as they are best suited to the concept of corporate governance within the scope of the thesis. Nonetheless, where appropriate, reference will be made to other business vehicles, particularly in light of the new reforms under the Nigerian CAMA 2020. The following section undertakes a brief discussion of the corporate economic background of Nigeria post-colonialism and perceived effects of Nigeria's current economy on SMEs.

1.2. Introduction to the Corporate Economic Background of Nigeria

Nigeria's colonial history influenced her economic policies and, to a large extent, made the policymakers more cautious in permitting (although not prohibiting) investment by foreigners in the country. Following Nigeria's independence, the government embarked on a wide scale indigenisation policy, to create opportunities for indigenous businessmen and reduce foreign

[15] S. Ukpabi, *Mercentile Soldiers in Nigeria History (History of the Royal Niger Company Army 1886-1900* (Zaria: Gaskiya Corporation 1987) 3. Others included, Miller Brothers, MacIver, Thomas Welch, British West African Timber Company

[16] See J. O Orojo, 'An Overview of the Companies and Allied Matters Decree 1990' in E.O Akanki (eds). *Essays in Company Law* (1st edn, Lagos: University of Lagos Press 1992) 1

[17] Companies Ordinance 1912 – this was based on the UK Companies Act 1862, as companies in Nigeria were still subject to UK Company Law.

ownership of Nigerian businesses.[18] In line with modern economic trends, however, the country now maintains a more favourable attitude to foreign investment.[19] The study of Nigeria's economic background, policies, and the attendant effects on corporate ownership are important because, when discussing corporate governance and control, there is a debate about the driving force of corporate change in a country. Hansman and Kraakman attribute this to global economic competition and they believe this is what will shape the direction of corporate governance systems worldwide.[20] However, Bebchuk and Mark Roe maintain that a nation's economic history and an evolutionary path is what determines the future of corporate governance in that country.[21]

1.3. History and Corporate Ownership Structure in Nigeria Following Her Independence

The value of SMEs to economic growth and development has already been identified.[22] Therefore, this section traces the economic history of Nigeria after independence[23] with a focus on how the corporate ownership structure has evolved to impact the governance of SMEs. Further, the section provides a hypothesis that Nigerian SMEs and their governance structure are a derivative of the government's privatisation drive. On 1 October 1960, Nigeria gained independence from British colonial rule. As a newly independent nation, it was expected that corporate ownership and corporate law in Nigeria in general, would tilt in favour of increased indigenous participation. Economic independence was understood to be indigenous ownership

[18] C. S. Ogbuagu, 'The Nigerian Indigenization Policy: Nationalism or Pragmatism? (1983) 82(327) *African Affairs* 241.
[19] See discussion of the Nigerian Investment Promotion Commission Act (formerly Decree) at 1.3.
[20] H. Hansman and R. Kraakman, 'The End of History for Corporate Law' (2001) 89 Georgetown Law Journal 439-449
[21] L.A Bebchuk and M.J Roe, 'A Theory of Path Dependence in Corporate Ownership and Governance' (1992) 52 Stan. L. Rev. 127
[22] See discussion at 1.1, page 3.
[23] The focus on Nigeria's post-independence economic history is justifiable because the economic climate pre-independence, was underscored by large companies with predominantly British ownership. To this extent, corporate ownership was largely monolithic. It was not until independence that Nigeria took an active role in defining its economic climate vis-à-vis corporate ownership.

and control of the means of production and distribution. As such, the government had absolute control over infrastructure, public utilities and facilities and provided social services.

The Nigerian government's desire for local and national control over production and distribution led the government to enact the Exchange Control Act 1962 (ECA 1962) and Nigerian Enterprises Promotion Decree 1977 as amended (NEPD 1977). Notably, the former was enacted shortly after independence (under civilian rule), while the latter was promulgated under the military regime. Nevertheless, both legislations changed the ownership structure of corporations in Nigeria. However, commentators like Yerokun disagree with this position and suggest that the NEPD had little or no significant impact on the pre-existing practices of corporate governance, and in particular the ownership structure of corporations in Nigeria during the colonial period.[24] On the other hand, Ndebbio believes that the NEPD altered the ownership pattern in favour of indigenous investors. He notes that the NEPD ACT 1977 was revolutionary, as it paved the way for Nigerians by altering industrial enterprises' control and ownership structure in favour of Nigerians.[25] Furthermore, Ake supports the view that the NEPD altered the ownership structure of corporations in Nigeria as it increased Nigerians participation in equity, even though it was difficult to measure the extent of the increase.[26] Over time, the country's economic participation pattern moved from that of deregulation of ownership to deregulation of foreign exchange control and ultimately privatisation. The following section discusses these reforms and their effects on the current ownership structure in Nigeria, and by extension, SMEs.

[24] O. Yerokun, '*The Changing Investment Climate Through Law and Poicy in Nigeria' in C. O Okonkwo, Contemporary Issues in Nigerian Law* (Lagos: Taiwo Fakoyede, 1992) 219

[25] J.E.U. Ndebbio, 'Industrial Development Policies/Incentives and their impact on the Nigerian Economy in J.EU Ndebbio and A.H Ekpo, *The Nigerian Economy at the Crossroads: Policies and their Effectiveness* (Calabar, Nigeria: University of Calabar Press 1991). However, it should be noted that he did not provide any statistical evidence for the revolutionary effect he attributes to the enactment of the NEPD.

[26] C. Ake, 'Indigenisation: Problems of Transformation in a Neo-Colonial Economy in C Ake, *Political Economy of Nigeria (*London: Longman 1985) 173.

While numerous private and public entities existed pre-independence, corporate ownership in Nigeria was largely vested in British as well as other foreign nationals and entities, with a limited number of Nigerian elites performing peripheral economic roles.[27] The first stage in the evolution of corporate ownership in Nigeria came about post-independence, with the deregulation of foreign ownership. Following Nigeria's independence, foreign participation was limited in Nigerian companies as various rules[28] were in place to this effect. A noteworthy point is that the government had complete ownership control of infrastructure, public utilities, and social services through state-owned corporations.[29] Meanwhile, other sectors of the economy were gradually opened to increased indigenous ownership.[30] After deregulation of foreign ownership came privatisation. **N**igeria commenced a wide-scale program of privatisation of corporations in 1988 with a view to opening the Nigerian business market to private investment. The Nigerian Privatisation and Commercialisation Decree, 1988 laid down the principles of the privatisation programme. The first phase of the privatisation agenda occurred between 1988 and 1992, wherein over seventy (70) government companies were privatised. The vast majority of these companies operated in the insurance, banking, agricultural, shipping and food processing sectors. The major industrial companies such as oil exploration and refining companies, telecommunications and electricity companies remained government-owned with the government holding the monopoly in these companies.[31]

[27] ibid n 17.
[28] Notably, some categories of enterprises were completely precluded from foreign ownership, while others were restricted to no more than 60% of foreign ownership. See, for instance, Sections 4 and 16 of the Nigerian Enterprises Promotion Decree 1972, Decree No. 4
[29] B. Ahunwan, 'Corporate Governance in Nigeria' (2002) 37 *Journal of Business Ethics* 269, 270.
[30] Such sectors included: commercial transportation, distribution of locally manufactured goods, the production of blocks/bricks, tile manufacturing, newspaper publishing, radio and television broadcasting etc.
[31] Government monopoly is arguably no longer the norm in these industries. For instance, the Power Holding Company of Nigeria, a government agency formerly responsible for electricity in Nigeria, was privatised in 2013, in line with the Electric Power Sector Reform Act 2005. Similarly, the telecommunications sector was privatised in 2001, through the auctioning of licenses for private operators for the operation of the Global System of Mobile Telecommunications (GSM).

Notably, in 1995, the Nigerian Investment Promotion Commission Decree[32] was enacted (NIPC 1995 Decree), as an offshoot of the government's privatisation agenda. The Decree, in effect opened foreign participation in companies, to make up for the paucity in indigenous ownership and investment potential. Also, there was the deregulation of foreign exchange control to encourage foreign ownership. The enactment of the Foreign Exchange (Monitoring and Miscellaneous Provisions) (Decree)[33] led to the deregulation of foreign exchange control across the country. Foreign companies were also allowed to bring in their foreign capital into the country unhindered, provided they had a certificate of capital importation from Nigerian Banks. This implies that foreign participation (vis-à-vis foreign corporate ownership) has been restored in the Nigerian corporate sphere.

Nevertheless, since the commencement of privatisation, there has been an emergence of small and medium-sized indigenous businesses engaged in various aspects of Nigeria, such as microfinance banks, commercial transport, and food processing companies. This seems to suggest that the government's liberalisation agenda has fared well so far. More specifically, the macroeconomic challenges and the government stance towards privatisation have led to SMEs' emergence in different areas of economic activity.[34]

From the foregoing discussion, it is evident that the privatisation exercise in Nigeria has had tremendous effects on Nigerian corporate ownership structure. However, one could argue that though it changed the composition of ownership of Nigerian corporations, it did not necessarily alter the pattern of ownership. "Composition" in this respect alludes to the type of shareholders while "pattern of ownership" refers to the distribution of ownership interests. The erosion of government ownership paved the way for increased private participation, thereby changing the

[32] Nigerian Investment Promotion Commission Decree 1995, Decree No 16 (as amended by the Nigeria Investment Promotion Commission (Amendment Decree (Nigeria) 1998, Decree No 32.
[33] The Foreign Exchange (Monitoring and Miscellaneous Provisions) Decree No. 17 of 1995
[34] For a general discussion on the impact of privatisation in developing countries such as Nigeria, see S. Estrin and A. Pelletier, 'Privatization in Developing Countries: What Are the Lessons of Recent Experience? (2018) 33(1) *The World Bank Research Observer* 65.

composition of ownership; nevertheless, the pattern of concentrated ownership remains unchanged. Nevertheless, what remains clear is that government participation as a proactive actor in Nigeria has been substantially reduced. However, as will be suggested in this thesis, SMEs' operation remains fraught with practical corporate governance challenges.

1.4. Effect of Nigeria's economy on SMEs

As earlier discussed, SMEs account for the bulk of business activity in Nigeria. Therefore, it follows that Nigeria's existing economic and legal frameworks have the propensity to impact SMEs and their operation, whether positively or adversely. Similarly, the Nigerian economy's overall state is crucial to SMEs' operation and their capacity to contribute to the nation's economic well-being. However, it should be noted that the majority of SMEs are not publicly listed companies and therefore operate outside the legislation governing capital markets.[35] This observation also underscores the fact that SMEs fall outside the capital markets' scope[36] when discussing economic policy and the state of the economy. Nevertheless, a significant proportion of SMEs (registered as private limited companies and business names) are still subject to company legislation provisions. This should ordinarily mean that they are expected to adhere to good corporate governance tenets in running their affairs. However, the reality of SMEs in Nigeria reveals a lack of adherence to good corporate governance practices.

Notably, while SMEs make up the bulk of business organisations, the discourse on corporate governance in Nigeria has so far focused exclusively on publicly listed firms, i.e. those quoted on the Nigerian Stock Exchange.[37] Though this choice of focus is understandable and perhaps justifiable, a problem of exclusion is inevitably created whereby an understanding of SMEs' corporate governance behaviours and outcomes (which constitute the bulk of business activity

[35] A. Eniola, 'SME firms' performance in Nigeria: Competitive advantage and its impact' (2014) 3(2) International Journal of Research Studies 75

[36] A possible exception to this is companies listed on the Alternative Investment Market (AIM) in the UK. The AIM is renowned for being a growth market for fast-growing SME companies seeking external funding.

[37] See for example A Sanda, A.S. Mikailu & T. Garba, *Corporate Governance and firm mechanism and firm financial performance in Nigeria* (Centre for Study of African Economics, University of Oxford, March 2008)

in Nigeria) is foreclosed.[38] Nevertheless, in undertaking the present course of the inquiry, Nigeria's current economic and legal realities must be borne in mind. This is because a careful examination of these variables might reveal a corresponding impact on SMEs, including their corporate governance issues.

It is now settled that a good corporate governance structure ensures judicious and accurate disclosure of material information[39] regarding a company. Information is said to be material if there is a "substantial likelihood that the reasonable person would consider it important"[40] in assessing the company's operations, financial standing, and the viability of investing in (or financing) such a company. Material information about a company includes, but is not limited to its performance, financial position, ownership, and governance of the company.[41] It follows that a good corporate governance structure should ordinarily disclose information of the above nature.

Arguably, however, adherence to the above tenets of good corporate governance is only feasible where the legal frameworks in place enable companies to adopt good corporate governance practices. In other words, the policies in a country should be structured to ensure that corporate governance frameworks guide businesses' operation, including SMEs. This is because of the crucial role that SMEs play in any economy. In fact, in the UK, SME failures have spurred legislative responses.[42]

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[38] C. Uchehara, 'Corporate Governance and Management of Small and Medium Scale Enterprises in Lagos-Nigeria' (2017) 3(2) IJRDO- Journal of Business Management 1

[39] For examples of disclosure requirements on financial reporting and company accounts, see Part 15 of the Companies Act 2006 and SI 2008/409 The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008

[40] D.A. Katz and L.A. McIntosh, 'Corporate Governance Update: "Materiality" in America and Abroad' (Harvard Law School Forum on Corporate Governance, 1 May 2021) <https://corpgov.law.harvard.edu/2021/05/01/corporate-governance-update-materiality-in-america-and-abroad/> accessed 25th June 2021.

[41] ibid. See also the Nigerian Code of Corporate Governance 2018

[42] See *Farepak Foods and Gifts Ltd and others v Revenue and Customs and Another* [2006] EWHC 3272 (Ch) and proposed consumer preference legislation

In Nigeria, it could be argued that there are legal frameworks that foster corporate governance practices in SMEs. The Code of Best Practices for Corporate Governance was adopted in 2002 and revised in 2018. It also necessitates an examination of the extent to which corporate governance codes contribute to SMEs. However, it must be acknowledged that codes only constitute a source of regulation. At present, the corporate governance code does not have the same binding effect across the board. This problem might not be exclusive to Nigeria as most codes are soft laws which are formulated on a "comply or explain" basis. Thus, SMEs might face a comparatively higher compliance cost, in respect of corporate governance practices, than larger firms. Kajola suggests that public listed firms are more likely to be adherent to good corporate governance practice, as there is a correlation between adherence and positive financial results for a company.[43] Further, he observes that adherence to good corporate governance practice could also impact on a company's cost of equity, debt and market transactions. He notes that public quoted firms are driven by the desire to attract investment, whereas SMEs largely exist for sustenance and do not have the drive to comply with corporate governance.[44]

With respect to the state of the economy, Nigeria – like many other nations of the world – is faced with an ongoing public health crisis – the COVID-19 pandemic, which has had a significant impact on businesses, with SMEs among the hardest hit. Furthermore, Nigeria experienced an economic recession between April and June 2016,[45] and again in 2020;[46] the country is only just said to be recovering, although this very fact is debatable.[47] During the

[43] I. Kajola, 'Corporate Governance and firm performance: the case of Nigeria listed firms' (2008) 14(14) European Journal of Economics, Finance and Administration Science 200
[44] ibid.
[45] P. C. Mba et al, 'Effect of Economic Recession on the Performance of Manufacturing Firms in Enugu State' (2018) 7(2) Internal Journal of Academic Research in Economics and Management Sciences 32, 34.
[46] N. Munshi, 'Nigeria slumps back into recession as Covid bites' (Financial Times, 21 November 2020) <https://www.ft.com/content/ea70f0b4-5f13-423b-b1ed-6d6c424d1b91> accessed 20 June 2021
[47] R. Olurounbi, 'Nigeria should brace for 'its worst recession in four decades'' (The Africa Report, 27 August 2020) <https://www.theafricareport.com/39196/nigeria-should-brace-for-its-worst-recession-in-four-decades/> accessed 8 June 2021.

recession, businesses (including SMEs) bore the brunt of stringent economic policies.[48] Restrictions were placed on the foreign exchange market, and business owners could not readily obtain the Central Bank rate for foreign currency (foreign exchange), which is required for the import of raw materials.[49] As a result, recourse was taken to the black market for foreign exchange, which is known to have comparatively higher exchange rates.[50] Unsurprisingly, a significant proportion of SME owners struggled to stay afloat. Also, in a recession, microfinance banks who provide credit for SMEs to stay afloat might lack sufficient funds to stay afloat and provide needed credit to struggling SMEs. While large banks with many customers and huge deposits can be rescued by the Nigeria Deposit Insurance Commission (NDIC), they might have little appetite to rescue smaller or microfinance banks. This has a knock-on effect on SMEs as they are the regular providers of finance for SMEs. This ultimately impacts SMEs and their ability to access finance. Therefore, it is not far-fetched to suggest that in an economic climate, where SMEs struggle for survival, compliance with corporate governance would be at the very bottom of the average SME's agenda. Overall, it could be argued that Nigeria's economic situation limits SMEs' ability to carry out business and contribute to the Nigerian economy, while also increasing the likelihood of SMEs trivialising corporate governance.

1.5. Research Question

This thesis examines selected corporate governance issues facing SMEs in Nigeria and the framework in place to address these issues. It compares provisions in the frameworks with similar provisions in the UK. The aim of the above is to identify suitable corporate governance mechanisms that could prove workable for SMEs in Nigeria, considering that Nigeria is still a

[48] E. A. Agbata and G. O. Okafor, 'Managing the Impact of Economic Recession on Nigerian Economy: The Role of Management Accountants' (2018) 6(3) Asian Journal of Economics, Business and Accounting 1, 3.
[49] A. O. Adeniran and B. O. Sidiq, 'Economic Recession and the Way-Out: Nigeria as a Case Study' (2018) 18(1) Global Journal of Human Social-Science: Economics 1, 2.
[50] ibid.

developing country with her unique issues. It is important to stress at this stage, that this thesis does not address every corporate governance issue facing SMEs in Nigeria. However, it endeavours to addresses some of their key governance issues; it characterises these challenges as the external and internal problems. Furthermore, it explores prospects for reform to address these issues. This thesis also considers the governance of SMEs vis-à-vis their financing options. Further, it aims to contribute to the field that studies the importance of an effective, healthy and functioning corporate governance mechanism for SMEs. Hence, the main research question is:

To what extent are the frameworks on companies in Nigeria capable of addressing the selected governance issues typical to SMEs in contradistinction to the laws on companies in the UK?

To answer this central question, this thesis will be exploring the following questions:

- Why are SMEs important, and what makes them vulnerable?
- What are the external and internal corporate governance issues that face SMEs in Nigeria?
- What benefits, if any, does corporate governance hold within the context of SMEs?
-Why is access to finance crucial for SMEs?
-Why is it important for distressed or insolvent SMEs to be rescued?

These questions will be critically discussed in tandem with the position in the UK.

There are several intellectual benefits of this research. Firstly, it adds to the existing literature on the importance of SMEs. Secondly, it aims to enlighten the Nigerian government, lawmakers and policy makers, on the importance of an effective corporate governance mechanism for SMEs. The importance of this objective is heightened by the fact that SMEs make up the bulk of the businesses in Nigeria; as such, they are economically significant

entities with the capacity to affect diverse stakeholders in Nigeria. Accordingly, it is important that these businesses are governed appropriately. In answering the aforementioned questions, this thesis utilises certain research methods. They are as discussed below.

1.6. Research Method

This thesis deploys a two-fold research method, which comprises the doctrinal and comparative analysis methods with an additional focus on the legal transplant method. It should be stated that due to nature of the topic under enquiry, the thesis also makes use of inter-disciplinary research by drawing upon literature in economics, business and sociology. This multi-faceted approach ultimately serves to enrich the quality and depth of this research.

1.6.1. Doctrinal Method

The doctrinal method is deployed in this thesis because it is widely regarded as the black letter[51] or traditional legal research method.[52] Principally, it entails the analysis of legal rules in the formulation of legal doctrines.[53] Salter and Mason define it as a research method geared towards addressing uncertainties and gaps in existing law by analysing and giving a systematic exposition of the rules, concepts, principles and context of a specific field of study.[54] The doctrinal research method has three central objectives; namely to describe, prescribe and justify.[55] This basically connotes describing the current legal regulation and identifying possible loopholes, prescribing prospects for reform or amendment and justifying the reasoning for the prescription with convincing and appropriate explanations.

The doctrinal research method can be broadly grouped into four stages. The first stage involves

[51] M. Salter and J. Mason, *Writing Law Dissertations: An Introduction and Guide to the Conduct of Legal Research* (Pearson, 2007) 31.
[52] A. K. Singhal and I. Malik, 'Doctrinal and socio-legal methods of research: merits and demerits' (2012) 2 Educational Research Journal 252
[53] P. Chynoweth, *Legal research*, in A. Knight and L. Ruddock, *Advanced research methods in the built environment*, (Wiley-Blackwell, 2008) 29
[54] Salter and Mason (n 34) 2.
[55] J. M. Smits, 'What is legal doctrine? On the aims and methods of legal-dogmatic research', Maastricht European Private Law Institute, Working Paper, No.2015/06, 8. <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2644088> accessed 18 June 2018

analysing legal issues in order to identify the issue(s) that require further examination. The second stage entails determining the relevant law that is applicable to the issue(s). The third stage involves analysing the facts in terms of the law, with the objective of fusing the issues raised with the appropriate rules. Lastly, and upon conducting this examination, a probable conclusion is reached based on the facts established and the law considered.[56]

This thesis examines legal regulations that pertain to business enterprises in Nigeria generally, the regulations applied to SMEs, as well as those specifically charged with improving the ease of business to attract inward investment. It notes that cumulatively, the legal regulations prove inadequate in promoting good corporate governance in SMEs.[57] In some respects, the current legal regulations fail to cover certain material aspects of corporate governance, whereas, in other instances, the problem is one of enforcing existing legal regulations on corporate governance.[58] In relation to the latter instance, the thesis proffers possible solutions to make these legal regulations function more efficiently based on comparison with similar provisions in the UK.[59]

1.6.2. Comparative Analysis

Another research method deployed in this thesis is the comparative analysis. This is achieved by comparing the legal provisions regulating businesses (specifically SMEs) in the Nigerian market with analogous provisions in the UK. Particular attention is given to the Corporate Governance Codes regulating business enterprises in Nigeria and the UK. The comparative analysis method entails the examination of rules and procedures of one system in tandem with the equivalent rules and procedures in one or more other system(s).[60] Broadly speaking, a comparative analysis is the study of the similarities, nuances and more pronounced differences

[56] ibid
[57] See discussion in Chapter 3 at 3.7.
[58] See discussion in Chapter 3 at 3.10.1.
[59] See discussion in Chapter 3 at 3.11.
[60] A.Watson, *Legal transplants: An approach to comparative law*, (2nd edition, University of Georgia Press 1993) 2.

between the laws of two or more countries or between two or more legal systems. Comparative analysis purposes to make a specific aspect of domestic law more coherent by external comparison. Gottwald suggests that to improve a legal system, it is important to consider what obtains on the other side of the border, i.e. in other countries, especially if the area sought to be improved is already thriving in the other country.[61] However, it is arguable that importing solutions from other countries may not always be feasible due to practical differences in context.

In recent times, the comparative legal research method has gained considerable popularity. An illustration worthy of note in this regard is the effort to harmonise the law of the EU member states.[62] There are three possible ways of carrying out a comparative analysis, namely: comparative history of law, descriptive comparative law and comparative legislation or comparative jurisprudence.[63] The third category, comparative legislation, applies to this thesis. This represents the effort to define the common basis on which present national doctrines of law are designed to attach themselves because of both the development of the study of law as a social science and of the legal consciousness.[64]

Although comparative analysis is often utilised, there have been notable disadvantages of this research method. As a starting point, it is arguably shallow because it does not offer in-depth knowledge of one branch of the law of one system, as well as the history of that branch and its relationship with that of another system.[65] Furthermore, a possibility exists of wrongly applying the foreign law in question.[66] Another shortcoming in comparative analysis is an error of the law. Arguably, this is because the understanding of the foreign law is largely dependent on the

[61] P. Gottwald, 'Comparative Civil Procedure' (2005) 22 Ritsumeikan Law Review 23.
[62] M.V. Hoecke and M. Harrington, 'Legal cultures, legal paradigms and legal doctrine: Towards a new model for comparative law' (1998) 47 International and Comparative Law Quarterly 495
[63] Watson (n 40)
[64] ibid
[65] ibid
[66] H. C. Gutteridge, *Comparative law*, (2nd Edition, Cambridge University press 1946) 15

writings of others, including other comparative analysts.[67] It has been held that too often, little knowledge is derived from too few original sources, and too frequently linguistic deficiencies interpose a formidable barrier between the scholar and his subject.[68] Additionally, the systems being studied may not be sufficiently related to each other; the danger with this is that the conclusions reached might be insignificant.

Nevertheless, the comparative analysis method is apt for this thesis because both countries operate a common law system and possess broadly similar companies' legislation. Historically, Nigerian laws – particularly the legal rules governing economic organisation – have been adopted from the UK both in its systemic and single-rule variations. Notably, the first ever-Nigerian Company legislation was the Companies Ordinance of 1912, which domesticated the Companies (Consolidation) Act 1908 of England. Similarly, the current companies' legislation in Nigeria – the Companies and Allied Matters Act (CAMA) – mirrors the provisions of the U.K Companies Act 1985.[69]

Based on the foregoing, it is suggested that an application of comparative analysis in this thesis is advantageous in various respects. Firstly, a comparison of the laws and codes in Nigeria and the UK provides an avenue for the development of Nigeria's legal framework. This is because an evaluation of the UK laws can lead to better understanding and promote the corresponding need to implement the same in the Nigerian legal framework. Indeed, it is plausible that the laws regulating Nigerian business entities (particularly SMEs) could potentially be enhanced by applying the relevant sections of analogous UK provisions that are favourable to the Nigerian context.

Furthermore, this thesis highlights some inadequacies in the legal framework regulating Nigerian business enterprises, particularly with respect to corporate governance issues and

[67] Watson (n 40)
[68] ibid
[69] Companies and Allied Matters Act 2020

SMEs. While it is conceivable that these problems were once present in the UK, the country has arguably adapted its legal regulations to cope with modern-day demands and reality. Notably, there have been recent policies and legislative changes[70] in Nigeria (which are similar to what obtains in the UK); however, these have ultimately proved abortive and fallen short in terms of efficient enforcement.[71]

In addition to the foregoing, the thesis adopts a comparative analysis of SMEs and large enterprises. It examines the regulatory frameworks for SMEs and large enterprises with a view to discovering the level of compliance with corporate governance practices as well as the effects of compliance. Although the focus of the thesis is on SMEs registered as private companies, it also juxtaposes companies and other business vehicles such as registered business names, limited partnerships and limited liability partnerships. This is predicated on the earlier mentioned fact that the bulk of SMEs in Nigeria are registered as business names. Accordingly, the thesis examines and compares the various business vehicles on their corporate and financial governance.

In the section that follows, an aspect of the comparative analysis method – '*legal transplants'* – is discussed. It is essential to discuss this research method because this thesis proffers several recommendations based on how these issues have been addressed in the UK, with the aim of achieving the same in Nigeria.

1.6.2.1. Legal Transplants

The origin of legal transplant is widely associated with the name of Professor Alan Watson, a renowned legal historian.[72] As a research method, it involves moving a system of law or legal

[70] For a discussion on such recent policies and legislative changes, see Chapter 3 at 3.10.
[71] E.O. Ajibola, 'Nigeria Small and Medium Enterprise Sustainability Strategies' (Walden University: Walden Dissertations and Doctoral Studies, 2020) <https://scholarworks.waldenu.edu/cgi/viewcontent.cgi?article=11182&context=dissertations> accessed 14 June 2021.
[72] B. Kviatek, *Explaining Legal Transplants: Transplantation of EU Law into Central Eastern Europe* (University of Groningen, 2015) 15

rule from one country to another, or from one people to another.[73] It can be conceptualised as an offshoot of globalisation. This is because legal knowledge transcends geographical borders and enables the key players in a country's legal system to import legal solutions for local problems from the global space of legal ideas.[74] Centrally, legal transplant aims to enable a country to compare its laws with those in other countries.[75]

One can safely assert that legal transplants are common.[76] In fact, it has been suggested that the majority of the changes in most legal systems are the direct result of legal transplant.[77] By this reasoning, it is arguably the most common source of legal developments.[78] A careful look at the history of a given legal system would reveal that it has, at some point, drawn upon legal materials from other legal systems and integrated ideas from outside of the law.[79] Nevertheless, legal transplants may vary, from the holistic adoption of an entire legal system to the importation of a single rule.[80]

As earlier mentioned, Nigeria recently went through an economic recession and is just recovering.[81] Studying Nigeria's economic realities and its impact of business is beneficial at this stage because if SMEs operate in a thriving economy, they are more likely to adopt good corporate governance practices. Nevertheless, it is arguable that the rules regulating businesses in the UK as well as the UK's corporate governance frameworks may prove unworkable in Nigeria. Nigeria is widely regarded as a developing country, whereas the UK is a developed country. However, being a former British colony, common law migrated quite naturally into

[73] Watson (n 40)
[74] M. A. Waters, 'The future of transnational judicial dialogue' (2010) 104 American Society of International Legal Procedures 465
[75] ibid
[76] ibid.
[77] Alan Watson, Society and Legal Change (Scottish Academic Press, 1977)
[78] D. Berkowitz, K. Pistor and J. F Richard, 'The transplant effect' (2002) 51 American Journal of Comparative Law 170
[79] R. H. Lowie, *Primitive society*, (New York 1920) 441
[80] H. Kanda and C. J. Milhaupt, 'Re-examining legal transplants: The director's fiduciary duty in Japanese corporate law' (2003) 51 American Journal of Comparative Law 887
[81] A. Nevin and others, 'Nigeria's Economic Recovery: Defining the Path for Economic Growth' (2017) <www.pwc.com/ng/en/assets/pdf/nigerias-economic-recovery.pdf> accessed 16 June 2018

Nigeria.[82] Accordingly, the Nigerian legal and judicial systems are modelled after the UK. It is plausible that even if this were not so, lawmakers in developing countries are always seeking to improve their legal orders to attract capital due to international competition.[83] As such, they are likely to compare their provisions with more developed countries with a view to develop theirs.

Based on the foregoing, it is suggested that the recommendations and suggestions proffered in this thesis will effectively set out how selected corporate governance challenges encountered by SMEs in Nigeria may be addressed. It is suggested that the transplantation of legal codes into Nigeria is not novel. For instance, Elias records that legal transplantation has featured in Nigeria since the nineteenth century.[84] The legal rules governing economic organisation in Nigeria further lend proof to the transplant phenomenon both in its systemic and single-rule variations. In practical terms, it has been noted so far that company laws and regulations in Nigeria have largely been based on UK company laws. Nevertheless, the reality of transplanting regulations in Nigeria remains marked by some challenges. In fact, it has been argued that Nigeria exhibits the characteristics of an ineffective legal system, which is largely attributable to the unsuccessful transplant of UK corporate laws.[85] Other factors cited as being responsible for this failure include, but are not limited to, the following: an ineffective judiciary; high-rate corruption; and the difficulty in enforcing existing laws.[86]

It is suggested that the recommendations and areas for reform advanced in this thesis will be beneficial in ensuring more effective regulation of Nigerian businesses (particularly SMEs). They will also foster a considerable measure of adherence of SMEs to the tenets of good

[82] D. Nelken and J. Feest, *Adapting legal culture*, (Hart Publishing 2001) 94
[83] D. Campbell and M. Siems, 'Convergence, legal origins for transplants in comparative corporate law: A case based and quantitative analysis' (2015) 63 American Journal of Comparative Law 114
[84] T. O. Elias, *The Nigerian legal system* (Oxford University Press 1963) 3
[85] J. A. Arewa, 'Evolution of the Nigerian legal order: implication for effectiveness, economic growth and sustainable development' (2012) 1 NIALS Journal of Law and Public Policy 1, 3-5
[86] ibid

corporate governance. Arguably, for a legal transplant to be successful, it must be adapted to the receiving country's general and legal culture.[87] For the law to be effective, it must be meaningful in the context in which it is to be applied, as this creates an incentive to use the law and hold institutions to account so that they work to enforce, develop and modify the law.[88] In any event, it has been suggested that the transplant of laws may be more feasible if there is some familiarity with the legal system used as a model for borrowing.[89] Undoubtedly, the Nigerian legal system draws extensively from the UK due to colonialism, and by this reasoning, legal transplantation should be relatively straightforward.

1.7. Structure of The Thesis

In answering the primary research question, this thesis unfolds in six chapters. Each chapter aims to pay considerable attention to SMEs' finances, management, and social environment in Nigeria.

Chapter two evaluates SMEs. It starts by discussing their importance and vulnerability. It then proceeds to discuss the external and internal corporate governance challenges facing small private companies in Nigeria, albeit limited. It starts by discussing external corporate governance issues facing SMEs in Nigeria, such as insufficient capital and corruption. Thereafter, it discusses the management and shareholder conflict as a major internal corporate governance challenge affecting small private companies in Nigeria. Furthermore, it considers the regulatory frameworks applicable to small private companies and how they differ from those that apply to large, listed companies. The chapter concludes by discussing the precarious position of SMEs in the context of wrongful trading and insolvency.

[87] L. F. Del Duca and A. A. Levasseur, 'Impact of legal culture and legal transplants on the evolution of the U.S legal system' (2010) 58 American Journal of Comparative Law 1

[88] H. Kanda and C. J. Milhaupt, 'Re-examining legal transplants: The directors fiduciary duty in Japanese corporate law' (2003) 51 American Journal of Comparative Law 890

[89] ibid

Chapter three begins by elaborating on the concept of corporate governance, vis-a-vis the various theories that have been propounded. It explores these theories and mechanisms of corporate governance in view of their potential applicability to SMEs, particularly small private companies. Furthermore, it examines the internal and external challenges faced by SMEs, and highlights why it is crucial for SMEs to adopt a healthy and functioning corporate governance mechanism. Recognising the importance of good corporate governance for SMEs, the thesis considers what an ideal corporate governance mechanism for SMEs could look like. A detailed examination is undertaken of the existing corporate governance codes and regulations both in Nigeria and the UK.

Chapter four examines the importance of access and the availability of finance to SMEs both at start-up and trading phases. Furthermore, it explores the various sources of finance to SMEs in light of the different available business vehicles. The mechanisms in place provided by both the Nigerian and the UK government to extend finance to SMEs as well as how effective they are will also be briefly discussed. Furthermore, how SMEs can procure finance in the alternative finance market will also be explored. Undeniably, the lack of access to finance could lead to insolvency, and the next chapter considers insolvency finance.

Chapter five considers corporate insolvency in the context of small private companies. It introduces and compares the legal framework regulating insolvency and its procedures both in the UK and in Nigeria. Particular attention is paid to how these frameworks encourage or hinder small private companies' rescue in insolvency. This chapter also explores how SMEs can procure rescue finance in an insolvency zone in order to be rescued.

Notably, selected governance issues facing SMEs are examined in Chapter three, four and five. This is justifiable because of the multi-faceted nature of SME governance and governance issues. Specifically, the thesis considers governance issues peculiar to SMEs' internal and external structure (Chapter 3); governance issues pertaining to SME financing (Chapter 4); and

the governance of distressed SMEs (Chapter 5). The selected governance issues are interrelated and can be conceptualised as the governance cycle of SMEs. To illustrate, it is essential for SMEs to be well governed (both internally and externally), as this increases their access to low cost-financing. Moreover, SMEs that adopt sound corporate governance practices (such as financial governance) are less prone to insolvency and financial distress. Nevertheless, where an SME falls into distress, the thesis suggests that the right governance practices can facilitate its rescue.

Chapter six gives a reasoned conclusion of this thesis by summarising the issues identified and discussed. It further proffers some recommendations for the governance of SMEs in Nigeria. Lastly, the author's thoughts on the future of corporate governance, with particular reference to SMEs, will be presented.

1.8. Conclusion

This thesis considers that while SMEs are important to any given nation, they are plagued by a number of governance issues, particularly their finance and insolvency-related issues. It posits that the existing corporate governance mechanism regulating businesses in Nigeria have been largely inadequate, having regard to comparable jurisdictions such as the UK. It also notes that there is a general lack of incentive amongst SME owners to adopt good corporate governance practices. Furthermore, it suggests that even where the appropriate corporate governance mechanism exists, there is, sometimes, difficulty in enforcing and ensuring adherence to the existing corporate governance codes and tenets. However, it is important to stress the fact that the issues highlighted above and those discussed in the thesis, are not exhaustive. Nevertheless, they provide a lens through which to understand and address the corporate governance challenges faced by SMEs in Nigeria. By extension, they offer insight into the possible ways Nigeria could better cater for the SME sector and, in turn, boost the economy.

Chapter 2

2. A Critical Examination of SMEs

2.1. Introduction

This chapter examines SMEs vis-à-vis the concept of corporate governance. It starts by revisiting[1] and expounding the subject of SMEs, with a focus on the criteria by which they are defined. The chapter then proceeds to discuss the external and internal corporate governance challenges facing SMEs in Nigeria. It starts by addressing the external corporate governance issues facing SMEs in Nigeria, including – but not limited to – insufficient capital (including the issue of access to low-cost capital) and corruption. Thereafter, it discusses the major internal corporate governance challenges for SMEs in Nigeria, such as the manager and shareholder tension.[2] Furthermore, this chapter discusses the different regulatory frameworks governing small private companies. Specifically, it considers how SMEs are often exempted from the regulatory regime applicable to larger companies. Salient provisions of the Companies and Allied Matters Act[3] and the Draft Companies Regulations[4] are deployed to advance this argument. Some of the points discussed include (but are not limited to) the exemption from the requirement of filing annual returns and the lack of minimum start-up capital for small companies. To conclude, the chapter considers wrongful and fraudulent trading as potential consequences of the different regulatory regime governing SMEs. It is argued that because SMEs are largely exempted from the regulatory frameworks applicable to larger companies, wrongful and fraudulent trading become likely, often yielding dire outcomes.[5]

[1] See 1.1. above. (n 1).
[2] For a discussion on the agency problem, see S. Ross, 'The economic theory of agency: The principal's problem' (1973) 63(2) *American Economic Review* 134; M. Jensen and W. Meckling, 'Theory of the firm: managerial behaviour, agency costs and ownership structure (1976) 3 Journal of Financial Economics 305, 308.
[3] Companies and Allied Matters Act, 2020
[4] Draft Companies Regulations 2020
[5] **See discussions in 2.12 below *et seq*.**

2.2. Defining SMEs

At this point, it is worth restating in more detail what is meant by SMEs as discussed in the thesis. However, it should be appreciated that this definitional exercise is not straightforward. Indeed, Amuchie submits that the concept of SMEs is relative and dynamic; hence, there is no universally accepted definition for SMEs.[6] Nevertheless, within the fixed coordinates of national boundaries, it might be relatively easier to define SMEs. This is because each country tends to derive its definition based on the role SMEs are expected to play in the country's economic development and socio-cultural landscape.[7] Therefore, the definitions ascribed to SMEs often reflect the differing economic patterns of a country as well as its cultural and social dimensions.

While some countries rely on the number of employees as a distinctive metric for defining SMEs, others (such as the UK) rely on the invested capital or a combination of the number of employees, invested capital, turnover and operative industry.[8] For instance, the UK uses a combination of these metrics. In the UK, small companies are those with a turnover of £10.2 million or less, a balance sheet total of £5.1 million or less, and not more than 50 employees.[9] Medium-sized companies refer to those with a turnover of £36 million or less, balance sheet total of £18 million or less, and not more than 250 employees.[10] However, in relation to non-statutory policies, there appears to be a distinction between SMEs and mid-sized businesses. The Department for Business Innovation & Skills (now known as the Department for Business, Energy, and Industrial Strategy) defines SMEs as businesses with a turnover of up to £25m; whereas mid-sized businesses are businesses with a turnover of between £25m and £500m.[11]

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[6] A. Amuchie, 'Creating Employment via Small and Medium Scale Enterprises: The Case of Nigeria' (2015) 8 Journal of Poverty, Investment and Development 47, 48.
[7] ibid.
[8] R. Dababneh and F. Turkan, *Booklet of Standardized Small and Medium Sized Enterprises Definition- 2007* (Washington D.C.: A publication of USAID, 2007) 2.
[9] Companies Act 2006, s 382(3)
[10] Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015, part 2, regulation 9
[11] Department for Business, Innovation and Skills, 'Mid-sized businesses' (DBIS, 30 June 2012) <https://www.gov.uk/government/collections/mid-sized-businesses> accessed 10 December, 2018.

Suffice it to state that quantitative or qualitative criteria largely define SMEs, the former being more common.[12] This is perhaps unsurprising because quantitative criteria allow for delimitation between categories of SMEs, i.e. small enterprises on the one hand and medium-sized enterprises on the other hand. Moreover, SMEs are referred to by adjectives indicating size; thus, they tend to be divided into classes according to quantitative, measurable indicators. When viewed this way, the quantitative approach is arguably more pragmatic and accords with common sense. However, Berisha and Pula note that while the dominant approach to defining SMEs is in terms of numbers, it is still difficult to find two institutions or countries that speak the same language when defining SMEs.[13] Nevertheless, for definitional convenience, this paper adopts a quantitative approach to outlining the meaning of SMEs. It considers, as earlier stated,[14] that an SME in Nigeria is a business organisation with a turnover not exceeding N50 million (Fifty Million Naira)[15] per annum with less than 50 employees (for a small business); and turnover not exceeding N500 million (Five Hundred Million Naira) with less than 200 employees (for a medium-sized business).

2.3. Understanding the Utility of SMEs

This discussion would be incomplete without giving due consideration to the nature and extent of SMEs' importance. Undoubtedly, the importance of SMEs to the proper functioning of a nation and its economy cannot be overemphasised.[16] Globally, SMEs are viewed as a potent driver of economic growth.[17] This is largely made possible by the fact that the bulk of global

[12] M. Buculescu, 'Harmonization process in defining small and medium-sized enterprises: Arguments for a quantitative definition versus a qualitative' (2013) 20(9) Theoretical and Applied Economics 103, 108.
[13] G. Berisha and J. S. Pula, 'Defining Small and Medium Enterprises: a critical review' (2015) 1(1) Academic Journal of Business, Administration, Law and Social Sciences 17, 19.
[14] ibid. See **Chapter 1, at 1.1.**
[15] An equivalent of £209,537 as of 27th June 2021.
[16] T. Anigbogu et al, 'Role of Small and Medium Scale Enterprises in Community Development: Evidence from Anambra South Senatorial Zone, Anambra State' (2014) 4(8) International Journal of Academic Research in Business and Social Sciences 302, 303.
[17] D. J. Storey, *Understanding the Small Business Sector* (London: Routledge, 1994) 24.

corporate and business activity emanates from SMEs.[18] Milman also confirms that the majority of companies in the UK are small private companies (SMEs).[19] Indeed, Milman's estimation holds true when viewing statistical evidence. Recent data from the Companies House reveals that 93% (or 4,539,191) of companies in the Register are listed as private limited companies.[20] It is worth noting, however, that not all SMEs are necessarily registered as companies.

Nevertheless, within the EU, SMEs are said to represent 99% of the business population.[21] A similar statistic can be seen in the Asia-Pacific Region, where it is estimated that SMEs form 96% of the total business number.[22] Given their dominance in numerical terms, it is safe to conclude that SMEs invariably play a crucial role in the functioning of a nation's economy. Accordingly, SMEs performance has the propensity to affect a nation's economic growth and development, either positively or adversely.[23] Put differently, when SMEs thrive, a nation's economy is bound to follow suit. Conversely, when SMEs decline or fail to perform at the optimal level, this could adversely impact a nation's economy.[24]

SMEs are important for a number of reasons. Eniola and Entebang argue that SMEs are important because they provide gainful employment for all those who are willing and able to work.[25] They argue that because SMEs make up the largest business sector in every world

[18] D. Hassan, S. Aku and H. Aboki, 'Small and Medium Enterprises: A Tool for Economic Growth and Development in Nigeria' (2017) 3(9) International Journal of Advanced Academic Research, Social & Management Sciences 130, 132.

[19] D. Milman, 'Regulating close companies in Corporate Law: Towards a more formal recognition?' (2017) 46(3) Common Law World Review 198, 199.

[20] Companies House, 'Official Statistics: Companies register activities 2019-2020' <https://www.gov.uk/government/statistics/companies-register-activities-statistical-release-2020-to-2021/companies-register-activities-2020-to-2021> accessed 25 June 2021

[21] European Commission, 'Access to Finance for SMEs' <http://ec.europa.eu/growth/access-to-finance_en> accessed 29 November 2018.

[22] Asian Development Bank, 'Asia's SMEs Need Growth Capital to Become More Competitive—ADB Report' <www.adb.org/news/asia-s-smes-need-growth-capital-become-more-competitive-adb-report> accessed 4 December 2018.

[23] M.O. Agwu and E. Emeti, 'Challenges and Prospects of Small and Medium Scale Enterprises (SMEs) in Port-Harcourt City, Nigeria' (2014) 3(1) European Journal of Sustainable Development 101, 102.

[24] ibid

[25] A. A. Eniola and H. Entebang, 'SME firms performance in Nigeria: Competitive advantage and its impact' (2014) 3(2) International Journal of Research Studies in Management 75, 77.

economy, they account for the bulk of global business activity.[26] Thus, they are able to contribute to employment growth at a higher rate than larger firms. Confirming this assertion, Peacock's study revealed that at a macro level, SMEs have accounted for the creation of the majority of new jobs in OECD[27] countries since the 1970s.[28] Furthermore, it has been estimated that the SME sector provides over 84% of Nigeria's employment and 48% of the nation's GDP.[29] A similar figure is recorded in the UK, where SMEs account for 61% of employment in the private sector.[30]

In addition to providing formal employment, SMEs are noted to be a breeding ground for domestic entrepreneurial capabilities.[31] Entrepreneurship is said to provide a form of alternative to the traditional model of employment, i.e. employee-employer relationship.[32] It allows individuals to pursue their business interests; and in so doing, harness their creative capabilities and innovation.[33] The importance of employment and entrepreneurial opportunities is heightened in a country like Nigeria, where over 65% of the national population is estimated to be below the age of 35 years.[34] Given Nigeria's relatively young and employable population, it follows that ample employment opportunities are essential for the nation to succeed and maximise its economic potential. Nevertheless, it has been suggested that entrepreneurship has

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[26] ibid

[27] The OECD (also known as Organisation for Economic Co-operation and Development) is an intergovernmental economic organisation comprising 34 industrialised countries. It seeks to promote policies that will improve the economic and social welfare of people around the world. It also provides a forum in which governments can work together to share experiences and seek solutions to common problems. See OECD, 'About the OECD' <www.oecd.org/about/> accessed 10 December 2018.

[28] R. W. Peacock, *Understanding Small Business: Practice, Theory and Research* (Scarman Publishing: Adelaide, 2004) 13.

[29] G. Faminu, 'MSMEs: Oiling the wheels of Nigerian economy' (Business Day, 30 January 2020) <https://businessday.ng/business-economy/article/msmes-aolingg-the-weels-of-nigerian-economy/> accessed 6 March 2021

[30] Matthew Ward, 'Business Statistics' Briefing Paper Number 06152 (House of Commons Library, 22 January 2021) <https://researchbriefings.files.parliament.uk/documents/SN06152/SN06152.pdf> accessed 6 March 2021

[31] O. C. Aina, 'The Role of SMEs in Poverty Alleviation in Nigeria' (2007) 3(1) Journal of Land Use and Development Studies 124, 126.

[32] B. Clerico, 'Entrepreneurship Is Both Job Creator and Job Alternative' (Entrepreneur, September 3, 2014) <www.entrepreneur.com/article/237035> accessed 10 December 2018.

[33] D. Ribeiro-Soriano 'Small business and entrepreneurship: their role in economic and social development' (2017) 29(1-2) Entrepreneurship and Regional Development 1, 3.

[34] M B. Shettima, 'Impact of SMEs on Employment Generation in Nigeria' (2017) 22(9) IOSR Journal of Humanities and Social Science 43

a direct and positive impact on SME growth, as entrepreneurs typically set up their businesses[35] in the form of SMEs.[36] The implication of this is that there is a firm link between SMEs and entrepreneurship.

Similarly, SMEs are said to engage in primary and secondary economic activities that are heavily dependent on locally sourced materials. As such, they achieve high value-added operations, which is equally vital to economic growth and development.[37] Indeed, it has been posited that SMEs have a prodigious potential for sustainable development.[38] Nevertheless, with respect to economic development, s*tricto sensu*, it is arguable that SMEs not only strengthen a nation's economy but also enable it to withstand challenging periods. For instance, Landstrom and Frank conclude that it is through the growth of SMEs that employees made redundant by large firms (particularly during periods of the economic downturn) have been "absorbed into the workforce."[39] By the operation of the multiplier effect, the employment generated by SMEs provides income to regions, which stimulates a nation's economic activity, and in turn, drives wealth and further employment generation.[40] Still, in view of economic development, SMEs' contributions to the Gross Domestic Product (GDP) of a nation cannot be understated. For instance, it is estimated that SMEs contribute approximately 30% to the GDP in Australia and New Zealand; 51% of the GDP in the UK and USA; 57% of the GDP in

[35] Entrepreneurship is strengthened by the ease of setting up a private limited company in Nigeria and the UK. Under CAMA 2020, for instance, it is now possible for a private limited company to be incorporated in Nigeria, with a single member and single director. The position is the same in the UK (see s.123(1) and 154(1) CA 06).
[36] O. E. Abdul, 'Entrepreneurial Skills and growth of Small and Medium Enterprise (SMEs): A comparative analysis of Nigerian entrepreneurs and Minority entrepreneurs in the UK' (2018) MPRA Paper No. 87651 <https://mpra.ub.uni-muenchen.de/86751/>accessed 11 December 2018.
[37] K. O. Oduntan, 'The Role of Small and Medium Enterprises in Economic Development: The Nigerian Experience' International Conference on Arts, Economics and Management (March 22, 2014).
[38] Dr. M. O. Agwu, 'Issues, Challenges and Prospects of Small and Medium Scale Enterprises (SMEs) in Port-Harcourt City, Nigeria' (2014) 3(2) European Journal of Sustainable Development 101, 105.
[39] H. Landstrom and Hermann Frank, 'Entrepreneurship and Small Business in Europe: Economic Background and Academic Infrastructure', in Hans Landstrom, Hermann Frank & Jose M Veciana (eds.) *Entrepreneurship and Small Business Research in Europe: AN ECSB Survey* (Ashgate Publishing Ltd, 1997) 3.
[40] E. Walker and B. Webster, 'Gender Issues in Home-Based Businesses' (2004) 19(8) Women in Management Review 404, 406.

Canada and Japan; and 76% of the GDP in Luxembourg.[41] In Nigeria, SME contribution to the GDP stands at 48%.[42] The necessary implication of this is that SMEs, on average, contribute around half of the GDP in most nations.[43]

Furthermore, it has been suggested that SMEs play a huge role in poverty reduction.[44] Poverty remains rife in developing Sub-Saharan African countries of which Nigeria forms a part.[45] Through SMEs, however, rapid industrialisation is achieved, and economic growth is accelerated. This is because the entrepreneurial and innovative ventures in SMEs help to improve the growth of the economy and, in turn, reduce the level of poverty in the economy.[46] To this end, SMEs are said to provide individuals in an economy with income and savings, both of which are essential to eradicating poverty.[47] Overall, the contributions of SMEs to the GDP of a nation assist in tackling poverty.[48]

2.4. Policy Efforts in the UK and in Nigeria to Promote SME Growth

In view of the importance of SMEs to the national economy, both the UK and Nigerian governments have made efforts to cater for this sector by putting in place policies that, at least in theory, will promote their growth and development. A good reference point in the UK is the Government White Paper which immediately preceded the enactment of the Companies Act 2006.[49] In the White Paper, the government noted that UK company law was originally

[41] C. Wang, E.A. Walker and J. Redmond, 'Explaining the Lack of Strategic Planning in SMEs: The Importance of Owner Motivation' (2011) 12(1) International Journal of Organisational Behaviour 1, 5.
[42] Faminu (n 29)
[43] V. M. Pandya, 'Comparative analysis of development of SMEs in developed and developing countries' The 2012 International Conference on Business and Management (Phuket- Thailand, 6 September 2012).
[44] U. O. Oba and C. B. Onuoha, 'The Role of Small and Medium Scale Enterprises in Poverty Reduction in Nigeria: 2001-2011' (2013) 7(4) African Research Review 1, 10.
[45] Having recently overtaken India, Nigeria is now regarded as the poverty capital of the world, with the highest number of people living in extreme poverty. See Yomi Kazeem, 'Nigeria has become the poverty capital of the world' (Quartz Africa, June 25 2018) <https://qz.com/africa/1313380/nigerias-has-the-highest-rate-of-extreme-poverty-globally/> accessed 8 December, 2018.
[46] T. Beck, A. Demirguc-Kunt and R. Levine, 'SMEs, Growth and Poverty: Cross-Country Evidence' (2015) 10(3) Journal of Economic Growth 199, 202.
[47] ibid.
[48] ibid
[49] Department of Trade and Industry, *Company Law Reform* (White Paper, Cm 6456, 2005).

designed for large companies with numerous public investors but acknowledged the reality that the majority of companies are smaller – often owner-managed – companies, i.e., SMEs.

In a bid to address this problem, the government introduced what it referred to as a "Think Small First"[50] Approach. The essence of this approach was to simplify what was hitherto a cumbersome area of law by redesigning it with the small private business (SME) in mind. Whether or not the "think small first" policy successfully achieved this aim remains debatable.[51] Nevertheless, the UK Government has put in place other policies aimed at providing a more enabling business environment for SMEs. For instance, in March 2012, it launched a National Loan Guarantee Scheme to help businesses (especially SMEs) access cheaper finance by reducing the cost of bank loans under the scheme.[52] In addition, the UK Government set up the British Business Bank in 2014 with a view to increasing the supply of credit to SMEs.[53] Since its establishment, the Bank has supported thousands of SMEs with low-cost finance.[54]

Nigeria has also made positive strides with respect to catering for the SME sector. In order to facilitate the growth of SMEs, the Nigerian government has established several financial institutions in charge of microcredit and policy instruments. These include the Nigeria Agricultural Co-operative and Rural Development Bank (NACRDB), Nigerian Bank for Commerce and Industry (NBCI), National Economic Reconstruction Fund (NERFUND) and

[50] Ibid (n 28).

[51] For a detailed discussion of the successes and pitfalls of the think small first policy, see Paul Omar, 'In the Wake of the Companies Act 2006: An Assessment of the Potential Impact of Reforms to Company Law' (2009) 1(2) International Company and Commercial Law Review 44, 51; Marlies Braun, 'So, was the Companies Act 2006 a success?' (Lexology, 18 January 2011) <www.lexology.com/library/detail.aspx?g=6e4d1b7f-2f7a-45ee-bf3f-530d45d32e38> accessed 15 December 2018.

[52] UK Debt Management Office, 'National Loan Guarantee Scheme' <www.dmo.gov.uk/responsibilities/guarantee-schemes/national-loan-guarantee-scheme/> accessed 7 December 2018; See Chapters 3 and 4 for government interventions during the COVID-19 pandemic.

[53] British Business Bank, 'British Business Bank supporting over 98,000 businesses with £8 billion finance, an increase of 21% over the year' <https://www.british-business-bank.co.uk/british-business-bank-supporting-over-98000-businesses-with-8bn-of-finance-an-increase-of-21-over-the-year/> accessed 11 June 2021.

[54] ibid

Bank of Industry (BI), amongst others.[55] Similarly, the Small and Medium Enterprises Equity Investment Scheme (SMEEIS), Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) and other policy-oriented institutions like the Entrepreneurship Development Policy (EDP) run by the National Directorate of Employment (NDE), Industrial Development Centres (IDC), among others, were introduced to offer technical and financial assistance to SMEs.

In addition, the Nigerian Government put in place practical financial incentives aimed at fostering the growth of SMEs. For instance, the Vice-President of Nigeria announced the Federal Government's ("FG") approval of a 90-day special window commencing from 1st October 2018 to 31st December 2018 for the registration of business names at a reduced rate of N5,000 (five thousand Naira) per registration.[56] The cost of registration (which is exclusive of the N500 name reservation fee) was a reduction of the previous registration fee of N10, 000 (ten thousand naira), and is an integral part of the government's wider Business Incentive Strategy (BIS). The government viewed this reduction as necessary to afford micro, small and medium enterprises the opportunity to formalise their businesses, own corporate accounts with banks etc. This, in turn, enabled SMEs to benefit from private loans and other government interventions.[57] In line with the FG's announcement, the Corporate Affairs Commission (the "CAC") issued a public notice on its website confirming that the cost of business name

[55] C. B. Onuoha, 'The Relationship between Government Policies on SMEs and Development: A Study of Selected Countries' (2012) 1(3) AFRREV IJAH 288, 293.

[56] A. Dada, 'Government okays 90-day special window for MSME registration' (The Punch Online, 3 October, 2018) <https://punchng.com/govt-okays-90-day-special-window-for-msme-registration/> accessed 3 January, 2019.

[57] The true objectives of this incentive remain in question. Having been introduced on the eve of the 2019 General Elections, it could be viewed by sceptics – and quite rightly so – as the Government's attempt to score political points in a bid to secure re-election. Moreover, it would appear that this incentive is geared towards ensuring that SMEs no longer operate in the informal economy, which is largely unaccounted for. In other words, that they are no longer hidden from the government's purview. This objective is vital to the government's ability to impose taxes and secure revenue. Nevertheless, incentives such as reduced business registration cost are laudable, as they ensure that SMEs enjoy the benefits of being registered businesses.

registration had been reduced by 50%.[58] Notably, this special window of reduced registration cost was extended from 31st December 2018 to 31st March 2019, representing a 90-day extension period.[59] It was reported that between October 2018 – when the incentive was first launched – and November 2018, there were 39, 000 new business name registrations.[60] This indicates that Nigerian SME owners took full advantage of the government's incentive scheme.[61]

Though commendable, the incentive arguably falls short. In particular, the reduction in registration costs only applies to the registration of business names. However, it does not extend to the registration of other corporate forms such as private limited companies. This is undoubtedly restrictive because it fails to acknowledge that though registered business names account for the bulk of SMEs in Nigeria, they are not the only business form in which SMEs in Nigeria operate.

It is noteworthy, however, that the Companies and Allied Matters Act (CAMA) 2020 has addressed the above concern by reducing the requirements for registration of business concerns more broadly. The legislative intent behind the formulation of the new CAMA 2020 was to remove all unnecessary regulatory requirements for small companies. With regard to companies, there are new incentives for forming a private company under Nigerian law. For

[58] Corporate Affairs Commission, 'Reduction of Cost of Business Names Registration by 50%' (Corporate Affairs Commission, 2 October, 2018) <http://new.cac.gov.ng/home/reduction-cost-business-names-registration-50/> accessed 3 January, 2019

[59] Corporate Affairs Commission, 'Public Notice – Extension of Reduction of Cost of Business Names Registration by 50%' (Corporate Affairs Commission, 31 December, 2018) <http://new.cac.gov.ng/home/public-notice-extension-reduction-cost-business-names-registration-50/>accessed 4 January, 2019.

[60] N. Ekekwe, 'In Two Months, Nigeria registered about 39,000 Businesses' (Tekedia Forum, January 17, 2019) <https://www.tekedia.com/forum/topic/in-two-months-nigeria-registered-about-39000-businesses/?part=1> accessed 17 January, 2019. A business name is the name under which a business trades for commercial purposes in Nigeria. It is typically used to form sole proprietorships and partnerships, without the benefits of incorporation such as separate legal personality. Any person/entity carrying business under a business name must register same within 28 days of operation unless the conditions in s. 814 of CAMA 2020 apply. Failure to register a business name which registered attracts penalties under s.863 of CAMA.

[61] This conclusion finds statistical support in the fact that a large proportion of registered business names in Nigeria are, by definition, SMEs. See PWC, 'MSME Survey 2020 Building to Last: Nigeria report' <https://www.pwc.com/ng/en/assets/pdf/pwc-msme-survey-2020-final.pdf> accessed June 24, 2021

instance, previously, two members were required to form a company. However, one person may now form and incorporate a private company.[62] This provision is particularly beneficial to SME owners of whom a majority constitute registered business names. Furthermore, CAMA 2020 has ushered in electronic filing for the purpose of registration alongside a 65% reduction in filing fees.[63] Consequently, more incorporated SMEs will emerge and thereby enjoy the attendant benefits of being a company such as the ease of access to finance and other legal protections.

2.5. The External Challenges Faced by SMEs

Notwithstanding the aforementioned merits of SMEs, and the government's pro-SME policies, SMEs are still faced with numerous obstacles that limit their growth and survival, particularly in developing countries such as Nigeria.[64] These obstacles have, in turn, led to a higher rate of failure of SMEs in the developing world than in the developed world.[65] Okpara posits that the problems facing SMEs in Africa are unique and should be understood differently from those being faced in the developed world.[66] Nevertheless, he categorises the challenges faced by SMEs in Africa into four broad categories, namely: the administrative; operating; strategic; and exogenous problems.[67]

Administrative constraints relate to the organisational structure and its ability to obtain and develop necessary resources for operation, such as finance and personnel.[68] Operating constraints concern issues of efficient allocation of resources, and they more commonly arise

[62] CAMA 2020, s 18(2)
[63] CAMA 2020, s. 222(12).
[64] J. K Arinaitwe, 'Factors constraining the growth and survival of small-scale businesses: a developing countries analysis' (2006) 8(2) Journal of American Academy of Business, Cambridge 167, 169.
[65] ibid
[66] J. O. Okpara, 'Factors constraining the growth and survival of SMEs in Nigeria: Implications for poverty alleviation' (2011) 34(2) Management Research Review 156, 162.
[67] ibid
[68] N. Hossain, 'Constraints to SME Development in Bangladesh' Job Opportunities and Business Support Program Institutional Reform and the Informal Sector (University of Maryland College Park, October 1998) <http://jobs-group.org/jobsproject/content/publication/const%20sme.pdf>accessed 5 January, 2019.

in the functional areas of SMEs.[69] Examples include marketing, inventory management and operations. The strategic constraints relate to the capability of SME owners to meet the demands of the external environments.[70] It requires that SME owners fully grasp the nature of the business as well as customers' needs. Finally, the exogenous constraints, which are most applicable to SMEs in Nigeria, include corruption and lack of access to capital.[71] The focal point of discussion in this thesis is the exogenous constraints. This is so for two reasons. Firstly, they are more aptly located within the current scope of inquiry.

2.5.1. Insufficient capital/financial resources[72]

The access to cost-effective capital is no doubt instrumental to the success of any business organisation. It has been suggested that the lack thereof severely hampers the growth and smooth operation of SMEs. Although, extensive capital is not always a prerequisite for carrying out successful business activity and it has been suggested that lack of capital can be compensated through creativity and initiative.[73] Admittedly, the strength of these arguments is dependent on the specific type of business in question. For instance, a manufacturing or production business is by nature capital-intensive, often incurring overheads such as the cost of renting/purchasing premises, cost of raw materials, cost of labour as well as the cost of production.[74] In such businesses, one could hardly conceive that the lack of capital can be compensated for through initiative or creativity. Conversely, a start-up business which is driven

[69] B. Clegg, 'Perceptions of growth-impeding constraints acting upon SMEs' operations and the identification and use of transitionary paths to elevate them*'* (2018) 38(3) International Journal of Operations & Product Management 756, 760.
[70] M.O Agwu and E. Emeti, 'Challenges and Prospects of Small and Medium Scale Enterprises (SMEs) in Port-Harcourt City, Nigeria' (2014) 3(1) European Journal of Sustainable Development 101, 105.
[71] ibid
[72] A cursory discussion of the problem is undertaken here. For a more nuanced legal and commercial analysis of the problem, see Chapter 4.
[73] K. M. Kallon, *The Economics of Sierra Leonean Entrepreneurship* (University Press of America, 1990) 34.
[74] R. Banker et al, 'An Empirical Analysis of Manufacturing Overhead Cost Drivers' (1992) Cornell University School of Hotel Administration: The Scholarly Commons; <https://scholarship.sha.cornell.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1916&context=articles> accessed 15 January, 2019.

by technology would more likely be receptive to creativity and innovation;[75] this, in turn, reduces the overall capital required for business. Nevertheless, the more dominant side of the argument holds that SMEs are largely under-capitalised.[76] This is partly attributable to the fact there is legally no minimum capital requirement for SMEs. Thus, most SME owners in Nigeria rely upon their personal savings or family contributions to start and run their business.[77] Arguably, this means of capitalisation is greatly limited. Therefore, it may be apt to state that access to sufficient capital remains a challenge for SMEs.

Laudably, the new position under Nigerian law provides for a minimum issued share capital of ₦100,000[78] for private limited companies instead of the formerly used 'authorised share capital'.[79] The previous position required a company to have a prescribed minimum authorised share capital and to have issued at least 25% of its authorised share capital.[80] However, under CAMA 2020, a company is no longer required to have issued 25% of its share capital since, by implication, its entire share capital will always be fully issued (although it may issue more shares in future by passing a resolution). The old regime also required a company to pay stamp duties and filing fees upon creating or increasing its authorised share capital, regardless of whether the shares have been allotted. Under CAMA 2020, however, a company will only incur these costs in relation to actual additional share capital it issues, thus significantly reducing the capital cost burden. Notably, there is no minimum share capital for registered

[75] John-Christopher Spender et al, 'Startups and open innovation: a review of the literature' (2017) 20(1) European Journal of Innovation Management 4, 5.
[76] U. B. Ihua, 'SMEs Key Failure-Factors: A Comparison between the United Kingdom and Nigeria' (2009) 18(3) Journal of Social Sciences 199, 201.
[77] M. Dia, African Management in the 1990s and Beyond: Reconciling Indigenous and Transplant Institutions (The World Bank, 1996) 45.
[78] An equivalent of £175 as of 27 July 2021.
[79] Companies and Allied Matters Act 2020, s 27(2)
[80] See Section 27(2) and 99 of CAMA 1990,

business names in Nigeria; while in the UK, there is generally no minimum capital requirement for companies.[81]

In addition to the difficulty in raising start-up capital,[82] SMEs remain particularly vulnerable in their relative inability to access growth capital. This is because they often require external financing to finance their growth and investments in order to achieve full profit potential and business success, especially in the absence of funding from family, friends and associates.[83] Indeed, finance has been recognised as an essential requirement for business survival and the lubricant that oils the wheels of any organisation.[84] This means that the ability of SMEs to survive, grow and contribute meaningfully to national productivity hinges on access to low-cost long-term financing.[85]

The difficulty of SMEs in obtaining finance in Nigeria has been most apparent during periods of economic downturn. Indeed, the global financial and health crisis coupled with periods of economic recession in Nigeria,[86] has exacerbated the difficulty faced by SMEs in accessing external finance. Arguably, the uncertainties and instability in the market during the economic recession as well as the information asymmetry and inability to offer collateral, fuel a general disinclination amongst banks to offer loans to small businesses.[87] This, in turn, accounts for SME vulnerability in terms of accessing loan capital. Even in the aftermath of the financial crisis, which forms the present environment, SMEs arguably remain vulnerable.[88] It is

[81] The UK position under the Companies Act 2006 has roots in the European Court of Justice decision in *Centros Ltd v Erhvervs-og Selskabsstyrelsen* [1999] ECR I-1459, where the Court held that minimum capital requirements infringed on the EU provisions on freedom of establishment.

[82] **See discussion 4.4.3.1. at Chapter 4 on the role of venture capitalists**

[83] J. Abor and N. Biekpe, 'Corporate governance, ownership structure and performance of SMEs in Ghana: implications for financing opportunities (2007) 7(3) International journal of business in society 288, 289.

[84] L. Effiom and S. E. Edet, 'Success of Small and Medium Enterprises in Nigeria: Do Environmental Factors Matter?' (2018) 9(4) Journal of Economics and Sustainable Development 117, 122.

[85] ibid.

[86] B. S. Shido-Ikwu, 'Economic Recession in Nigeria: A case for Government Intervention' (2017) 4(6) SSRG International Journal of Economics and Management Studies 48.

[87] Y. Ghulam and B. Iyofor, 'Bank Credit Availability to SMEs in Nigeria: The Impact of Firm and Owner Characteristics' (2017) 8 Research Journal of Finance and Accounting 10, 11.

[88] See for instance, B. S. Bernanke, 'Non-Monetary Effects of the Financial Crisis in the Propagation of the Great Depression', (1983) National Bureau of Economic Research working paper No. 1054,

suggested that finance and loan capital for SMEs can be enabled/fostered through legal frameworks. As such, creating potentially better legal vehicles would serve SMEs well in terms of enhancing their financial access. CAMA 2020 arguably achieves this to some extent, by introducing limited partnerships and limited liability partnerships as new corporate structures in Nigeria.[89] However, the UK experience lends proof that the problem of access to finance transcends legal vehicles. For instance, limited partnerships and limited liability partnerships – which are recent innovations in Nigeria – have long existed in the UK; yet access to finance has remained a challenge. This explains why, in 2017, the UK Government reformed the framework for limited partnerships to include private fund limited partnerships (PFLPs).[90] The reform was aimed at enhancing the viability of limited partnerships as investment vehicles and bolstering their access to external finance.[91] However, the success of this initiative remains to be seen, as access to finance still arguably remains an issue. Thus, one could argue that a plethora of legal vehicles does not necessarily guarantee access to finance. Nevertheless, it is hoped that the innovations in CAMA 2020 would yield a more favourable outcome in the Nigerian context.

Apart from creating better legal vehicles for accessing finance, it has also been argued that good corporate governance practices assist SMEs in improving their prospects of obtaining funding from investors and financial institutions.[92] Indeed, certain scholars observe that corporate governance influences the firm's access to external finance and capital market

<http://www.nber.org/papers/w1054.pdf> accessed 11 September 2018. This author argued that the availability of loans and other forms of credit was severely affected by the Great Depression. By extension, periods of economic downturn and recession have the same effect on the availability of finance to businesses.

[89] See Part C and Part D of CAMA 2020.

[90] The Legislative Reform (Private Fund Limited Partnerships) Order 2017.

[91] Travers Smith, 'Reform of UK Limited Partnership Law' (Travers Smith, 21 April, 2017) <https://www.traverssmith.com/knowledge/knowledge-container/reform-of-uk-limited-partnership-law/> accessed 8 May 2021.

[92] J. Abor and C. Adjasi, 'Corporate governance and the small and medium enterprises sector: theory and implications' (2007) 7(2) Corporate Governance: International Journal of Business in Society 111, 112.

development through controlling the insiders' and/or controlling shareholders' expropriation,[93] which in turn enhances the investors' confidence. The efficacy of this argument, as well as the overarching issue of access to finance, will be discussed in greater detail in Chapter 4 of the thesis.

2.5.2. Corruption

Another external constraint faced by SMEs is corruption. This menace is particularly rife in developing countries such as Nigeria. For instance, Nigeria has ranked the 149th least corrupt country out of 180 Countries, according to Transparency International's 2020 Corruption Perceptions Index.[94] This undoubtedly has a wider impact on how the nation is perceived internationally and, in turn, its ability to attract foreign investment. Local capital is also impacted as local investors are unwilling to invest in businesses with no track record, based on the widespread suspicion of corruption. Further, foreign investment is a key source of employment as well as a driving force behind the success of businesses.[95] However, studies have consistently shown that in addition to affecting the ability of a nation to attract foreign investment, the level of corruption in a nation ultimately impacts its Gross Domestic Product (GDP), economic growth and business performance of SMEs.[96]

The necessary implication of the above is that corruption in Nigeria is particularly inimical to the growth and prosperity of SMEs. While corruption is indeed detrimental to all kinds of businesses, SMEs are more likely to be affected. Due to the market vulnerability of SMEs, corruption poses a barrier to their ability to compete for contracts on fair terms. Moreover,

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[93] S. Claessens, S. Djankov and L. H .P Lang, 'The separation of ownership and control in East Asian Corporations (2000) 58 Journal of Financial Economics; R. J Gilson, *Transparency, Governance and Capital Markets*: The Latin American Corporate Governance Roundtable, Sao Paulo, Brazil (August 2000) <http://www.oecd.org/dataoecd/55/45/1921785.pdf>accessed 8 December 2018.

[94] Transparency International, 'Corruption Perceptions Index 2020: Result Table' <https://www.transparency.org/en/cpi/2020/index/nzl> accessed 16 June, 2021.

[95] PwC, 'Impact of Corruption on Nigeria's economy' (2016) <https://www.pwc.com/ng/en/assets/pdf/impact-of-corruption-on-nigerias-economy.pdf> accessed 27 August, 2018.

[96] See for instance P. H. Mo, 'Corruption and Economic Growth' (2001) 29(1) Journal of Comparative Economics 66; A. Akinlabi et al 'Corruption, Foreign Direct Investment and economic growth in Nigeria: An empirical investigation' (2011) 1(9) Journal of Research in International Business Management 278.

SMEs often lack the capacity (or capital) to develop and implement anti-corruption policies. Notably, the overall trend of corruption is less pronounced in developed countries such as the UK. This does not, however, mean that corruption is not an obstacle to the growth of SMEs in developed countries; the menace just appears less pronounced. Nevertheless, even in the UK, there seems to be an awareness of the problem.[97] Laws such as the Bribery Act 2010, Money Laundering, Terrorist Financing and Transfer of Funds 2017, Modern Slavery Act 2015 have been enacted to combat the problem. Corruption poses a potential barrier to profitability by distorting competition and putting at a disadvantage those businesses that conduct their affairs honestly.

On a practical level, businesses cannot be divorced from the social context and realities in which they operate. Therefore, where corruption pervades such as in Nigeria, the business climate is bound to be counter-productive, marked by weakened institutions and corporate governance structures as well as reduced investor confidence in the system. To counteract this, concerted efforts must be made to ensure that the business climate in Nigeria is more reassuring. Notably, there are ongoing efforts by the current Nigerian government in this regard,[98] although their efficacy remains to be seen.

Bribery is embedded in the phenomenon of corruption. Indeed, bribery and corruption are arguably coterminous. Bribery is an offer or receipt of any gift, loan, fee, reward or other advantages as an inducement to do something that is dishonest, illegal or a breach of trust, in

[97] C. Krishnan and R. Barrington, *Corruption in the UK: Overview and Policy Recommendations* (Transparency International UK, June 2011) 2. This report suggests that while corruption in the UK is not endemic, the UK's institutions are vulnerable, with inadequate procedures to detect and prevent corruption.

[98] Ongoing efforts include the Whistle blowing policy in Nigeria. Introduced in December 2016, the policy encourages people to voluntarily disclose information about fraud, bribery, financial misconduct and other forms of corruption to the Ministry of Finance. A whistle-blower who provides useful information about stolen funds or financial mismanagement is entitled to receive between 2.5% - 5% of the recovered funds from the Federal Government of Nigeria. For a critical evaluation of the policy, see C. Onuegbulam, 'Whistle blowing policy and the fight against corruption: implications for criminal justice and due process' (2017) 8(2) Nnamdi Azikiwe University Journal of International Law and Jurisprudence 174, 176.

the conduct of the enterprise's business.[99] Whereas, corruption involves misusing entrusted power for private gain.[100] In effect, bribery is a form of corruption; the hypothetical public official who collects bribes from business owners essentially misuses his power as a public official for private gain. The incidence of bribery in Nigeria is remarkably high. The United Nations Office for Drugs and Crime (UNODC) estimates that a third of Nigerian adults (inclusive of business owners) pay bribes when in contact with public officials.[101] In overall money terms, roughly N400 Billion is spent each on year on paying bribes to public officials.[102] The prevalence of bribery is further exacerbated by the fact that most bribing episodes are initiated (either directly or indirectly) by public officials and regulatory agencies, who ask for bribes in advance of providing services. As a result, those without (or with comparatively less) wherewithal to give bribes are short-changed within the Nigerian system. Conversely, large scale enterprises with considerable resources at their disposal can successfully bribe their way through the system and this automatically puts SMEs at a disadvantage.

The above point is illustrated by Halliburton bribery scandals involving Nigerian government officials. In 2003, the Nigerian subsidiary of Halliburton Inc., a large multinational enterprise, admitted to paying $2.4 million to a tax official to receive favourable tax treatment in the country.[103] This shows that large companies are ready to expend millions of dollars in bribing public officials to gain an advantage. It is plausible to state that Halliburton's size as a large enterprise, and the corresponding resources at its disposal, made it possible to churn out such significant sums to gain economic advantage. However, it is doubtful that a comparable SMEs operating in the same industry as these companies would readily afford (or otherwise be willing

[99] United Nations Office on Drugs and Crime, *Corruption in Nigeria: Bribery: public experience and response* (UNODC, 2017).
[100] ibid
[101] United Nations Office on Drugs and Crime, *Corruption in Nigeria: Bribery: public experience and response* (UNODC, 2017)- the term 'public official' contemplates employees of government agencies and parastatals.
[102] ibid.
[103] Wall Street Journal, 'Halliburton Discloses Bribe Paid to Nigerian Tax Officials' (Wall Street Journal, 9 May 2003) <https://www.wsj.com/articles/SB105248951680744000> accessed 6 September 2018.

to forego) millions of dollars in bribes. This is not to suggest that bribery is, in fact, a desirable act. Rather, larger enterprises have more financial capacity to give bribes in exchange for lucrative benefits and to gain an advantage over SMEs. As a result, SMEs often emerge at the losing end business-wise if they operate in the same industry as the large enterprises.

2.6. The Internal Challenges Faced by SMEs

The above analysis highlighted the wider social issues that affect corporate governance and control in Nigeria. These problems are generally external to the business enterprise, as they are hinged upon larger economic and socio-cultural structures and practices. However, these external problems occasion and indeed exacerbate the internal challenges of the company. Accordingly, the internal challenges also merit consideration in this thesis.

To begin with, internal corporate governance challenges are those that relate to the control and internal management of the corporation.[104] They result from the arrangement and distribution of powers between the different parties involved in the corporation.[105] These internal corporate governance challenges as they manifest in Nigeria are the subject of discussion in this section. It is worth noting that corporate governance study has historically been linked with a conflict between shareholders on the one hand, and directors and managers on the other hand; a conflict, which often manifests in the abuse of shareholder rights by directors and managers. Scholars such as Jensen and Meckling describe this problem in economic parlance as the "agency costs" problem.[106] Agency costs are the costs which arise from one person (the principal) employing

[104] B. Cheffins, 'Current Trends in Corporate Governance: Going from London to Milan via Toronto' (1999) 10 Duke Journal of Comparative and International Law 5, 7.

[105] Scholars of Law and Economics have studied these problems by identifying these different parties and their interests in the corporation. The corporation has been described as a "nexus of contracts" between directors, shareholders, managers, employees, and other stakeholders. For the nexus of contracts discourse, see B. R. Cheffins, *Company Law Theory, Structure and Operation* (Oxford: Clarendon Press, 1997) 31. In fact, the interrelationship between these different parties has been considered in some quarters as the corporate governance problem. For instance, Monks and Minow define corporate governance as "the relationship among different participants in determining the direction and performance of corporations. See R. Monks and N. Minow, *Corporate Governance* (Oxford, Blackwell Publishers, 1995) 1

[106] M. C. Jensen and W. H. Meckling, 'The Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structures' (1976) 3(4) Journal of Financial Economics 305, 308.

another (the agent) to do something.[107] In this context, the principal-agent relationship refers to shareholders employing management to run the affairs of the company on their behalf. An agency problem thus arises when management of the corporation pursues its own interest rather than, or at the expense of, the interests of shareholders (principal). This problem could also arise between managers or shareholders (insiders) and creditors (outsiders).

In developed countries such as the US and the UK, it is often said that the agency problem is exacerbated by the fact that shareholders could be passive in the governance of their corporations. Arguably, a major reason for the lack of participation is that shareholders are too widely dispersed to galvanise themselves for effective governance of the company. Berle and Means' seminal study on top American corporations revealed that corporate ownership in the US is dispersed.[108] According to the study, this dispersed ownership does not allow effective co-ordination of shareholders to sufficiently monitor corporate management.[109] This in turn leaves managers largely unregulated and more likely to pursue their own interests above shareholders' interests.[110] Arguably, however, the extent to which this applies to the typical SME is doubtful, as ownership and management is often fused, with both interests firmly aligned.

Deploying an economic analysis, Hart argues that in the absence of agency problems, corporate governance challenges are bound to arise from the transaction cost of the internal management of companies.[111] These transaction costs include the cost of defining and implementing the

[107] The "costs" refer to the costs incurred by the principal in monitoring the activities of the agent. For a more detailed discussion on the meaning of agency costs, see Victor Brudney, 'Corporate Governance, Agency Costs, and the Rhetoric of Contract' (1985) 85(7) Columbia Law Review 1403, 1410.

[108] Berle and Means' study highlighted the weaknesses in the power of shareholders to monitor management. See, A. Berle and Gardiner Means, *The Modern Corporation and Private Property* (New York: Harcourt, Bruce and World, 1968). Notably, their postulations have been built upon by other scholars. For example, see M. Roe, *Strong Managers Weak Owners: The Political Roots of American Corporate Finance* (Princeton, New Jersey: University Press, 1994).

[109] ibid.

[110] ibid.

[111] O. Hart, 'Corporate Governance: Some Theory and Implications' (1995) 105(430) The Economic Journal 678, 682

private relationships among the various parties involved in the corporation.[112] Below is an examination of the internal challenges as they apply to the Nigerian context.

2.6.1. Management vs. Shareholders in Nigeria

Arguably, the classical principal-agent problem as considered by Jensen exists in Nigeria, despite the involvement of majority owners in management. The participation of majority owners in management is particularly apparent in SMEs, as they are, in most cases, owner managed. Thus, small business owners often double as managers of their concerns. At first glance, it would appear that since ownership and management in SMEs are largely the same, then the incidence of agency problems is reduced. Nevertheless, the owner-managed business is not the only form of SME. Thus, even within the context of SMEs, small privately held companies (where ownership is separate from management) exist. This is particularly so in the modern era of venture capitalist investment.

The lack of adequate infrastructure in Nigeria translates to an asymmetry of information whereby shareholders may find it difficult to discover the true state of the affairs of the company. Thus, in the face of inadequate information available to shareholders, they are unable to monitor and control directors effectively. Against this background, managers and directors could potentially use corporate resources and opportunities for their own personal benefit at the expense of the company and its shareholders.

As SMEs have few employees, many of whom are relatives of the owners, it could be argued that there is no separation of ownership and control. This may mean an absence of the agency problem. However, the agency problem arises in SMEs that are high-growth entrepreneurial firms. This type of firms, although initially family-owned, later recognise the need to introduce standard corporate governance practices and hire good business managers to attain growth. This gives rise to agency problem between the non-family professional managers and owners.

[112] ibid.

Sufficient motivation and incentives would have to be given to these non-family professionals, who may have no emotional ties to the business, for them to exercise solid management expertise.[113]

Despite the challenges highlighted above, it remains clear that SMEs provide fertile ground for the economic development and well-being of a nation, as they provide employment opportunities and enhance economic development. Thus, promoting the growth of SMEs is of great importance because when SMEs thrive, the economy of a nation is bound to follow suit. Arguably, there is also a more equitable distribution of income, as SMEs do not only contribute to income generation but also income distribution. [114] It has been suggested that one of the ways to promote the growth, efficiency, and overall stability of SMEs, is to incorporate adequate and workable corporate governance mechanisms to guide their activities.[115] As such, the following section considers the essence of corporate governance and the potential that corporate governance holds in guiding the affairs of SMEs.

2.7. The Importance of Corporate Governance

It is worth noting that the discussion on corporate governance in SMEs focuses on small private companies. This is because they are representative of the SME business population and could be said to be challenged by the identified problems. Nevertheless, in the appropriate context, reference will be made to other business vehicles, especially with regard to new reforms to the governance of businesses in Nigeria.

Corporate governance is the system through which companies are directed and controlled.[116] The instrument of corporate governance comprises the policies, rules, processes, practices,

[113] ibid (n 92) 117.
[114] O. Fatoki, 'The Role of Small and Medium Enterprises in Alleviating the Development Challenges Facing South Africa' (2014) 5(23) Mediterranean Journal of Social Sciences 270, 272.
[115] Dr Ngozi N. Ijeoma and R. Ezejiofor, 'An Appraisal of Corporate Governance Issues in Enhancing Transparency and Accountability in Small and Medium Enterprises' (2013) 3(8) International Journal of Academic Research in Business and Social Sciences 162, 166.
[116] Committee on the Financial Aspects of Corporate Governance & Alan Cadbury, *Report of the Committee on the Financial Aspects of Corporate Governance* (London, Gee: 1992).

programs and institutions used in administering, directing and controlling the operations and affairs of a company.[117] Undoubtedly, corporate governance is now seen as essential to stable economies. This is because it helps to safeguard the rights and interests of shareholders and, increasingly, those of other stakeholders, providing a framework for effective monitoring of management actions and performance and for encouraging better business results. Furthermore, corporate governance plays a significant role in helping market economies realise their full economic potential through private economic enterprise and not state directed enterprise.

A detailed examination of corporate governance will be undertaken in Chapter 3. Within the present context, corporate governance can be conceptualised as a bridge between SMEs and their maximum potential. In practical terms, the institution of corporate governance seeks, *inter alia,* to address ownership structures within a firm. In this regard, the concept deals with practical variables such as the composition of the board of directors, and the possible separation of executive and non-executive (oversight) functions within the Board.[118]

It is generally accepted that good corporate governance upholds the principles of fairness, accountability, transparency and responsibility in the management of a company.[119] Some scholars have further suggested that a good and functional corporate governance system helps a company to obtain capital, avoid insolvency and strengthen performance.[120] Indeed, there is a demonstrable link between corporate governance and access to external finance. Shleifer and Vishny suggest that a possible reason for this link is that corporate governance provides assurances to investors that the affairs of a business are properly run; and by extension,

[117] C. C. Uchehara, 'Corporate Governance and Management of Small and Medium Scale Enterprises in Lagos-Nigeria' (2017) 3(2) IJRDO Journal of Business Management 1, 2.
[118] ibid
[119] B. I. Ehikioya, 'Corporate governance structure and firm performance in developing economies: evidence from Nigeria' (2009) 9(3) The International Journal of Business in Society 231.
[120] J. J. McConnell and H. Servaes, 'Additional evidence on equity ownership and corporate value' (1990) 27(2) Journal of Financial Economics 593, 600; M. Nishat and R. Shaheen, 'Corporate Governance and Firm Performance in an Emerging Market – An Exploratory Analysis of Pakistan' (2006) 4(2) Corporate Ownership & Control 216, 218.

investing in such a firm/business is worthwhile.[121] Furthermore, Adegbile submits that good corporate governance leads to lower costs of debt financing and better access to external finance.[122] This is because poorly governed firms are perceived by creditors as high-risk, and as such, higher costs of obtaining loans and finance are imposed on them.[123] Conversely, firms with good corporate governance frameworks are able to access finance on more favourable terms and at a cheaper cost.[124] As earlier highlighted, SMEs are plagued with the problem of inadequate access to finance. Good corporate governance could serve as a potential solution to this problem.

In the alternative, there could be a legal regime on diverse security instruments that could be used to offer different assets as collateral in loan finance transactions. This is seen in the Secured Transactions in Movable Assets Act 2017 (STMA), which was enacted to widen access to finance for SMEs in Nigeria.[125] The Act provides a framework for the creation of security interests in movable assets, where such interests are created by an agreement that secures the payment or performance of an obligation (such as a loan).[126] Importantly, movable assets under the Act include tangible or intangible property other than real estate,[127] and a creditor may also create security interests in accounts receivable of a business. A security interest is perfected by registering it at the National Collateral Registry[128] and priority for duly perfected security interests is determined by order of registration; thus, a security interest that

[121] A. Shleifer and R. W. Vishny, 'Large Shareholders and Corporate Control' (1986) 94 Journal of Political Economy 461.
[122] S. A. Adegbile, 'Corporate Governance Attributes and Capital Structure of Listed Firms in the Nigerian Food and Beverages Industry' (2015) 3(1) International Journal of Public Administration and Management Research 48, 50.
[123] F. Haque, T. G. Arun and C. Kirkpatrick, 'Corporate Governance and Capital Structure in Developing Countries: A Case Study of Bangladesh 43 Applied Economics 673.
[124] ibid.
[125] Y. Senbore et al, The Secured Transactions in Movable Assets Act: Key Highlights and Impact on the Existing Legal Landscape (Olaniwun Ajayt LP, November 2017) <https://www.olaniwunajayi.net/blog/wp-content/uploads/2017/11/Understanding-the-Secured-Transactions-in-Movable-Assets-Act-6.pdf> accessed 13 May 2021.
[126] STMA 2017, s. 2.
[127] ibid, s. 63.
[128] ibid, s. 13.

registered first in time enjoys priority over subsequent security interests, regardless of the date of creation.[129] The Act widens the scope of acceptable assets for collateral and enables SMEs to fulfil collateral requirements imposed by lenders, thus increasing their access to finance. However, Igbinosun observes that the Act falls short of procuring a harmonised framework for secured transactions in personal property or facilitating their effective use as collateral.[130] This holds true because the Act recognises a parallel system of security interests in the form of charges registered under CAMA (which imposes more onerous conditions on borrowers such as the payment of stamp duties).[131] Thus, there is the potential for uncertainty with respect to assets filtering across both regimes. Moreover, poor governance structures could still lead to the misuse of security or irresponsible borrowing leading to wrongful trading. Hence, even within SME financing frameworks such as the STMA, good governance structures remain paramount.

Notwithstanding this, one could argue that the seemingly straightforward concept of corporate governance presents a more difficult reality in the context of SMEs. This is because SMEs are largely private, unlisted companies.[132] As such, they are typically not subject to the stringent and extensive rules that apply to listed companies. A good example is financial disclosure,[133] which itself is indicative of good corporate governance. Notably, listed firms in Nigeria, the UK and indeed elsewhere are duty-bound to comply with extensive financial disclosure

[129] ibid s. 23.
[130] B. Igbinosun, 'Security Interests in Personal Property and the Nigerian Secured Transactions in Movable Assets Act 2017: An Appraisal' (2020) 64(3) *Journal of African Law* 357.
[131] STMA 2017, s. 2(3).
[132] S. Black, Amy Fitzpatrick, Rochelle Guttmann and Samuel Nicholls, 'The Financial Characteristics of Small Businesses' (2012) 3 Small Business Finance Roundtable 25, 30.
[133] For instance, listed companies are required to provide the remuneration of each director, whether in cash or otherwise; see the Rules and Regulations of the Securities Exchange Commission 2013, s, 279(1). There is no similar obligation on private, unlisted firms i.e., SMEs.

rules.[134] However, small unlisted companies are subject to a less stringent regime.[135] Overall, there is a general assumption that listed companies are adherent to the norms and standards set by regulatory bodies in the course of their business activities. Therefore, adopting corporate governance mechanisms fits well within their framework. Conversely, SMEs are subject to minimal regulatory oversight and standards. Thus, incorporating corporate governance mechanisms and frameworks in SMEs would ordinarily prove to be the more onerous undertaking.

Furthermore, it is worth noting that corporate governance frameworks and codes are often created primarily with the large, listed companies in mind, as these companies are required, by law, to have a formal policy on how management take decisions and disclose business information.[136] It must be noted that the frameworks and codes also apply to small private companies although they are exempted from some provisions; to this extent, the provisions are deregulatory. However, such frameworks and codes may not reflect the characteristics of the SME, where owners may often be its managers as well, or where company ownership may be shared across family members. Arguably, therefore, the dominant understanding of corporate governance would appear incongruent with the realities of SMEs. This problem is not helped by the fact that studies carried out so far on corporate governance have focused almost exclusively on listed companies.[137] While the basis for this choice is understandable, and

[134] The failure to file financial statements may lead to sanctions or public reprimand, both of which could have dire consequences the erring companies. In 2017, the Nigerian Stock Exchange threatened to suspend trading in the securities of eleven erring companies that had failed to file their audited financial statements. Though ultimately offering a grace period, the Exchange further warned investors to trade with caution on these companies' securities. See Helen Oji, '11 listed firms fail to file 2016 financial statement to NSE' (The Guardian, 13 April 2017) <https://guardian.ng/business-services/11-listed-firms-fail-to-file-2016-financial-statement-to-nse/> accessed 10 September, 2018.

[135] Notably, while companies are generally expected to make annual returns under CAMA 2020 (see s. 417), small companies are required to disclose limited information about their affairs; see s. 419 CAMA 2020.

[136] E. Y. Akinoye and O. O. Olasanmi, 'Corporate governance practice and level of compliance among firms in Nigeria: Industry analysis' (2014) 9(1) Journal of Business and Retail Management 13.

[137] M. Babatunde and O. Olaniran, 'The Effect of Internal and External Mechanisms on Governance and Performance of Corporate Firms in Nigeria' (2009) 7(2) Corporate Ownership & Control 330, 331; S. Kajola. 'Corporate Governance and Firm Performance: The Case of Nigerian Listed Firms' (2008) 14(14) European Journal of Economics, Finance and Administrative Sciences 16, 28.

perhaps even justifiable,[138] a problem of exclusion is inevitably created.[139] This exclusion effectively forecloses a comprehension of the corporate governance behaviours and outcomes of SMEs, which make up the bulk of organisations across the various business sectors of Nigeria. Overall, it would appear that the research on corporate governance (within the context of SMEs) is sparse.[140]

Nevertheless, for the sake of clarity, it is important to establish what good corporate governance for SMEs could possibly mean. In doing so, it should be appreciated at the outset that there is no universally accepted model of corporate governance for SMEs. However, there are sources of guidance which can be referred to. For instance, the European Confederation of Directors Associations issued a corporate governance guideline in 2010 which is designed to be a practical tool for businesses (including SMEs) as well as their stakeholders.[141] As the guideline suggests, good corporate governance for unlisted companies and SMEs entails "establishing a framework of company processes and attitudes that add value to the business, help build its reputation and ensure its long-term continuity and success."[142]

2.8. Corporate Governance: The Nigerian situation

Lodge and Wilson evince that corporate governance in Nigeria (and indeed in many African countries) is still poor when compared to Western counterparts.[143] They posit that corporate

[138] The focus on listed companies can be justified because of the availability of easily accessible data on listed companies. Data on listed companies is more readily available to enable prospective and existing investors to make informed business decisions. It can also be attributed to the fact that the agency problem is more accentuated when shareholders are widely dispersed.

[139] For a discussion on the problem of exclusion, see C. C. Uchehara, 'Corporate Governance and Management of Small and Medium Scale Enterprises in Lagos-Nigeria' (2017) 3(2) IJRDO Journal of Business Management 1, 3.

[140] See for instance, Uchehara, ibid; N. Ijeoma and R. Ezejiofor, ibid n 117; E. N. M. Okike, 'Corporate Governance in Nigeria: the status quo' (2007) 15 *An International Review* 173. For recent works, see A.O. Ugowe, *Corporate Governance as a Transformation Tool in Sustaining Nigeria's Small and Medium-Sized Enterprises (SMEs)* (Doctoral Thesis: University of Dundee, 2020)

[141] European Confederation of Directors Associations, Corporate Governance Guidance and Principles for Unlisted Companies in Europe (ecoDa, 2010). <https://ecgi.global/download/file/fid/9869> accessed 10 September 2018

[142] ibid.

[143] G. Lodge and C. Wilson, *A Corporate Solution to Global Poverty: How Multinationals Can Help the Poor and Invigorate Their Own Legitimacy* (Princeton: Princeton University Press, 2006) 3.

governance in Nigeria is at a rudimentary stage, as only 40% of companies (banks inclusive) quoted on the Nigerian Stock Exchange have recognised codes of corporate governance in place;[144] although, more recent estimates suggest over 50% of quoted companies now have internal corporate governance codes in place.[145] Lodge and Wilson further argue that poor corporate governance was a major factor in virtually all known instances of distress experienced by the country's financial institutions.[146] Arguably, a common thread in these monumental corporate failures was the poor corporate governance culture, marked by poor management, poor supervision and poor regulation.[147]

When placed against this background, it becomes easy to understand and better appreciate the importance of corporate governance frameworks to effective companies. It is worth noting that studies carried out so far on corporate governance in Nigeria have concentrated exclusively on firms quoted on the Nigerian Stock Exchange. However, it is worth nothing that legislations such as the Companies and Allied Matters Act 2020 have captured smaller, non-quoted businesses to some degree. Although the basis for the conventional focus on quoted companies is understandable, it, however, creates a problem of exclusion. This exclusion forecloses a comprehension of the corporate governance behaviours and outcomes of SMEs. As a result, the discourse on corporate governance in SMEs remains largely underdeveloped.

Furthermore, prior research has shown that many SMEs are family-owned businesses. For this reason, it has been suggested that they (SMEs) might provide the solution for the agency problem.[148] The major studies suggested that in family businesses, the large shareholders are normally the controlling families, and thus, they have sufficient power and incentive to

[144] ibid
[145] See E.Y. Akinoye and O. O. Olasanmi, ibid n 136.
[146] For a more detailed discussion on the various Bank failures in Nigeria, see B. Adeyemi, 'Bank failure in Nigeria: a consequence of capital inadequacy, lack of transparency and non-performing loans?' (2011) 6(1) Banks and Bank Systems 99.
[147] ibid
[148] D. McConaughy, C. Matthews and A. Fialko, 'Founding Family Controlled Firms: Performance, Risk and Value' (2001) 39 Journal of Small Business Management 31, 49.

frequently monitor managerial decisions. Additionally, the controlling families are commonly involved with day-to-day business management; therefore, they are normally the force that efficiently reduces the conflicts between managers and shareholders.[149] In this case, larger firms could possibly learn some operations that small and medium-sized businesses have, to adapt and apply to their own, and improve their business performance. Specifically, studies show that family ownership may affect corporate venturing in a positive way.[150] It might be because, commonly, family shareholders in the family firms, expect or at least have the intention to let their children inherit the businesses. Therefore, family firms invest more efficiently. Additionally, with the high family involvement in managerial decisions, they are more patient and cautious in making the investment to business opportunities.[151] Nevertheless, it would appear that there remains the problem of "tunnelling" or the expropriation of value out of minority shareholders' holdings.[152]

2.9. Regulatory Frameworks for Corporate Governance in SMEs

The foregoing discussion would be incomplete without highlighting the regulatory frameworks that relate to, and necessarily affect, the governance of SMEs. It is worth noting that most SMEs operate in the informal sector/informal economy and are largely outside the regulatory framework available to SME companies.[153] The Bank of Industry estimates that over 17 million SMEs in Nigeria are not registered (as companies) with the Corporate Affairs Commission,[154]

[149] An example of a study is A. Shleifer and R W Vishny, 'Large Shareholders and Corporate Control' (1986) 94 Journal of Political Economy 461, 482.
[150] Y. J. Wong, S. C. Chang and L. Y. Chen, 'Does a Family-controlled Firm Perform Better in Corporate Venturing?' (2010) 18 (3) Corporate Governance: An International Review 175, 180.
[151] R. C. Anderson and D. M. Reeb, 'Who Monitors the Family?' (2003) 5, <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=369620> accessed 11 September, 2018.
[152] ibid
[153] Small and Medium Enterprises Development Agency of Nigeria, *National Policy on Micro, Small and Medium Enterprises* (Federal Republic of Nigeria, 2017).
[154] Bank of Industry, '17 Million SMEs Not Registered with Corporate Affairs Commission- Joseph Babatunde' (August 21, 2015) <https://www.boi.ng/17-million-smes-not-registered-joseph-babatunde/> accessed 11 December, 2018.

while in the UK, over 3.3 million of the 6 million private sector businesses are unregistered.[155] The Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) in conjunction with the National Bureau of Statistics (NBS), also revealed that out of approximately 37 million SMEs in Nigeria, less than 5 million are registered companies.[156] Nevertheless, it is common ground that SME companies are bound by laws and regulations, which they must comply with, despite the fact that they differ from the typical large companies.[157] On the other end of the spectrum, however, it can be said that SMEs are largely exempted from the regulatory frameworks and formal requirements that govern the operation of larger companies.[158] The efficacy of this position will be examined below, with particular reference to the legislation and tenets of business operation that affect SMEs in Nigeria.

2.10. Corporate Governance Regulatory Regime: SME companies in Nigeria

A key legislation that governs the conduct of businesses in Nigeria, including SMEs, is the Companies and Allied Matters Act 2020 (CAMA). Under CAMA, the Corporate Affairs Commission (CAC) is responsible for: registering, regulating and supervising the formation, incorporation, management, striking off and winding up of companies; registering, regulating and supervising business names, managing and removing of names from the register; and the registration, regulation and supervision of the formation, incorporation, management and dissolution of incorporated trustees,[159]as well as limited liability partnerships and limited partnerships.[160]

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[155] Department for Business, Energy and Industrial Strategy, 'Business Population Estimates for the UK and the Regions 2020: National Statistics' (DBEIS, October 2020) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/923565/2020_Business_Population_Estimates_for_the_UK_and_regions_Statistical_Release.pdf> accessed 17 June 2021.

[156] National Bureau of Statistics, 'SMEDAN and National Bureau of Statistics Collaborative Survey: Selected Findings (2013)' (June 2013) <www.nigerianstat.gov.ng/download/290> accessed 9 December 2018.

[157] C. Summer, 'Drivers and Constraints for Adopting Sustainability Standards in Small and Medium-sized Enterprises (SMEs)' (German Development Institute, Discussion Paper, November 2017) <https://www.die-gdi.de/uploads/media/DP_21.2017.pdf> accessed 24 October 2018.

[158] P. Quartey, *Regulation, Competition and Small and Medium Enterprises in Developing Countries* (Centre on Regulation and Competition Working Paper No. 10, October 2001).

[159] CAMA, s 8.

[160] These new partnership variants are provided for under part C and D of CAMA 2020 respectively.

The foregoing functions of the CAC highlight the fact that there are different forms of business organisations under Nigerian law. Accordingly, the CAMA itself is divided into different "parts" in line with the various business forms available under the law. Part B provides for incorporation of companies (public and private); Part C deals with establishment of limited liability partnerships; Part D provides for limited partnerships; Part E applies to registration of business names.

In analysing the existing regulatory frameworks for SMEs, private companies are the focal point of reference, while limited liability partnerships, limited partnerships and registered business names are occasionally discussed as comparators.[161] However, the law relating to public companies is drawn upon in contradistinction to the frameworks governing SMEs.

2.11. Mapping the Differences in The SME Regulatory Regime in Nigeria

2.11.1. Filing of Annual Returns

As alluded to earlier in this chapter, SMEs are largely unlisted companies, and as such, less stringent requirements are imposed on them by the law. An example cited in this regard is the filing of annual returns, which is generally not a prerequisite for SMEs. Nevertheless, the provisions of CAMA on the filing of returns merit further examination. CAMA generally provides that "every company" shall, at least once in every year, file annual returns in the form, and containing the matters specified in sections 418, 419 or 420 of the Act as may be applicable.[162] The starting point, therefore, is that all companies (whether public or private) are required to file annual returns.

At first glance, it would appear that SMEs (which operate as private limited liability companies) fall within the scope of the above provision, and to this extent, are not offered any preferential treatment under the law. Unsurprisingly, however, Section 419 goes further to limit

[161] This approach is apt because SMEs in Nigeria would necessarily be private limited liability companies or registered business names, not public companies.
[162] See CAMA, s. 417.

the annual returns of a small company to matters specified in Part 1 of the Eighth Schedule of the Act. A careful look at the matters specified in Part 1 of the Seventh Schedule (which larger companies are bound to specify) and Part 1 of the Eighth Schedule (which relates to small companies)[163], reveals that the requirements for a small company filing annual returns are comparatively less stringent than large companies.[164] For context, a small company is a private company,[165] with a turnover not exceeding N120 million (One Hundred and Twenty Million Naira)[166] and net assets value not exceeding N60 million[167] in the financial year of filing the returns. Additionally, none of its members must be alien, i.e. Non-Nigerian;[168] a Government, a Government corporation or agency or its nominee.[169] Furthermore, the directors between themselves must hold not less than 51% equity share capital.[170] Notably, the criteria relating to turnover aligns with the earlier conceptualisation of an SME in this chapter. To this extent , a small company under CAMA is akin to an SME.[171] In any event, it should be noted that the above requirement on filing returns only applies to companies and other business vehicles like Limited Partnerships and Limited Liability Partnerships.

Notably, the private company is just one business form in which an SME might choose to operate. In the alternative, an SME may choose to operate as a registered business name or as a limited partnership (LPs) or limited liability partnership (LLPs). For an SME that operates as an LLP, the law requires that it should file annual returns.[172] With regards to Limited Partnership, since the law provides that the provisions governing LLPs are to apply except in

[163] As stipulated in CAMA, s. 218.
[164] The Seventh Schedule requires more extensive disclosure on share capital, such as the number of shares taken from commencement up to the date of the return; see CAMA, Seventh Schedule, 3(b).
[165] CAMA, s 394(3)(a).
[166] ibid., s. 394(3)(b).
[167] ibid, s. 394(3)(c).
[168] ibid, s. 394(3)(d).
[169] ibid, s. 394(3)(d).
[170] ibid, s. 394(3)(e).
[171] See SME definition in Chapter 2, at 2.2.
[172] CAMA, s. 773

case of inconsistency,[173] it can be said that the requirement to file returns apply to an SME that operates as an LP. It is however important to note that unlike small private companies which face less stringent requirements compared to large companies, there is no such distinction between small and large LPs or LLPs under CAMA. This means that SMEs who operate as LP or LLP may find the requirements onerous. Further, there is notably no provision in CAMA (or Nigerian law more generally) for the filing of annual returns by registered business names. The necessary implication of this is that SMEs operating as registered business names, are not required to, and indeed do not file annual returns. The conclusion, therefore, is that unlike large companies, the regulatory regime governing SMEs on the filing of returns is liberal.

On the one hand, it remains debatable that the filing of annual returns is desirable or in fact feasible for SMEs. In view of the fact that an SME may take the form of a sole trader or partnership, one could argue that bringing SMEs within the requirement of filing annual returns might be too onerous.[174] However, it can hardly be disputed that the filing of returns increases the accountability of a business concern. It also enables a business to "put its house in order" which is ultimately essential for obtaining external financing; and finally, it paints a clear picture to the regulator and wider public of the true financial position of a business organisation. This is particularly important because business activity is not restricted to large companies. On the contrary, the bulk of business activity is carried out by SMEs which may operate merely as registered business names, and which under the current law, are not required to file annual returns. However, when considering the benefit of being able to ascertain the financial position of a business – a benefit enabled by the filing of annual returns – a compelling

[173] ibid s. 807.

[174] Indeed, there is an inherent danger of over-regulating SMEs. Some authors have viewed that with increased regulations, comes the additional cost of compliance. For an example of such authors, see Ruth Schmidt et al, 'Legislation and SME retailers – compliance costs and consequences' (2007) 35(4) International Journal of Retail & Distribution Management 256, 259.

argument is sustained for the filing of returns by businesses of all forms, including SMEs. Nevertheless, at present, this would appear to be a suggestion for future reform.

2.11.2. Legal capital

Under CAMA, the minimum share capital of a private limited company is N100,000 while the minimum share capital of a public limited company is N2,000,000.[175] However, for SMEs operating as registered business names, the law does not prescribe a minimum capital for a hypothetical proprietor or firm.

The desirability and feasibility of minimum capital rules has been the subject of intense debate. On the one hand, minimum capital requirements are argued to serve the purpose of protecting investors and creditors from hastily established and potentially insolvent firms. In particular, they are alleged to safeguard creditors' equity cushion represented by the capital which has been injected into the business.[176] The English Courts have confirmed this view, noting that the minimum share capital is "fixed and certain, and every creditor of a company is entitled to look to that capital as his security".[177] Following this reasoning, minimum capital requirements could serve to protect creditors' interests, although the desirability of this in the SME context is questionable. Indeed, CAMA 2020 does not impose a minimum capital requirement on SMEs, save for private (SME) companies.

On the other hand, the absence of a minimum capital requirement for SMEs (operating as registered business names) arguably aligns with pragmatism, as imposing such requirement could potentially discourage SMEs from starting up. Moreover, it has been suggested, that the aim of protecting creditors is often not actualised by legal capital rules. Ferran and Ho argue

[175] CAMA, s. 27(2)(a)

[176] N. Andreicheva, 'The role of legal capital rules in creditor protection: contrasting the demands of Western market economies with Ukraine's transitional economy' A thesis submitted to the Law Department of the London School of Economics and Political Science for the degree of Master of Philosophy (January 2009) <http://etheses.lse.ac.uk/2528/1/U615477.pdf> accessed 9 January, 2019.

[177] See the House of Lords decision in *Ooregum Gold Mining Company of India v Roper* [1892] AC 125. Notably, the case itself concerned the par value requirement and resulting issue of shares at a discount.

that legal capital rules are crude mechanisms that fail to protect creditors.[178] They note that their intended protective effect is nullified by skilled legal and financial professionals who successfully devise circumventive schemes,[179] which render the minimum capital requirement to be inefficient. Other scholars suggest that minimum capital rules have become outdated.[180] John Armour, for instance, argues that the legal capital requirement is no longer an appropriate apparatus to employ in safeguarding the interests of creditors.[181] He posits that such mandatory rules impose a 'one size fits all approach' which tends to be over-regulatory, even for large companies.[182]

The minimum capital rule could cause hardship and hinder entrepreneurship, as it creates barriers to entry in the market for SMEs. SMEs who do not have the required minimum capital may be delayed before registering and commencing business. Consequently, it increases the monopolistic power of existing businesses and prevents healthy competition.[183] Creditors may also be tempted to believe that the company has assets that have the same value as the amount of minimum capital.[184] Thus, it does not guarantee that the debts will be paid.

Flowing from the above, it is arguable that the legal capital requirement is not desirable for SMEs, as it would impose an unduly onerous regulatory regime. Moreover, the legal capital requirement has waned significantly in both the UK and Nigerian company frameworks. Machado suggests alternatives to minimum capital rules such as creditor self-help with restrictions on loan contract, ex-post mechanisms like fraudulent trading and wrongful trading,

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[178] E. Ferran and L. C. Ho, *Principles of Corporate Finance Law* (2nd Edition, Oxford University Press, 2014) 157.
[179] ibid
[180] H. K. Shan, 'Revisiting the Legal Capital Regime in Modern Company Law' (2017) 12(1) The Journal of Comparative Law 1, 4.
[181] J. Armour, 'Legal Capital: An Outdated Concept?' (March 2006) Centre for Business Research, University of Cambridge, Working Paper No. 320 <www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp320.pdf> accessed 7 January 2019.
[182] J. Armour, 'Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law?' (2000) 63 Modern Law Review 355, 357.
[183] F. S. Machado, 'Effective Creditor Protection in Private Companies: Mandatory Minimum Capital Rules or Ex Post Mechanisms?' (2010) 3(4) RDS II, 681, 687
[184] ibid at 688

disqualification of directors, piercing the corporate veil and equitable subordination of shareholder loan.[185]

2.11.3. Capacity in formation and running of a company

CAMA clearly stipulates the capacity of an individual to form a company. Section 20 of the Act provides that an individual[186] may not participate in the formation of a company if: he is less than 18 years of age;[187] or he is of unsound mind and has been so found by a court in Nigeria or elsewhere;[188] or he is an undischarged bankrupt;[189] or he is disqualified under section 254[190] of this Act from being a director of a company.[191] Notably, the Act contains a similar provision as to the capacity for directorship of a company.[192] The clear purport of these provisions is to ensure that only fit and proper persons with full legal and mental capacity may form and run a company. Thus, the law generally provides safeguards for the formation and running of a company. Similar provisions apply to the legal capacity of an individual to be a partner in a limited partnership and limited liability partnership.[193]

Indeed, the benefits of these safeguards are not far-fetched. For instance, it would be inimical to commerce if a minor was allowed to form and run a company. Such minor could enter into contracts with third parties which might ultimately not be binding on him,[194] to the detriment of third parties. Likewise, it is undesirable for the law to permit persons of unsound mind to form or run the affairs of a company, as they lack the mental capacity to do so. The law relating to companies thus fares well.

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[185] Ibid at 681

[186] These requirements as to capacity would not apply if at least two other persons not disqualified under subsection (1) have subscribed to the memorandum of the company.

[187] CAMA, s. 20 (1)(a).

[188] CAMA, s. 20 (1)(b).

[189] CAMA, s. 20 (1)(c).

[190] This section generally limits the age of a director of a public company to no more than 70 years, except where special notice is given to the company of the resolution appointing or approving the appointment of such a director.

[191] CAMA, s. 20 (1)(d).

[192] ibid s. 283(a)-(e).

[193] ibid. s. 747 & 796

[194] This is because a minor could potentially plead infancy to render a contract non-binding.

It should be noted, however, that there are no comparative safeguards in the context of registered business names, majority of which are SMEs in Nigeria. While the law stipulates general guidelines for the registration of business names, these relate to form and not substance, and with less scrutiny than companies.[195] For instance, there is no requirement for proprietor(s) of a registered business name to be a person of sound mind or not to be an un-discharged bankrupt. It is therefore conceivable that the proprietor of a registered business name could be of unsound mind or be an un-discharged bankrupt. This point of distinction between companies and business names is not readily justifiable.

Curiously, the emphasis in CAMA is on the form of the business name sought to be registered and the procedure for registration. For instance, section 814 of CAMA states that every individual, firm or corporation having a place of business in Nigeria and carrying on business under a business name must be registered,[196] unless it satisfies the exceptions in section 814(1)(a)-(c). A holistic examination of CAMA reveals its failure to provide any substantive safeguard for the operation of registered business names.[197]

A plausible conclusion from the foregoing, therefore, is that SMEs operating as registered business names are not held to the same standards as incorporated companies. This reality holds potentially dire consequences because such companies are subject to less regulatory oversight. Moreover, in instances where the business names need not be registered at all (and they are SMEs), they are arguably located outside the scope of business regulation.

However, it is not always the case that SMEs are exempted from the scope regulatory frameworks applicable to larger companies. Rather, in respect of certain matters, they are subject to the same or similar regulatory frameworks as larger companies (public companies).

[195] This argument is justifiable on the ground that the law places no comparable safeguards such as capacity i.e. who can validly register a business name.
[196] CAMA, s. 814 (1).

In such instances, there are attendant burdens imposed on SMEs. It is this very fact that necessitates further discussion.

2.12. Insolvency, Wrongful Trading and the Precarious Position of SMEs

A company is said to go into insolvency when it cannot afford to pay its debts as they fall due, or when its liabilities exceed its assets.[198] Over the last decade in the UK, the number of recorded insolvencies has more than doubled.[199] For instance, in 2019, 17,196 companies in the UK (the majority of which are SMEs) went into insolvency[200] – the highest number of recorded company insolvencies in the UK since 2013.[201] By contrast, in 2020, the UK recorded historically low insolvency numbers (12,557),[202] due to government measures to support businesses during the pandemic.[203] Unfortunately, there are no comparable statistics on insolvency in Nigeria.

Although going into insolvency is not an uncommon phenomenon for SMEs, trading while under the threat of insolvency[204] is difficult and carries the risk of personal liability for managers.[205] Notably, in the UK, by virtue of s. 172(1) of the Companies Act 2006 the directors of a company ordinarily owe their duties to the company for the benefit of its members as a whole.[206] However, s. 172(3) of the Companies Act makes this general duty subject to any

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[198] Insolvency Act 1986, s. 214(6).

[199] See P. Inman, 'UK Insolvencies hit six-year high as finances come under pressure' (The Guardian, 27 July 2018) <https://www.theguardian.com/money/2018/jul/27/uk-insolvencies-hit-six-year-high-as-record-number-take-out-ivas> accessed 2nd November 2018; Trading Economics, 'United Kingdom Bankruptcies' (Trading Economics, 21 July 2018) <https://tradingeconomics.com/united-kingdom/bankruptcies> accessed 9 November, 2018.

[200] The Gazette, 'UK company insolvency statistics for 2019' (The Gazette, 31 January 2020) <https://www.thegazette.co.uk/insolvency/content/103498> accessed 7 February, 2021

[201] ibid

[202] The Gazette, 'UK company insolvency statistics – Q4 2020' (The Gazette, 29 January 2021) <https://www.thegazette.co.uk/insolvency/content/103888> accessed 21 May, 2021.

[203] For instance, the Corporate Insolvency and Governance Act 2020 was enacted to increase restructuring options for businesses dealing with financial difficulties.

[204] For a detailed discussion on trading and governance during insolvency period, see Professor D. Milman, *Governance of Distressed Firms* (Edward Elgar Publishing, 2013) 40.

[205] J. Lydenhoff, 'Directors' liability and insolvency- is it time to give directors of SMEs a break?' (Linder Myers, 19 February 2015) <http://www.lindermyers.co.uk/directors-liability-insolvency-time-give-directors-smes-break/> accessed 1 November, 2018.

[206] See section 172(1) of the Companies Act 2006 which makes directors duty-bound to promote the success of the company for the benefit of its members.

enactment or rule of law, which requires directors to consider or act in the best interests of the company's creditors.[207] An example of such enactment is the Insolvency Act 1986, which contains several provisions that, either directly or by implication, enjoin directors to act in the interest of the company's creditors.[208]

Thus, a director's duty to the company to have regard to creditors' interests may arise prior to insolvency. In the case of *Casey Oils Ltd*,[209] the newly appointed administrators of a company successfully sued the director and controlling shareholder of a company, who paid sums to himself from company money, when the company was on the verge of insolvency. The court held that his action amounted to a breach of his fiduciary duty to have regard to the interests of the company's creditors. Conversely in ***Dickinson***,[210] the company was under threat from the risk of environmental claims against it, and the managing director and controlling shareholder-initiated transactions, which extracted £2.5 million of net assets from the company; transactions which the liquidators alleged were motivated by a desire to place the company's assets beyond the reach of creditors. The court, while finding the transactions void on other grounds, held that they were not made in breach of directors' duties. The fact that there was a recognised risk of adverse events such as the environmental claim that might result in liability and lead to insolvency, did not mean that the creditors' interests took priority over those of members. *Dickinson* proceeded on appeal, and the Court of Appeal dismissed the appeal.[211] However, the appellate court did not examine the duty of directors to consider creditors' interests in any detail or substance. It thus becomes evident that while directors' duties to creditors might arise pre-insolvency, there is a lack of clarity as to the precise point.

[207] Companies Act 2006. s. 172(3); West Mercia Safetywear Ltd v Dodd [1988] BCLC 250.
[208] For instance, see Section 243 of the Insolvency Act 1986, which proscribes against transactions that defraud creditors.
[209] *Casey Oils Ltd (In Liquidation) v Wood* [2018] CSOH 42
[210] *Dickinson v NAL Realisations (Staffordshire) Ltd* [2017] EWHC 28 (Ch)
[211] *Dickinson v NAL Realisations (Staffordshire) Ltd* [2019] EWCA Civ 2146.

Nevertheless, one of the clear instances where directors are required to consider, or at a minimum, "have proper regard for"[212] the interest of creditors, is when a company becomes insolvent. During insolvency, the interests of the company's creditors become paramount.[213] The English Court of Appeal in *West Mercia Safetywear v. Dodd*[214] emphasised the importance of this duty as one, which directors must conscientiously exercise in favour of the company's creditors. The court declared Mr. Dodd, the director, to have been in breach of duty when for his own purposes, he caused the £4,000 to be transferred in disregard of the interests of the general creditors of his insolvent company. Furthermore, in *Re Micra Contracts Ltd (in liquidation),*[215] the court clarified that the duty owed by the directors of a company to have regard to creditors' interests (during insolvency) is a fiduciary one; and as such, there is a consequential evidential burden of proof on directors to justify the actions taken by them, i.e. by proving that their actions were not at variance with creditors' interests.[216]

More importantly, if a director continues trading where there is no reasonable prospect of the company avoiding insolvency, he could potentially be found guilty of wrongful trading. Under UK law, wrongful trading occurs if, at some time before the commencement of the winding up[217] of the company, a director of the company knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation.[218] Where this is the case, the liquidator of the company in insolvent liquidation (or administrator of a company in administration) may bring an action against the erring director(s) to make such contribution to the company's assets as the court thinks proper. Furthermore, he may also be

[212] *Bilta (UK) Ltd (in liquidation) and ors v Nazir and ors* (No 2) [2016] AC 1 at [123] per Lord Wilson.
[213] S. Leslie, 'Director's duties in insolvency- paramountcy of creditors' interests (Re Mining Contracts Ltd (in liquidation))' (LexisNexis, 10 August, 2015) <https://blogs.lexisnexis.co.uk/randi/directors-duties-in-insolvency-paramountcy-of-creditors-interests/> accessed 6 November 2018; K. V. Zwieten, 'Director liability in insolvency and its vicinity' (2018) 38(2) Oxford Journal of Legal Studies 382, 383.
[214] (1988) 4 BCC 30.
[215] [2015] All ER (D) 24 (Aug).
[216] ibid.
[217] Notably, wrongful trading also extends to procedures such as administration; see Insolvency Act 1986, s. 246ZB as modified by the Small Business, Enterprise and Employment Act 2015, s.117.
[218] Insolvency Act 1986, s. 214(2).

disqualified[219] from acting as the director of the company for a specified period of time.[220] However, no liability would arise if the court adjudges that the director took every step he ought to have taken in the circumstance, with a view to minimising the potential loss to the company's creditors.[221] Similar wrongful trading provisions were recently introduced in the Nigerian corporate insolvency regime.[222]

Arguably, the incidence of wrongful trading is more likely to occur in SMEs. As earlier noted, SMEs are largely exempt from the regulatory frameworks that govern larger public companies such as the filing of returns and maintaining proper accounting records.[223] Thus, the majority of SMEs are bound to implement bare minimum accounting and bookkeeping processes.[224] Some authors argue that this shortcoming is partly attributable to the general lack of accounting knowledge amongst SME owners.[225] Nevertheless, the net result of minimal accounting and bookkeeping is that SME owners and directors are unable to ascertain the true financial position of their firms.

In *Re Purpoint Ltd*,[226] a liquidator brought an action for wrongful trading against the majority shareholder and director of an insolvent small-scale company. While the company had appointed a firm of accountants as its auditor, no accounts were ever produced and the company's accounting records were exiguous.[227] The failure to keep proper accounts triggered unintended liability, whereby upon liquidation, the company owed substantial tax liability to

[219] Under the Company Directors Disqualification Act 1986- director disqualification ranges from a minimum period of two years to a maximum period of fifteen years.
[220] It should however be noted that director disqualification only applies if the company in question is a UK limited liability company.
[221] Insolvency Act 1986, s. 214(3).
[222] CAMA, s. 673
[223] **See discussion at 2.11. of this Chapter**.
[224] A. Musah, 'Benefits and Challenges of Bookkeeping and Accounting Practices of SMEs in Ghana and Its Effect on Growth and Performance in Ghana' (2017) 24(2) Journal of Accounting, Business and Management 16, 18.
[225] M. Mbogo, 'Influence of Managerial Accounting Skills on SMEs on the Success and Growth of Small and Medium Enterprises in Kenya' (2011) 3(1) Journal of Language, Technology and Entrepreneurship in Africa 109, 119; R. A. Ezejiofor et al, 'The Relevance of Accounting Records in Small Scale Business: The Nigerian Experience' (2014) 4(12) International Journal of Academic Research in Business 69, 72.
[226] [1991] B.C.C. 121.
[227] ibid

the Revenue. Moreover, the failure to keep proper accounts and records, arguably made it difficult to ascertain the company's true financial standing and indebtedness to creditors. This ultimately led to the company becoming insolvent and the director being found guilty of wrongful trading. Further, his failure to keep proper account can be argued to be a breach of his duty under s. 172 of the Companies Act 2006. Admittedly, SMEs are exempted from extensive accounting reporting (although their directors have a duty to keep proper accounts). However, it can be argued that the SME regulatory regime, which is characterised by exemptions, makes them more prone to adopting bare minimum accounting practices. This translates to a higher risk of becoming insolvent, and by extension, their directors being found liable for wrongful trading.

Even where bare minimum accounting practices are not at stake, the fact remains that a director could still be liable for wrongful trading. This is worsened by the fact that the imminence of liability for wrongful trading may not immediately be obvious to the director(s). In *Re Produce Marketing Consortium Ltd (No 2)*,[228] the first case to be brought under the wrongful trading provision of the Insolvency Act,[229] a small company (managed by a couple) was engaged in the importation of fruits. Over a period of seven years, the company slowly drifted into insolvency unbeknown to the directors. They were ultimately found liable for wrongful trading and made to contribute £ 75, 000 jointly and severally to the assets of the company. Notably, while the court conceded that there was no deliberate wrongdoing by the directors, it suggested that they failed to acknowledge what should have been clear. This case aptly illustrates the unpalatable outcome of wrongful trading.

One could argue from the above, that in cases involving wrongful trading, the courts set the bar too high and overlay their views excessively with the benefit of hindsight. In addition, the

[228] (1989) 5 BCC 569.
[229] D. Prentice, 'Creditor's Interests and Director's Duties' (1990) 10(2) Oxford Journal of Legal Studies 265, 266.

courts often undertake a complex exercise of prescribing the exact point at which the director ought to have stopped trading. However, this seemingly neutral determination is often incongruent with the subjective perception of the directors who are responsible for the business of the firm. Indeed, Whincop suggests that it is not uncommon for company directors and business owners to be optimistic about the prospects of their business succeeding even in challenging times.[230] On the one hand, the law on wrongful trading could lead them to stop trading at the earliest sign of financial trouble, to avoid the risk of future prosecution. However, the defence of taking every step to minimise loss to creditors could avail such a director/SME owner. Arguably, a genuine desire to protect business and livelihood mirrors the mindset of the average SME owner/SME director who may eventually be found liable for wrongful trading. This is more so because SMEs are largely owner-managed, and these owner-managers have both a genuine desire and strong incentive to see their businesses succeed. However, the courts have sometimes been oblivious to this reality, describing the genuine desire to protect business as overly optimistic. In *Roberts v Frohlich*,[231] the court concluded that the directors of a small company were driven by wilfully blind optimism.[232] Hence, their view that the company would secure vital business and avoid insolvent liquidation was baseless.[233] It remains debatable whether the law does true justice in adopting a punitive approach towards directors or business controllers whose actions are not made in bad faith. It can be argued in the affirmative because English law does not penalise directors for filing for insolvency too early; it does so for filing too late.

[230] M. Whincop, 'Taking the Corporate Contract More Seriously: The Economic Cases Against, and a Transaction Cost Rationale for, the Insolvent Trading Provisions' (1996) 5 *Griffith Law Review* 1- this optimism is more apparent in smaller owner-controlled businesses wherein the business managers have an interest in seeing the business succeed.
[231] [2011] EWHC 257 (Ch).
[232] ibid at 111.
[233] ibid at 112.

Notably, however, recent decisions underscore the courts' awareness of the aforementioned dangers inherent in the law of wrongful trading. For instance, in *Ralls Builders Limited (in liquidation),*[234] the court held that the directors ought to have concluded six weeks prior to ceasing trading that the company could not have avoided insolvent liquidation. Nevertheless, the court found that it was not appropriate to order them to make any contribution to the assets of the company because the liquidators had failed to establish that continued trading had caused any loss to the Company. The court held that the proper measure of loss to the Company for these purposes was the increase in the net deficiency or 'IND' basis and that the evidence did not establish any IND between when the company ought to have stopped trading and when the company eventually fell into administration. This arguably takes a more holistic approach than the classical wrongful trading cases and would allow more scope for directors and SME owners to manoeuvre. As this is a relatively recent decision, its impact and implications are yet to be fully seen.[235] Nevertheless, a recent decision suggests that is possible for a director to be liable for wrongful and fraudulent trading, where there is a causative link between the continuation of the company's trading and increase of creditors' deficit, alongside knowledge that the company was trading with the intention to defraud.[236]

Notably, the Corporate Insolvency and Governance Act 2020 (CIGA) was passed during the pandemic to modify the wrongful trading rules. It provides that when considering the contribution that a director is required to make to the company's debt, the court is to assume that the director is not responsible for worsening the company's financial position or that of its creditors.[237] However, this temporary modification only applied between 1 March 2020 and 30

[234] [2016] EWHC 243 (Ch).
[235] Gabriel Moss has criticised this decision, arguing for a to return to the original idea of wrongful trading as in the Cork Report namely: the impropriety of taking on new liabilities with no reasonable prospect of paying back. This is particularly important for SMEs in distress to appreciate the inevitable challenges of life to exonerate them from personal liabilities. See, Gabriel Moss QC, 'No compensation for wrongful trading – where did it all go wrong'? (2017) 30(4) *Insolvency Intelligence* 49
[236] Biscoe and Baxter as Joint Liquidators of Equitable Law Capital Limited v Milner [2021] EWHC 763 (Ch).
[237] CIGA, s.2.

September 2020, as well as 26 November 2020 to 30 June 2021; hence, the status quo on wrongful trading has been restored. In Nigeria, due to the recent introduction of wrongful trading provision, it remains yet to be seen how the wrongful trading provisions will be interpreted by the courts. A detailed discussion on Insolvency and the precarious position of SMEs will be undertaken in chapter 5 of this thesis.

2.13. Conclusion

In conclusion, this chapter considered the meaning and importance of SMEs, as well as the legislative and policy efforts made by the UK and Nigerian governments to cater for the SME sector. It also highlighted the nature of corporate governance problems in Nigeria, noting that they are rooted in the social, political and macro-economic environment of Nigeria.

Furthermore, it was argued that because SMEs are often exempted from the regulatory frameworks applicable to larger companies, the risk of insolvency and wrongful trading are significantly higher; both bearing unfavourable consequences for SMEs. Overall, while SMEs have tremendous economic potential, they are fraught with numerous challenges which have been discussed in this chapter. The following chapter builds upon this discussion by considering how corporate governance could alleviate the challenges faced by SMEs.

Chapter 3

3. Corporate Governance: Challenges and Prospects for Nigerian SMEs

3.1. Introduction

This chapter examines the governance of SMEs both in Nigeria and in the UK. The first part of the chapter begins with a brief background on the concept of corporate governance, particularly its development in the US and UK. It then proceeds to consider the various conceptions of corporate governance (propounded by different schools of thought), as well as the relevant theoretical explanations of the concept. Thereafter, it outlines the definition of corporate governance adopted in this thesis, providing justifications for same. Building upon the conceptual framework established, the chapter examines corporate governance through the lens of the agency theory vis-à-vis its interrelationship with SMEs.

The second part of the chapter attempts to map out a suitable corporate governance model for SMEs in Nigeria. In so doing, consideration is given to the corporate governance codes that have been promulgated in Nigeria, including but not limited to, the Code of Corporate Governance 2018 (NCCG 2018). The aim of this is to examine the suitability (or otherwise) of these codes to the operation of SMEs in Nigeria. Where appropriate, a comparison is made with corporate governance codes obtainable in the UK, particularly those that are applicable to SMEs. The aim of this, is to suggest an optimum corporate governance model for SMEs in Nigeria, having regard to their limited financial resources, board structure, shareholders, and in view of the fact that Nigeria is a developing economy with its attendant challenges.

The latter part of the chapter discusses financial governance as an essential tenet of corporate governance and makes a case for strategic SMEs to have audit committees in order to produce quality financial reporting. By way of contradistinction, it examines insolvency as a possible outcome of poor financial governance. This is followed by a brief discussion on the protection

of minority shareholders under UK and Nigerian law. The corporate governance ramifications of the COVID-19 pandemic are also examined in outline.

It must be acknowledged that SMEs cover a wide range of companies and business vehicles. Therefore, the scope of SMEs covered throughout this chapter and indeed in this thesis, are SMEs registered as private companies although other business vehicles are used as comparators. The overarching aim of this chapter is to buttress the utility of good corporate governance to the optimal operation of SMEs.

3.2. Background to the Concept of Corporate Governance

Tricker posits that while the idea of corporate governance has long existed, the phrase 'corporate governance' did not emerge until the 1980s, from which point it began to occupy a central position in academic discourse.[1] Goswami understands that the term "corporate governance" became prominent in the United States of America after the oil shock[2] in 1979 when activist pension funds started demanding board-level performance for its investors, and junk-bond funded raiders began targeting under-performing companies.[3] He further explains that the term gained significance in the UK in the late 1980s and early the 1990s after the fall of the Bank of Credit and Commercial International ("BCCI") and the mismanagement of the Maxwell Group which resulted in the press faulting the British system of monitoring public companies.[4]

Cheffins observes that the UK experienced numerous business restructurings in the 1980s in response to poor industrial management. Thus, corporate governance garnered little attention

[1] R. Tricker, Corporate Governance: Principles, Policies, and Practices (3rd Edition, Oxford University Press, 2015) 4.
[2] The oil shock arose in 1973, when Arab members of Organisation of Petroleum Exporting Countries (OPEC) placed an embargo on exports to the United States, bringing the American economy to a grinding halt. For an account of the oil shock and its attendant impact, see John Ikenberry, 'The Oil Shocks and State Responses' in *Reasons of State: Oil Politics and the Capacities of American Government* (Cornell University Press, 1998) 2.
[3] O. Goswami, OECD Development Centre, 'The Tide Rises, Gradually Corporate Governance in India', 2000 <http://www.oecd.org/daf/ca/corporategovernanceprinciples/1931364.pdf > accessed 7 March 2020.
[4] ibid

in the 1980s due to the sturdy nature of Britain's market for corporate control.[5] In 1985, Tricker noted the little attention given to corporate governance in the UK. He observed that until 1985, the term "corporate governance" was only mentioned once in a 1978 article of the Times Newspaper.[6] Despite Tricker's observation, the term remained largely ignored as it was only referenced on one occasion each by Guardian, the Economist and the Observer in 1989, 1990 and 1991 respectively.[7]

The inauguration of the Sir Adrian Cadbury Committee in the UK in 1991 was, perhaps, the milestone step towards the increased prominence of corporate governance in the UK.[8] The Cadbury Committee was inaugurated in response to the perceived erosion of confidence in the standard of disclosure in published company accounts and in auditors' ability to meet the expectations of users of corporate financial statements.[9] The Committee was responsible for considering corporate governance issues, particularly the duties of executive and non-executive directors to examine and report on the corporate performance of companies.[10] The deliberations of the Cadbury Committee coincided with the UK experiencing harsh economic conditions. The recession, therefore, revealed the managerial inefficiencies which the economic boom of the 1980s had concealed.[11] In addition, the corporate scandals and failures which occurred subsequent to the inauguration of the Cadbury Committee led to the Cadbury Committee

[5] Brian R. Cheffins, 'The Rise of Corporate Governance in the U.K.: When and Why 2015' University of Cambridge Faculty of Law Research Paper No. 18/2015; ECGI - Law Working Paper No. 293/2015. <https://ssrn.com/abstract=2598179> or <http://dx.doi.org/10.2139/ssrn.2598179> accessed 20 February 2020

[6] Tricker, (n 1) 9.

[7] Cheffins (n 5) 57; (Economist) Mary Brasier, 'US-Style Proxy War Looks Set to Spread to British Companies', Guardian (London, 22 June 1989) 15; Maurice Gillibrand, 'Accountability is the Key to Wider Share Ownership' Observer (London, 19 May 1991) 30 (search conducted using the ProQuest Historical Newspaper database).

[8] The Rise of Corporate Governance in the U.K.: When and Why 2015). University of Cambridge Faculty of Law Research Paper No. 18/2015; ECGI - Law Working Paper No. 293/2015. <https://ssrn.com/abstract=2598179> accessed on 18 August 2019

[9] Laura F. Spira and Judy Slinn, 'The Cadbury Committee: A History', First Edition, Oxford University Press (2013) 45; Brian R. Cheffins, *Company Law: Theory, Structure and Operation* (Oxford University Press 1997) 9.

[10] ibid

[11] A. Brummer, 'Stirring Up Lifestyles of the Company Directors' Guardian (London, 30 May 1991) 11; M. Fowle, 'Directors, Not Auditors, Govern Companies' Financial Times (London, 13 June 1991) 12; R. Trapp, 'Much Ado About a Little' Independent (London, 31 May 1992) 11

Report recommending corporate governance standards with a view to averting similar scandals and failures in future. Indeed, the Cadbury Report noted that if a similar code had been in existence in the past, instances of unexpected company failures and cases of fraud would have received attention earlier.[12] For example, in 1990, the UK experienced the collapse of Polly Peck International Plc amidst the perpetration of the biggest English commercial fraud in history.[13] In July 1991, BCCI was shut down on account of corruption and fraudulent activities which arose from minimal boardroom oversight.[14] Events occurring following the death of Ian Robert Maxwell unearthed the fraudulent diversion of pension funds perpetrated at Maxwell Communications Corporation and Mirror Group Newspapers Plc which ultimately led to the collapse of both companies.[15]

A Swiss law expert, in capturing the global impact of the Cadbury Committee report, suggested that any discussion of corporate governance today would necessarily include the Cadbury Report and the corresponding Code of Best Practice.[16] In 1992, the Cadbury Committee published the Cadbury Code of Best Practice (the "Code"), and in 1994, principles of the Code were appended to the Listing Rules of the London Stock Exchange ("LSE"). Thus, companies listed on the LSE were required to adhere to the Code or proffer valid reasons for non-compliance.[17] Unfortunately, the implementation of recommendations set out in the Code failed to yield optimal results globally as corporate scandals similar to those in the early 1990s were perpetrated in the United States of America in the early 2000s. This resulted in the liquidation of Enron Corporation and MCI Communications Corp (WorldCom) in 2001 and REFCO in 2005. There was, therefore, the need for stricter measures to be implemented in

[12] Committee on the Financial Aspects of Corporate Governance, Report (n 8) 12
[13] G. David, 'Polly Peck: From £2 Billion to Zero', Sunday Times (London, 28 October 1990), sec. 2, 8; A. Davidson, 'Scandal' Sunday Times (London, 29 October 1991) 3
[14] S. Prokesch, 'Years of Problems' NY Times (New York, 6 July 1991) 1; 'Wholesale Deception to Misrepresent and Falsify' Financial Times (London, 3 August 1991) 7
[15] B. R. Cheffins, *Company Law: Theory, Structure and Operation* (Oxford University Press, 1997) 612 - 613
[16] P. Böckli, 'Switzerland' A.R. Pinto and G. Visentini (eds), The Legal Basis of Corporate Governance in Publicly Held Corporations: A Comparative Approach (Kluwer, 1998), 195, 198
[17] Stock Exchange, *The Listing Rules* (London Stock Exchange, 1993), para. 12.43 (j)

preventing such scandals in future. In response, the US Congress enacted the Sarbanes-Oxley Act in 2002 to protect investors, by making corporate disclosures more extensive, reliable, and accurate.

Furthermore, in 2007, the world experienced a global financial crisis that led to the failure of large financial institutions, though some received government bailouts. The crisis was attributable to poor board performance and flawed executive compensation practices that led to aggressive risk taking.[18] It has been observed that firms with higher institutional ownership took more risks before the crisis and this resulted in larger shareholder losses during the crisis period.[19] This is because external monitoring by boards and shareholders encourage risk-taking to increase shareholder returns. On the other hand, financial firms with good corporate governance practices mitigated their losses. A research conducted on large public U.S banks acknowledges that banks with stronger corporate governance mechanisms had; higher profitability, higher market valuations and less negative stock returns during and after the crisis.[20] Hence, as corporate governance is a mechanism for addressing risk management, initiatives in recent times are now being geared towards the importance of effective corporate governance practices.

The above historical background is indispensable, as it illustrates that corporate governance was originally developed with larger firms and public companies in mind. This would suggest that the concept is more apposite to larger companies and holds little, if any, practical significance to small businesses – the focus of this thesis. However, this chapter will demonstrate that while corporate governance was originally conceived for large companies, it is equally applicable – and indeed holds much potential – within the SME context. Moreover,

[18] H. Tarraf, 'The Role of Corporate Governance in the Events Leading Up to the Global Financial Crisis: Analysis of Aggressive Risk-Taking' (2011) 5(4) Global Journal of Business Research 93, 95.
[19] D. H. Erkens, M. Hung, P. Matos 'Corporate Governance in the 2007-2008 Financial Crisis: Evidence from financial institutions worldwide' 18 (2012) Journal of Corporate Finance 389, 411
[20] E. Peni, S. Vahamaa 'Did Good Corproate Governance Improve Bank Performance During the Financial Crisis' 41 (2012) J Financ Serv Res 19, 35.

there is arguably an interrelationship between corporate governance in large companies and SMEs, such that bad governance in the former, could have dire consequences on the latter. A noteworthy example is the collapse of Carillion plc, which was hitherto Britain's second largest construction company. The company is said to have collapsed due to deep corporate governance failings, particularly the lack of board accountability.[21] It is estimated that nearly 30,000 businesses, majority of which were SMEs, undertook work for and relied on the construction giant.[22] Following the company's liquidation, most of its SME subcontractors lost considerable amounts of work and were left with substantial bad debts vis-à-vis unpaid invoices.[23] More than two years on, the financial impact of Carillion's collapse is still being felt by SMEs.[24] This illustrates the fact that poor governance leading to the failure of a large company, could also potentially lead to the demise of its SME stakeholders.

3.3. Defining Corporate Governance

Corporate governance (as presently understood) is a multi-faceted concept;[25] one that is bereft of a clear-cut meaning.[26] Furthermore, the boundaries of the concept vary. Accordingly, Babic suggests that one must first recognise the complexity and interdisciplinary nature of corporate governance before attempting to research its problems, particularly in a developing economy (such as Nigeria).[27]

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[21] S. Sadan, 'Carillion's collapse exposes deep corporate governance failings' (Financial Times, February 14, 2018) <https://www.ft.com/content/1958fb80-0fe6-11e8-940e-08320fc2a277> accessed 19 October 2020.
[22] Graham Toy, 'Carillion crisis proves that SMEs are on a knife edge' (Small Business, 30 January 2018) <https://smallbusiness.co.uk/carillion-proves-smes-knife-edge-2542510/> accessed 16 October 2020.
[23] The Construction Index, 'SMEs hit hardest by post-Carillion lending cuts' (The Construction Index, 20 November 2018) <https://www.theconstructionindex.co.uk/news/view/smes-hit-hardest-by-post-carillion-lending-cuts> accessed 14 October 2020.
[24] T, Sasse, Colm Britchfield and Nick Davies, "Carillion: Two years on" (Institute for Government, March 2020) <https://www.instituteforgovernment.org.uk/sites/default/files/publications/carillion-two-years-on.pdf> accessed 14th October 2020
[25] G. J. D. Rossouw, 'Balancing Corporate and Social Interests: Corporate governance theory and practice' (2008) 3(1) African Journal of Business Ethics 28.
[26] G. Abid, B. Khan, Zeeshan Rafiq and Alia Ahmed, 'Theoretical Perspectives of Corporate Governance' (2014) 3(4) Bulletin of Business and Economics 166, 167.
[27] V. Babic, 'Corporate Governance Problems in Transition Economies' 34(2) Teme 555, 559.

Nevertheless, it is essential to appreciate and delineate the various conceptions of corporate governance; and thereafter adopt a working definition for this thesis. Firstly, there is the operational perspective of corporate governance. This perspective considers corporate governance through the lens of governance structures, practices and processes. In the Cadbury Report on the Financial Aspects of Corporate Governance, for instance, corporate governance was defined as the system by which companies are directed and controlled.[28] This perspective was also adopted in the OECD Corporate Governance Code 2004.[29] Tricker notes that the operational perspective has been the basis for much work in corporate governance.[30]

Secondly, there is the relationship perspective to defining corporate governance. This considers the relationship between the various participants of the company. It stipulates the distribution of rights and responsibilities among the different participants in the organisation – such as the board, managers, shareholders – and lays down rules and procedures for decision-making. This bears wider significance to the concept of corporate law. While companies can be conceptualised as a network of competing interests, corporate law largely seeks to reconcile these interests. Indeed, John Armour understands that corporate law exists to address three fundamental problems: the conflict between managers and shareholders; the conflict between controlling and minority shareholders; and the conflict between shareholder and non-shareholder constituencies.[31] Thus, the relationship perspective advances corporate governance discourse by placing companies within the broader sphere of interests, which are ultimately aimed to be reconciled.

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[28] Committee on the Financial Aspects of Corporate Governance & Alan Cadbury, *Report of the Committee on the Financial Aspects of Corporate Governance* (London, Gee: 1992)

[29] OECD, 'OECD Principles of Corporate Governance' (2004) <www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf > accessed 18 August 2019

[30] Tricker (n 1)

[31] J. Armour, 'Basic Governance Structure: The Interests of Shareholders as a Class' in Kraakman et al, *Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd Edition, Oxford University Press, 2017) 49.

Thirdly, there is the stakeholder perspective, which takes a wider view of those involved in and affected by corporate governance. Unlike the relational perspective, this view takes an outward looking approach to corporate governance, focusing not only on the relationship between the company's internal participants and its primary external constituents like creditors, but also examines the company's relationship with wider constituents. Corporate governance thus examines the company's interaction, *inter alia, with* external auditors, regulators and other legitimate stakeholders.[32] This is similarly expressed in the UK Companies Act 2006 (albeit within the context of directors' duties). Section 172 of the Act provides that in line with promoting the success of a company, a director must have regard to the wider interest of stakeholders such as employees, customers, suppliers, the community and the environment.[33]

Fourthly, there is the financial economics perspective, whereby corporate governance deals with the way financiers of companies assure themselves of getting a return on their investment.[34] This perspective considers corporate governance vis-à-vis the financing of a company and the legal protection/redress mechanisms available to investors/financiers.[35] Under this perspective, corporate governance and finance are inextricably linked.[36] Notably, the financial economics perspective has been a dominant contributor to corporate governance research which applies the agency theory.[37]

Finally, there is the societal perspective, which places the corporate entity within the larger society. According to this theory, corporate governance deals with striking a balance between economic and social goals, and between individual and communal goals.[38] The corporate

[32] Tricker (n 1)
[33] Companies Act 2006, s 172(1)(b)(c)
[34] Andrei Shleifer and Robert W. Vishny, 'A Survey of Corporate Governance' (1997) 52(2) Journal of Finance 737, 740.
[35] ibid. See also *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 B.C.L.C. 598.
[36] **See Chapter 4 for an extensive discussion of corporate governance and finance, specifically access to finance.**
[37] Tricker (n 1)
[38] A. K. Buchholtz, J. A. Brown and K. Shabana, *Corporate Governance and Corporate Social Responsibility* in A. Crane, D. Matten, A. McWilliams, Jeremy Moon and Donald S. Siegel (eds) *Oxford Handbook of Corporate Social Responsibility* (Oxford University Press, 2008) 328.

governance framework therefore exists to encourage the effective use of resources and equally to require accountability for the stewardship of those resources.[39] Sir Alan Cadbury once noted that the essence of the societal perspective is to align, as nearly as possible, the interests of individuals, corporations and society.[40] Similarly, section 172(1)(d) of the Companies Act 2006 enjoins directors to have regard to the impact of the company's operations on the community and environment. This recognises the fact that business entities interact with their immediate environment and community. Thus, corporate objectives must not be pursued at the expense of the environment or community.

The different perspectives of corporate governance are arguably interconnected. The operational perspective, which borders on how a company is directed and controlled, is invariably linked to the relationship perspective, the stakeholder perspective, the financial-economic perspective, and the societal perspective. The Board and the other stakeholders (the stakeholder perspective) through whom the affairs of a company are directed and controlled (the operational perspective) interrelate (the relationship perspective) within the bounds of the powers conferred on each stakeholder in achieving the ultimate objectives of investors (the financial objective perspective) and the society at large (the societal perspective). The role of the stakeholders is to protect the ultimate interest of the investors through the maximization of profit. This will, in turn, imbue the company with the financial buoyancy to discharge its corporate social responsibility whilst also contributing to the nation's economy. Thus, from the combined consideration of the different perspectives of corporate governance, the concept can be defined as *a delineated process of directing and controlling the activities of a company by*

[39] ibid

[40] See Sir A. Cadbury's "Foreword" in Magdi R. Iskander and Nadereh Chamlou, *Corporate Governance: A Framework for Implementation* (The International Bank for Reconstruction and Development/The World Bank Group, 2000) <www.documents1.worldbank.org/curated/pt/831651468781861 9/pdf/30446.pdf> accessed 18 August 2019.

stipulating the role of stakeholders, with the ultimate aim of achieving financial profitability and contributing to the development of the society at large.

Notwithstanding the above definition, one could argue that in order to engage meaningfully with the concept of corporate governance, there are further considerations to be made,[41] namely: (i) the distinctions between the internal and external dimensions of corporate governance and (ii) the agency theory.

3.4. Internal and External Corporate Governance

The distinction between internal and external corporate governance borders on whether the locus for control of corporate governance is located within or outside the corporation.[42] Thus, conceptions of corporate governance that locate the responsibility for corporate governance within the corporation (i.e. the board and executive management) can be termed as internal corporate governance. On this level, corporate governance is concerned with how a company directs its own affairs, and the responsibility for corporate governance lies with the board of directors and executive management of a company, for the purpose of directing and controlling the company.[43] The legal rationale behind this is that directors have actual-express authority to manage a company's business.[44] However, by virtue of Company Law internal facility, in the event of a deadlock or an incompetent board, shareholders as part of corporate management can act at management level.

[41] G. J. Deon Rossouw, 'Balancing Corporate and Social Interests: Corporate governance theory and practice' (2008) 3(1) African Journal of Business Ethics 28, 30.

[42] G. J. Deon Rossouw, A.van der Watt and D. P. Milan, 'Corporate Governance in South Africa' (2002) 37 Journal of Business Ethics 289, 291

[43] The UK Corporate Governance Code 2018 highlights the role of the board in corporate governance vis-à-vis the establishment of the company's purpose, values and strategy; ensuring that company objectives are met and performance measured against them; and promoting the long-term sustainable success of the company, inter alia. The Code also notes the division of responsibilities between the board and executive management of the company's business (See Principles 1 and 2 of the Code).

[44] See *LNOC Limited v Watford Association Football Club* [2013] EWHC 3615 (Comm) and *Hely-Hutchinson v Brayhead* [1968] 1 QB 549 on the actual-express authority of directors to manage the affairs of a company. See also Companies (Model Articles) Regulations 2008, Schedule 1 (Model Articles for Private Companies), Art.2; Schedule 3 (Model Articles for Public Companies) Art 3; Companies Act 2006, s.40; and CAMA, s. 87(1).

Conversely, where the locus of corporate control can be located outside the corporation, it is external corporate governance. Corporate governance within this view, contemplates the legal/regulatory environment within which companies' function as well as the market for corporate control. It entails control over companies through institutions like the state and judiciary. Comprehensively, it comprises the private and public institutions (including laws, regulations and accepted business practices) which together govern the relationship, in a market economy, between corporate managers and entrepreneurs (corporate insiders) on the one hand, and those who invest resources in corporations, on the other hand.[45] These institutions exercise external control over companies by determining the network of laws, rules and regulations within which corporations have to operate.[46] Apart from laying down ground rules for key role players, this external control aims to protect shareholders and/or stakeholders in a corporate action, and also to prevent the market from failing due to malpractices.[47] The second aspect of external control is the control over companies exercised through the market.[48] The noteworthy point here is the possibility of mergers and acquisitions in order to gain control over companies that do not satisfy market expectations.[49] Within the SME context, the market for corporate control arguably serves two complementary corporate governance functions. On the one hand, it serves as a check to prevent the affairs of the company from being run sub-optimally. On the other hand, it incentivises solid managerial performance, and serves as a growth and financial value strategy for SME managers and shareholders. This latter function

[45] C. P. Oman, 'Corporate Governance and National Development' (2001) OECD Development Centre Working Paper No. 180 <https://www.oecd-library.org/docserver/113535588267.pdf> accessed 28 August 2019
[46] J. C. Coffee, 'Inventing a corporate monitor for transitional economies: The uncertain lessons from the Czech and Polish Experiences' in Klaus Hopt, Hideki Kanda, Mark J. Roe, Eddy Wymeersch and Stefan Prigge (eds) *Comparative Corporate Governance: The State of the Art and Emerging Research* (Oxford University Press, 1998) 68.
[47] R. Romano, 'Empowering Investors: A Market Approach to Securities Regulation' in Klaus Hopt, Hideki Kanda, Mark J. Roe, Eddy Wymeersch and Stefan Prigge (eds) *Comparative Corporate Governance: The State of the Art and Emerging Research* (Oxford University Press, 1998) 144.
[48] Market control could also include compliance and disclosure requirements that come with a public listing. However, these aspects of market control are less applicable to SMEs.
[49] E. R. Gedajlovic and D. M. Shapiro, 'Management and ownership effects: Evidence from five countries' (1998) 19 Strategic Management Journal 533, 535.

is strengthened by the link between managerial performance and share prices. The impact of the market for corporate control is apparent in the IT and Fintech industries. Paystack, a medium-sized Nigerian fintech startup, was recently acquired by Stripe (a US based financial services company) for an unprecedented[50] sum of $200 million. It is not far-fetched to suggest that Paystack's high valuation was due, in no small part, to the company's solid corporate governance practices.

3.5. Theorising Corporate Governance: The Agency Theory

Arguably, the bulk of the research into corporate governance stems from the agency theory.[51] Since the scholarly contributions of Berle and Means in 1932,[52] corporate governance has focused upon the separation of ownership and control, which results in principal-agent problems arising from the dispersed ownership in the modern corporation. They regarded corporate governance as a mechanism where a Board is a crucial monitoring device to minimise the problems brought about by the principal-agent relationship.[53]

At its core, the agency theory suggests that the separation of ownership and control in firms raises the potential conflicts of interests (agency costs), whereby personal interests may be pursued at the expense of other constituencies in the company. For instance, self-interested managers as agents of shareholders, could take actions that benefit themselves at the expense of shareholders. This may arise where, contrary to the wishes of the shareholders (on the basis that the proposed action will not be in the best commercial interests of the company), the Board implement business policies that would only increase their remuneration as directors.

[50] Till date, it is the largest ever M&A deal in Nigerian tech and one of the biggest in Nigerian corporate history. See Ruth Olurounbi, 'Nigeria: $200m Paystack/Stripe deal is a tip-off for global investors' (The Africa Report, 16 October 2020) <https://www.theafricareport.com/46335/nigeria-200m-paystack-stripe-deal-brings-visibility-to-ecosystem/> accessed 19 October 2020.
[51] W. Fauziah, W. Yusoff and I. A. Alhaji, 'Insight of Corporate Governance Theories' (2012) 1(1) Journal of Business & Management 52, 53.
[52] A. A. Berle and G. Means, *The Modern Corporation and Private Property* (Transaction Publishers, 1932)
[53] ibid

Arising from the above is the agency problem on how to mandate the agent(s) to act in the principal's best interest. As highlighted in Chapter 2, this inevitably results in agency costs, for example, monitoring costs and disciplining the agent to prevent abuse.[54] Jensen and Meckling define agency costs as the sum of monitoring expenditure by the principal to limit the aberrant activities of the agent,[55] as well as the residual loss arising from the divergence between the agent's decisions and those decisions that would maximise the principal's welfare.[56] The scope/extent of the agency problem arguably depends on the ownership characteristics of each country. In countries with dispersed ownership structures, if the investors disagree with the management or are disappointed with the performance of the company, they utilise the exit options. Conversely in countries with concentrated ownership structures, large dominant shareholders tend to control management and expropriate minority shareholders to gain private control benefits, subject to countries where control enhancing mechanisms may be used by the minority to protect their operational and financial control.

The agency theory is also relevant in the SME context as between SME owners/managers and their companies (as principals), to consider interests of stakeholders like creditors.[57] The creditors provide debt finance to SMEs as business counterparts, in return for payment of the principal amount and an agreed interest. However, SME owners/managers who are agents of their companies (in facilitating the honouring of the loan obligations) are often deficient in financial and accounting reporting systems. In some instances, they may fail to make full disclosure of their companies' financial circumstances to creditors. This lack of transparency results in information asymmetries to the detriment of the creditors.[58]

[54] A. Shleifer and R. W. Vishny, 'A Survey of Corporate Governance' (1997) 52(2) Journal of Finance 737, 740
[55] M. C. Jensen and W. H. Meckling, 'The Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structures' (1976) 3(4) Journal of Financial Economics 305, 308.
[56] ibid
[57] F. Yahya, Syed Atif Ali, Zahiruddin Ghazali, 'The relevance of agency conflicts in small and medium enterprises' (2016) International Journal of Advanced and Applied Sciences, 3(7) 41; See chapter 4.4.1 on the discussion of information asymmetry
[58] ibid 42

Furthermore, the agency problem is heightened where SME managers embark on underinvestment or choose to invest in risky projects. Some SME managers do so, believing that bulk of the risk burden lies on the creditor in case of business failure. To prevent the moral hazard of actions like this, creditors may specify terms in the loan instrument that may restrict managers from participating in some activities.[59] These terms include monitoring terms and reporting procedures. This serves as a form of corporate control over the managers. Also, lenders may conduct due diligence to investigate and ascertain managerial capabilities, creditworthiness, and current financial status. However, this results in agency costs which may be passed on to the SME and eventually constitute a major impediment to small firms obtaining external financing.[60]

Arguably, the agency problems that arise from the separation of the management and control of business are less likely to occur in an SME. This is because SMEs typically (though not always) consist of the owner, who doubles as the manager of the business. As a result, SMEs have a less pronounced separation of ownership and management than larger, publicly listed firms.[61] Further, the reduced likelihood of the agency problem in SMEs – particularly in the light of (a) the fusion of the ownership and management in SMEs; and (b) the fact that SMEs are not accountable to the public since they do not rely on public funds – has led to the suggestion that corporate governance should not apply to SMEs.[62] However, given the global concern for the applicability of corporate governance to SMEs, it is arguable that the codes and guidelines applicable to larger companies should equally apply to SMEs.[63] Moreover,

[59] ibid 43
[60] H. Landstrom, 'Agency Theory and Its Application to Small Firms: Evidence from the Swedish Venture Capital Market' (1993) Journal of Small Business Finance 2(3) 203, 206.
[61] J. Abor and N. Biekpe, 'Does Corporate Governance Affect the Capital Structure Decisions of Ghanaian SMEs? <http://www.africres.org/SMME%20Research/SMME%20Research%20General/Conference%20Papers/Capital%20structure%20of%20SMEs%20in%20Ghana.pdf> accessed 18 August 2019
[62] ibid
[63] J. Abor and C. Adjasi, 'Corporate Governance and the Small and Medium Enterprises Sector: Theory and Implications (2007) 7(2) Corporate Governance International Journal of Business in Society 111, 113.

corporate governance has a significant impact on the financing decisions of SMEs. Therefore, it can potentially improve the financing of SMEs through the combination of better management practices, effective control and accounting systems, stringent monitoring, effective regulatory mechanism and the efficient utilisation of firms' resources.[64] It can also reduce the risk of default and, to some extent, insolvency.

This thesis, thus far, has focused on company SMEs, as the principle of corporate governance in Nigeria is less applicable to other forms of SMEs such as business names and partnerships. This is because the word "corporate" in Nigeria is used in relation to entities that are conferred with corporate legal personality.[65] In addition, the organs of corporate governance, particularly the Board, are not present in those other forms of SMEs. Nonetheless, one could argue that unincorporated SMEs in Nigeria ought to be subject to a management system comprising of rules and policies (similar to corporate governance for private limited liability companies), to ensure accountability and ultimately position them to achieve desired results.

3.6. Corporate Governance: The SME Reality

Abor and Beikpe submit that SMEs tend to have a less pronounced separation of ownership and management than larger firms.[66] It is sometimes argued that because SMEs have few employees who are often relatives of the owner and, thus no separation of ownership and control, there is little or no need for corporate governance in their operations.[67] Additionally, there is the question of non-accountability of SMEs to the public, since they do not depend on public funds.[68] In spite of these arguments, SMEs' survival in contemporary global markets

[64] ibid
[65] In the UK, the word corporate also applies to limited companies and LLPs. In Nigeria, the word 'corporate' applies to incorporated companies and LLPs, but not registered business names and limited partnerships (LPs). For the UK, see, sections 1, 3, 4 and 5 of the Companies Act 2006 and s.1 of the Limited Liability Partnerships Act 2000. For Nigeria, see sections 21 and 746 CAMA.
[66] J. Y. Abor and N. Beikpe, 'Corporate Governance, Ownership Structure and Performance of SMEs in Ghana: Implications for Financing Opportunities' (2007) 7(3) Corporate Governance International Journal of Business in Society 288, 290.
[67] P. Rosa, 'Corporate Governance in SMEs' (2005) 18(4) Family Business Review 350, 351.
[68] ibid

largely depends on the quality of their corporate governance structure. Prior to the development of corporate governance as it exists today, SMEs were not committed to its tenets.[69] However, as corporate governance continues to gain traction, its importance has become more pronounced.[70] For instance, an SME's ability to secure funding and expand its operations is intrinsically linked to its corporate governance structure vis-à-vis transparency, financial disclosure and good financial reporting.[71] Hence it is crucial to examine the application of corporate governance in the SME context.

Huse suggests that, in recent years, governance research has extended from large firms to studies of SMEs.[72] Nevertheless, while the literature has provided valuable insights into different governance forms and mechanisms, it shares the simplistic view that different governance mechanisms operate independently of each other.[73] This is particularly relevant to the study of SMEs because many of these firms are closely held and governance issues are more entwined than in large, publicly held firms where the separation of ownership and management is more clear-cut.[74] In SMEs, ownership, board, and top management often overlap, with the same people, or people from the same family, involved at all levels.[75] Indeed, the majority of SMEs are owner-managed and closely held.[76]

[69] F. Ekow Arthur, 'Adherence to Good Corporate Governance in Small and Medium Enterprise in Ghana: An Investigative Report' (2016) 7(9) Research Journal of Finance and Accounting 1, 3.
[70] S. N. Radebe, 'The benefits of good corporate governance to small and medium enterprises (SMEs) in South Africa: A view on top 20 and bottom 20 JSE listed companies' (2017) 15(4) Problems and Perspectives in Management 271, 272.
[71] ibid
[72] M. Huse, 'Boards of Directors in SMEs: A Review and Research Agenda' (2000) 12(4) Entrepreneurship and Regional Development 271, 273.
[73] K. Rediker and A. Seth, 'Board of Directors and Substitution Effects of Alternative Governance Mechanisms' (1995) 16(2) Strategic Management Journal 85, 89.
[74] M. Cowling, 'Productivity and Corporate Governance in Smaller Firms' (2003) 20 Small Business Economics 335; W. S. Schulze *et al*, 'Toward a Theory of Agency and Altruism in Family Firms' (2003) 18(4) Journal of Business Venturing 473, 475.
[75] M. Mustakalio *et al*, 'Relational and Contractual Governance in Family Firms: Effects on Strategic Decision Making' (2002) 15(3) Family Business Review 205, 208.
[76] M. Nordqvist and L. Melin, 'The Dynamics of Family Firms: An Institutional Perspective on Corporate Governance and Strategic Change' in D. Fletcher (ed.) *Understanding the Small, Family Firm* (Routledge, 2002)

The effect of concentrated ownership and the fusion of ownership and management is that managers are subjected to less external pressures from investors and other monitors who require transparency and accountability. The concentrated nature of ownership in closely held firms makes them susceptible to inertia,[77] especially because many closely held firms (SMEs) are also family firms.[78] The blending of family and business matters in decision-making may promote inertia in these firms, when for instance a CEO postpones necessary business decisions, such as a generational succession, for concerns about the family welfare. It is arguable that family ownership impedes strategic change activities, such as innovation, venturing and strategic renewal activities, due to the risk aversion of the concentrated ownership, altruistic incentives, and problems with self-control.[79]

There is also the argument that closely held SMEs/family firms are conservative and resistant to change, paralysed by internal family conflicts and have a defensive attitude harming long-term efficiency.[80] Ultimately, this negatively affects how such closely held firms are governed. Conversely, it is arguable that the concentration of ownership in the same individual or a limited group of individuals increases the likelihood that the firm is run through consistent values, interests and corporate governance practices.[81] Thus, closely held family firms (SMEs) present a two-pronged phenomenon when it comes to corporate governance. Nevertheless, research suggests that the success of closely held family firms is dependent on their ability to

[77] William Schulze, Michael Lubatkin and Richard Dino, 'Altruism, Agency, and the Competitiveness of Family Firms' (2002) 23(4) Managerial and Decision Economics 247.
[78] The European Commission, *Overview of Family-Business-Relevant Issues: Research, Networks, Policy Measures and Existing Studies,* Final Report of the Expert Group, November 2009.
[79] O. Brunninge, M. Nordqvist and J. Wiklund, 'Corporate Governance and Strategic Change in SMEs: The Effects of Ownership, Board Composition and Top Management Teams' (2007) 29(3) Small Business Economics 295, 298.
[80] E. Memili, Erick P.C. Chang, Franz W. Kellermanns and Dianne H.B Welsh, 'Role Conflicts of Family Members in Family Firms' (2015) 24(1) European Journal of Work and Organizational Psychology 143, 147
[81] M. Singal and V. Singal, 'Concentrated ownership and firm performances: does family control matter?' (2011) 5(4) Strategic Entrepreneurship Journal 373, 378.

establish effective leadership, clarity of roles and a logical organisational structure – all of which are tenets of good corporate governance.[82]

Babic posits that in most developed economies, an organised system of corporate governance has been built gradually over time, and today it is a mosaic comprising regulations, laws, public institutions, professional associations and ethics codes.[83] Conversely, she argues, a lot of the details of the mosaic are still missing in transition economy (developing) countries.[84] Further, efforts to develop a system of good corporate governance in developing countries is made difficult by problems such as complex corporate ownership structures, vague and confusing relationships between the state and financial sectors, weak legal and judicial systems, absent or underdeveloped institutions and scarce human resource capabilities.

The development of corporate governance demands the establishment of certain market economy institutions necessary for economic growth. Arguably, developing economies such as Nigeria either lack, or are deficient in these requisite market economy institutions. Nevertheless, without good corporate governance, businesses cannot maximise their main profit-making potential and contribute to social welfare at an optimal level. Companies cannot operate successfully without adequate rules of governance and supporting institutions, or without the acceptance of a culture of corporate governance among managers, owners and other stakeholders.[85]

3.7. Regulating Corporate Governance

Recurring corporate scandals have arguably reiterated the need to ensure the effective governance of corporations across the globe.[86] In particular, the global financial crises arose

[82] C. Howorth and M. Kemp, *Governance in Family Businesses: Evidence and Implications* (IFB Research Foundation, 2019) <https://www.ifb.org.uk/media/4133/governance-in-family-businesses-evidence-and-implications_web.pdf> accessed 21 June 2021
[83] V. Babic, 'Corporate Governance Problems in Transition Economies' 34(2) Teme 555, 559.
[84] ibid
[85] Babic (n 85) 561.
[86] I. Filatotchev and C. Nakajima, 'Internal and External Corporate Governance: An Interface between an Organization and its Environment' (2010) 21(3) British Journal of Management 591, 594.

partly due to sub-optimal corporate governance practices among several organisations across the globe.[87] These scandals and corporate lapses have led to the emergence of Codes of Best Practices in different countries, Nigeria being no exception.[88] Notwithstanding this, this thesis proffers two theoretical insights, which have been provided to explain why countries adopt corporate governance codes.

The first perspective relates to the efficiency gains or benefits that would result from the adoption of corporate governance codes. In the context of corporate governance regulation, the adoption of codes of conduct and best practices would be seen to improve actual governance practices and produce better governance outcomes, in the light of protecting and attracting investments.[89] For instance, Picou and Rubach found in their study, that firms that announced the enactment of corporate governance guidelines experienced increased stock prices following the announcements.[90] Such benefit arguably provides a rational basis for the adoption of corporate governance codes.

The second perspective is premised on social legitimation, which is essentially the adoption of principles/practices which are expected within the society. Social legitimacy emphasises the consistency of organisational goals with societal functions such that organisations are subject to the application of generalised societal norms.[91] Accordingly, organisational systems (and in this context, corporate governance regulatory systems) seek legitimacy and support by incorporating structures and procedures that match widely accepted cultural models embodying international beliefs and knowledge systems.[92]

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[87] ibid

[88] E. Okike and E. Adegbite, 'The Code of Corporate Governance in Nigeria: Efficiency Gains or Social Legitimation?' (2012) 95(3) Corporate Ownership and Control 262.

[89] A major premise of the efficiency gains theory is that countries and companies with weak corporate governance systems are unlikely to attract foreign investments. Conversely

[90] A. Picou and M. J. Rubach, 'Does Good Governance Matter to Institutional Investors? Evidence from the Enactment of Corporate Governance Guidelines' (2006) 65(1) Journal of Business Ethics 55, 57.

[91] P. J. DiMaggio and W. W. Powell, 'The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields' (1983) 48(2) American Sociological Review 145, 153.

[92] M. Ruef and R. Scott, 'A Multidimensional Model of Organisational Legitimacy: Hospital Survival in Challenging Institutional Environments' (1998) 43(4) Administrative Science Quarterly 877, 879.

Aguilera and Jackson argue that countries with efficient legal systems and strong shareholder protection rights tend to be more prone to develop codes for efficiency reasons.[93] Conversely, developing countries (such as Nigeria) tend to adopt corporate governance codes due to the social legitimation pressures placed by cross-border investors and the international financial market.[94] Given Nigeria's reputation as a country where corruption is endemic, the government of Nigeria has appeared keen to eradicate such a reputation. Hence, the adoption of corporate governance codes can be seen as an attempt to ensure that Nigeria effectively competes in the global marketplace and attracts international investors to facilitate economic growth and development.

3.8. Corporate Governance Codes in Foreign Jurisdictions

Across the world, efforts have been made to propose corporate governance guidelines for SMEs. While there is no universally approved standard model of corporate governance for SMEs, there are useful sources of guidance.[95] The European Confederation of Directors Associations (ecoDa) has issued Corporate Governance Guidance and Principles for Unlisted Companies in Europe, designed to be a practical tool for businesses and their stakeholders. Though developed with European companies in mind, the guidance and principles are equally relevant to businesses in other regions.[96] As ecoDa notes, good corporate governance for unlisted companies is about 'establishing a framework of company processes and attitudes that add value to the business, help build its reputation and ensure its long-term continuity and success'.[97] Notably, the EU has adopted corporate governance-focused directives and

[93] R. V. Aguilera and G. Jackson, 'The Cross-National Diversity of Corporate Governance: Dimensions and Determinants' (2003) 28(3) The Academy of Management Review 1
[94] ibid.
[95] The Association of Chartered Certified Accountants, *Governance for all: the implementation challenge for SMEs* (ACCA, 2015)
[96] B. A. Asunka, 'A Case for Regulating Corporate Governance for SMEs in Ghana' (2017) 12(4) International Journal of Business and Management 168, 171.
[97] European Confederation of Directors' Associations, Corporate Governance Guidance and Principles for Unlisted Companies in Europe (ecoDa, 2010) <https://ecgi.global/download/file/fid/9869> accessed 10 September 2018

regulations.[98] However, Enriques considers these efforts to be somewhat trivial, as they fall short of providing measurable impact in Member States.[99] He further suggests that there is a lack of uniformity and harmonisation in EU corporate governance policy.[100]

The UK's Institute of Directors has also offered guidance in the form of Corporate Governance Guidance and Principles for Unlisted Companies in the UK.[101] Similarly, the British Standards Institute published a standard on governance designed to be applicable by any type and size of entity, called the Code of Practice for Delivering Effective Governance of Organisations.[102] Elsewhere in the world similar efforts have been made, such as The Corporate Governance Code for Small and Medium Enterprises in Dubai[103] and Guidelines on Corporate Governance for SMEs in Hong Kong.[104] The aforementioned Codes and guidelines, though developed with their respective contexts in mind, provide useful traction for developing an SME-focused corporate governance framework. As Nigeria is a developing country, the following sub-section aims to explore the corporate governance framework in Nigeria and its shortcomings.

3.9. Corporate Governance Codes in Nigeria

Until recently, there has been no codified corporate governance regime in Nigeria, which applies to various sectors of the economy. Aina and Adejugbe posit that the Companies and

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[98] Enriques estimates that since 2005, over 95 new directives and regulations have come into force on EU company law, more than half of which cover corporate governance issues such as disclosure of financial information. See L. Enriques, 'A Harmonized European Company Law: Are We There Already?' (2017) 66(3) International & Comparative Law Quarterly 763, 767

[99] L. Enriques, 'EC Company Law Directives and Regulations: How Trivial Are They?' (2014) 27(1) University of Pennsylvania Journal of International Law 1, 6.

[100] ibid n 100

[101] Institute of Directors, *Corporate Governance Guidance and principles for Unlisted Companies in the UK* (31st March, 2010) <https://www.iod.com/news/news/articles/Corporate-Governance-for-Unlisted-Companies> accessed 10th June, 2019.

[102] The British Standards Institution, *Code of practice for delivering effective governance of organisations* (2013) <https://shop.bsigroup.com/upload/risk/resources/BSI-BS-13500-introductory-guide-UK-EN.pdf> accessed 18 June 2019

[103] SME Dubai and Hawkamah, *The Corporate Governance Code For Small and Medium Enterprises: Building the Foundations for Growth and Sustainability* (2011) <https://ecgi.global/download/file/fid/10008> accessed 19 June 2019

[104] Hong Kong Institute of Directors, *Guidelines on Corporate Governance for SMEs in Hong Kong* (2014) (3rd Edition, Hong Kong Institute of Directors) <www.hkiod.com/documents/corporateguide/sme_guidelines_eng.pdf> accessed 18 June 2019

Allied Matters Act and other company laws provide limited protection to shareholders and stakeholders.[105] However, the void created by the lack of a widely applicable multi-sectoral national code was, to some extent, mitigated by a few sector-specific corporate governance codes issued by regulators to address sectoral governance challenges.[106] For instance, in 2009, the National Insurance Commission issued the Code of Good Corporate Governance for the Insurance Industry in Nigeria, to regulate all insurance, reinsurance, broking and loss adjustment companies in Nigeria.

Subsequently, to consolidate the various sectoral corporate governance requirements and create a codified corporate governance regime applicable across the board, the Financial Reporting Council of Nigeria ("FRCN") released the National Code of Corporate Governance 2016 (the "NCCG 2016"). Notably, the NCCG was preceded by similar attempts (at a unified corporate governance code), which ultimately fell short because of their limited application to public companies.[107]

Unfortunately, whatever governance relief that the NCCG 2016 brought was short-lived, as it was suspended due to controversies surrounding its legality and impact on the ease of doing business drive of the Federal Government of Nigeria ("FGN").[108] Indeed, the NCCG 2016 was noted to be too prescriptive,[109] and the Code's implementation with respect to not-for-profit organisations generated immense controversy, primarily among religious organisations.[110]

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[105] K. Aina and B. Adejugbe, 'A Review of Corporate Governance Codes and Best Practices in Nigeria' (2015) 38 Journal of Law, Policy and Globalisation 78, 80.

[106] ibid

[107] Examples of these attempts include the Code of Corporate Governance for Public Companies issued by the Securities and Exchange Commission ("SEC") in 2003; as well as the Code of Corporate Governance for Public Companies issued by SEC in 2011 (and subsequently revised in 2014).

[108] K. Ojeshina and A. Adelupe, 'The Code of Corporate Governance 2018 – A New Dawn for Corporate Governance in Nigeria?'<http://www.mondaq.com/Nigeria/x/779394/Corporate+Governance/The+Code+Of+Corporate+Governance+2018+A+New+Dawn+For+Corporate+Governance+In+Nigeria> accessed 2nd January, 2020

[109] PwC Nigeria, 'Government suspends the new Codes of Corporate Governance issued by the Financial Reporting Council of Nigeria' (November 2016) <https://pwcnigeria.typepad.com/files/pwc-regulatory-alert_fg-suspends-frcn-code.pdf> accessed 28 December, 2019

[110] The resignation of Pastor E. A. Adeboye, the Overseer of the Redeemed Christian Church of God (the largest Pentecostal church in Nigeria), stemmed from the stringent requirements in the NCCG 2016. The Code restricted

Thus, the NCCG 2016 was incongruent with the government's drive to ease doing business in Nigeria, and disruptive to the operation of not-for-profit organisations. These lapses arguably underscored the need for reform. Moreover, previous attempts at creating a corporate governance framework failed to pay specific attention to SMEs and unlisted companies.

In view of the failings of the NCCG 2016, the FRCN was tasked with redeveloping a national corporate governance code – in consonance with international best practice and the Federal Government's ease of doing business objective. Consequently, the Nigerian Code of Corporate Governance 2018 (NCCG 2018) was unveiled by the FRCN, on 15th January 2019. The FRC's responsibility is limited to implementation and monitoring compliance.[111] The Nigerian Stock Exchange, Sectoral Regulations and other Trade Associations are empowered to issue to sanctions in the event of non-compliance based on the specific deviation noted and the company in question.[112]

Notably, the Code does not expressly prescribe its scope of application. The absence of a definitive scope arguably suggests that it is intended to apply to all companies in Nigeria. Presumably with a view to clarifying this, the Minister of Trade and Investment on 18th February 2019 issued a regulation[113] (effective 15th January 2019) expressly setting out the scope of application of the Code.[114] The said regulation directed that the Code will apply to all regulated private companies being companies that file returns to any regulatory authority, other than the Federal Inland Revenue Service (FIRS) and the Corporate Affairs Commission

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the tenure of leaders of not-for-profit organisations (including religious organisations) to a maximum period of twenty years. It further stipulated that such leaders should either resign after spending more than 20 years atop the organisation or upon attaining the age of 70 years. See s. 9 NCCG 2016. Notably, as at the time of Pastor Adeboye's resignation he had spent over 20 years as the Overseer of the Church in Nigeria, and also attained the age of 70 years. See S. Eboyoka and O. Latona, 'Why Adeboye quit as G.O in Nigeria' (Vanguard, January 8, 2017) <https://www.vanguardngr.com/2017/01/adeboye-quit-g-o-nigeria/>accessed 8th March 2020

[111] Nigerian Code of Corporate Governance 2018, Principle 6.

[112] ibid

[113] Section 73 of the Financial Reporting Council of Nigeria Act, 2011 empowers the Honourable Minister for Industry, Trade and Investment to make regulations pursuant to the Nigerian Code of Corporate Governance 2018.

[114] Regulation on the Adoption and Compliance with Nigerian Code of Corporate Governance 2018.

(CAC).[115] The FIRS is the regulatory body to which companies file tax returns, while the CAC is responsible for receiving companies' annual returns. The code therefore applies to all private companies that file returns and are regulated by bodies other than the FIRS (tax collector) and CAC (companies' regulator). It is conceivable that private companies would fall within this purview, provided that they operate within a sector that has its own regulator i.e. a small-sized food production company and a mid-sized pharmaceutical company both file returns with, and are regulated by, the National Agency for Food and Drug Administration and Control (NAFDAC); a small or medium-sized media and entertainment company is regulated by the National Broadcasting Commission. Thus, it would appear that the Code is equally applicable to private (SME) companies.

Notwithstanding the scope of application of the Code as clarified in the aforesaid regulation, its applicability to private companies remains debatable in view of the Federal High Court of Nigeria's decision in *Eko Hotels Limited v. Financial Reporting Council of Nigeria,*[116] where the Court held that the jurisdictional scope of the FRCN is limited to public companies as well as other public entities, and does not include private companies.[117] As this decision reflects the judicial position (which remains unchanged) on the jurisdictional scope of the FRCN, it is arguable that the Corporate Governance Code 2018 was not intended to apply to SMEs. Nevertheless, the full impact of this decision is yet to be tested; moreover, it would appear that the Code applies equally to smaller private companies.

3.9.1. Shortcomings of the 2018 Code

The underlying philosophy of the 2018 Code is arguably unsatisfactory. Companies are required to adopt the '**Apply and Explain'** approach in implementing and monitoring compliance with the Code.[118] The Apply and Explain approach mandates that all principles

[115] ibid s 1(1)
[116] Unreported: Suit No. FHC/L/CS/1430/2012 delivered on 21/03/2014
[117] ibid
[118] Notably, this is different from the 2016 Code which utilised the more forceful 'Comply or Else' approach

should be applied and, therefore, requires companies to demonstrate how the specific activities they have undertaken best achieve the outcomes intended by the corporate governance principles specified in the Code.[119] By imposing a mandatory standard, this philosophy arguably increases the cost of compliance, especially for SME companies, wherein the cost of complying may far exceed the benefit.[120] Moreover, compliance costs disproportionately impact SMEs, placing them at a competitive disadvantage to larger firms due to inefficient capital allocation.[121]

The UK's '**Comply or Explain'** Approach is arguably a more favourable corporate governance philosophy.[122] Companies must either comply with the Code or provide justifications for their non-compliance. This leaves more room to manoeuvre, giving companies the flexibility to make the arrangements that suit their circumstances, rather than mandating a one-size-fits-all approach.[123] Further, the Nigerian local context, which is marked by inadequate access to capital for SMEs,[124] lies in favour of the reduced compliance costs and flexibilities afforded by the UK philosophy. Moreover, numerous jurisdictions[125] across the world have adopted this philosophy (albeit, sometimes, with slight variations). This lends proof to its desirability and viability as a corporate governance philosophy.[126]

A closer examination of the philosophy of the 2018 Code arguably reveals that it is not materially different from the UK approach. The Nigerian approach can be scaled, in line the

[119] Ibid (n 110).
[120] N. Mazhan and C. M. Yan, 'Harnessing the Benefits of Corporate Governance and Internal Audit: Advice to SME' (2014) 115 Procedia – Social and Behavioural Sciences 156, 163.
[121] E. Eragbhe and K. P. Modugu, 'Tax Compliance Costs of Small and Medium Scale Enterprises in Nigeria' (2014) 2(1) International Journal of Accounting and Taxation 63.
[122] A. Keay, 'Comply or explain in corporate governance codes: in need of greater regulatory oversight?' (2014) 34(2) Legal Studies 279, 280.
[123] P. Swabey, 'ICSA: Comply or explain is vital for UK governance' (Institute of Chartered Secretaries and Administrators, March 6, 2018)
[124] See discussion in Chapter 2 at 2.5.1.
[125] As at 2012, over 60 countries across the world had adopted the 'comply or explain' approach in their domestic corporate governance frameworks, with the notable exception of the USA and India. See M. Becht, 'Comply or Just Explain?' in Financial Reporting Council, *Comply or Explain: 20th Anniversary of the UK Corporate Governance Code* (The Financial Reporting Council Ltd, 2012) 11
[126] S. Sarkar, 'The Comply-or-Explain Approach for Enforcing Governance Norms' in Asish Bhattacharyya (ed.) *Corporate Governance in India: Change and Continuity* (Oxford University Press, 2017) 64.

UK's philosophy, such that an SME only needs to explain how far the Code has been applied. While the language of this approach has been criticised,[127] it is arguably flexible and adaptable to different company sizes, as they will only apply or explain what they can.

On the composition of the Board of Directors, the 2018 Code prescribes an "appropriate mix of Executive, Non-Executive and Independent Non-Executive Directors, such that majority of the Board are Non-Executive Directors."[128] Notably, this provision presupposes that 'regulated' SMEs necessarily have or carry out their operations through a Board of Directors, whereas, in reality, this is not always the case. An SME may be run by, and revolve around a single individual, who takes all the managerial and administrative decisions pertaining to the business. For instance, the newly enacted CAMA in Nigeria, gives statutory footing to the single-member company, otherwise known as a one-man company.[129]

Furthermore, the Code prescribes that the Board of Directors should comprise mostly Non-Executive Directors. While this accords with other jurisdictions,[130] its applicability to the SME context remains doubtful. Admittedly, non-executive directors bring objectivity to the board, especially in family businesses where family ties may render impartial business decision-making (such as succession planning) difficult.[131] Furthermore, while they are not involved in day-to-day management of the company, non-executive directors act as a check and balance on the executive directors in ensuring adherence to good corporate governance practices.[132]

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[127] LeishTon Consulting & BoardGov Ltd, 'The Unveiled Nigerian Code of Corporate Governance (NCCG) 2018: Progress or Setback for Corporate Governance, Corporate Nigeria and Sectoral Regulators? – Part Five' <https://leishton.com/web/wp-content/uploads/2019/03/The-NCCG-2018-Progress-or-Setback-for-Corporate-Nigeria-Part-Five.pdf> accessed 22 April 2020.

[128] Nigerian Code of Corporate Governance 2018, principle 2.3(b)

[129] CAMA 2020, s. 18(2); see also s. 123(1) of the UK Companies Act 2006 which recognises the formation of a company with one member. For an earlier reference, see *Salomon v A Salomon & Co Ltd* [1897] AC 22, per Lord Macnaghten at p. 54, on the validity of companies under the absolute control of one person following the 1862 Companies Act.

[130] See, for instance, the 11th Provision of the UK Corporate Governance Code 2018, to the effect that "at least half the board, excluding the chair, should be non-executive directors whom the board considers to be independent."

[131] Beatrice Ballini, 'Every Family Business Needs an Independent Director' (Harvard Business Review, January 27, 2020) <https://hbr.org/2020/01/every-family-business-needs-an-independent-director>

[132] A. Sarbah, I. Qauye and E. Affum-Osei, 'Corporate Governance in Family Businesses: The Role of Non-Executive and Independent Directors' (2016) 4(1) Open Journal of Business and Management 14

However, the presence and positive influence of non-executive directors in SMEs would arguably depend on SMEs' receptiveness towards them. Moreover, studies have discredited the perceived benefits of independence[133] and objectivity attributed to non-executive directors.[134] Thus, the likelihood of SMEs adhering to the prescription of having more non-executive directors on their Boards, remains to be seen.

3.10. An Ideal Corporate Governance Framework for SMEs in Nigeria

Despite the shortcomings of the 2018 Code (as well as other Codes), the essential question of creating an ideal corporate governance framework for Nigerian SMEs subsists. Some preliminary points are worth noting. Firstly, to successfully implement a corporate governance framework for SMEs, their key-decision makers (i.e., shareholders) must be convinced of the benefits of doing so, as their commitment is essential to make governance work. This means that potential benefits should outweigh the cost of compliance. However, for SME owners to be convinced about the benefits of corporate governance, they must be properly educated about the concept and its importance. Thus, education and sensitisation would play a crucial role in actualising a corporate governance framework for SMEs.

Furthermore, the governance framework should be implemented in a proportionate and realistic manner. This is because corporate governance is not an end in itself, but rather, a means of adding value and providing continuity.[135] Moreover, SMEs are by nature heterogeneous and diverse. Thus, corporate governance principles should be applied in a pragmatic and flexible

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[133] J. Pearce and S. Zahra, 'Board Composition from a Strategic Contingency Perspective' (1992) 29(4) Journal of Management Studies 411, 417. Pearce and Zahra suggest that the independence of outside directors is not always guaranteed. They posit that within the category of outside directors, there are affiliated and non-affiliated directors; the former category being less independent.

[134] W. Voordeckers et al., 'Board Composition in Small and Medium-Sized Family Firms' (2007) 45(1) Journal of Small Business Management 137, 143. The presence of outside directors does not guarantee increased productivity. Thus, the adoption of outside directors should be driven by resource, advice and information needs of the firm.

[135] OECD, 'G20/OECD Principles of Corporate Governance' <http://www.oecd.org/g20/summits/antalya/principles-corporate-governance.html> accessed 15 May, 2019

manner, bearing in mind the individual circumstances of each firm or business, and without precluding the possibility of growth/expansion.

Carr suggests that a governance approach based on legislation and strict rules would likely result in bureaucracy and increased compliance and monitoring costs.[136] However, one could argue that this assertion cannot be readily sustained. Notably, CAMA, a principal law that regulates corporate governance in Nigeria has introduced novel provisions for the governance of SMEs. For instance, small companies are no longer required to appoint a company secretary.[137] This governance provision easily frees more funds for SMEs, obviating the need to hire private companies can use electronic means to hold general meetings.[138] Also, Annual General Meetings are no longer mandatory for small companies.[139] These updates to CAMA demonstrate that legislation and rules could be deregulated.

A principle-based approach encourages the board to be more efficient in its corporate governance responsibilities. It encourages the adoption of best practices of corporate governance; rather than fixating on the acceptable or minimum standard of corporate governance, as the rule-based approach usually advocates.[140] Therefore, it is arguably more desirable if the corporate governance framework encourages adherence to the spirit of laid down principles, rather than simple obedience to the letter of the law. Nevertheless, deregulated legislation (such as in CAMA) remains relevant within this framework.

This thesis considers two possible approaches to actualising an ideal corporate governance framework for SMEs in Nigeria. The first option is to remodel or reform an existing corporate

[136] Sir R. Carr, 'Adherence to the spirit' in Financial Reporting Council, *Comply or Explain: 20th Anniversary of the UK Corporate Governance Code* (The Financial Reporting Council Ltd, 2012) 15.
[137] CAMA, s, 330(1)
[138] ibid s. 240(2)
[139] ibid, s. 237
[140] L. M. Sama and V. Shoaf, 'Reconciling Rules and Principles: An Ethics-Based Approach to Corporate Governance' (2005) 58 Journal of Business Ethics 177, 179.

governance framework such as the 2018 Code of Corporate Governance. This would involve addressing the lapses and/or amending salient provisions of the Code, to make them more attune to SME realities. The second option, however, is to formulate an entirely new framework based on international best practice, bearing in mind the peculiarities of Nigeria as a country. This thesis favours the latter approach.

As a potential corporate governance framework for SMEs in Nigeria, this thesis proposes a new SME Code which is premised on **six** basic governance principles (and with an underlying philosophy of 'Comply or Explain'). These principles largely derive from an Institute of Directors (IOD) report titled 'Corporate Governance Guidance and Principles for Unlisted Companies in the UK.'[141] The reason for choosing this specific corporate governance guideline is not far-fetched. In Chapter 1, legal transplantation was considered as a viable tool for improving the law in a country. Arguably, UK corporate legislation and provisions are suitable for legal transplant to the Nigerian context, as most of Nigeria's corporate legislation and guidelines (in their present form) draw heavily from UK corporate law. Moreover, Nigeria is similarly a common law jurisdiction by virtue of UK influence. Thus, as a matter of consistency and coherence, UK legislation and guidelines are arguably more transferable to Nigeria. Furthermore, this thesis finds these principles to be both useful and applicable for SMEs. This is because private companies – the focus of the guidance this section draws from – are subject to a less stringent corporate governance regime than public, listed companies. Moreover, since SMEs are largely unlisted, they are more aligned with governance principles for (private) unlisted companies. Arguably, therefore, the IOD Guidance and Principles for Unlisted Companies in the UK, could set the framework for an ideal corporate governance regime for

[141] Institute of Directors, Corporate Governance Guidance and Principles for Unlisted Companies in the UK (March, 2010) < https://www.iod.com/Portals/0/PDFs/Campaigns%20and%20Reports/Corporate%20Governance/Governance%20code%20for%20unlisted%20companies.pdf?ver=2016-11-29-134715-607> accessed 22 April 2020> accessed 22 April 2020

Nigerian SMEs – a framework that is both practical and non-onerous; and one which minimises compliance costs for SMEs. Accordingly, the proposed principles to regulate SMEs in Nigeria are as follows:

Principle 1: Every company should establish a competent and effective leadership structure, responsible for the long-term success of the company

This principle requires SMEs to have a leadership structure (typically a board) tasked with leadership, setting corporate strategy and objectives, contingency planning and taking other necessary steps to ensure the long-term continuity of the company. With regard to competence, this principle simply prescribes that the leadership of an SME should have the necessary capacity (i.e. qualifications and experience) to discharge their duties; effectiveness, on the other hand, denotes that the leadership should discharge its function to the required standard. An essential element to ensuring effectiveness is regular appraisal/board performance evaluation,

At the early stages of the company's development, many aspects of the board's activities can be operated in a relatively informal manner. However, as the company grows in complexity and size, so also should the board – introducing independent/non-executive directors to develop the company's governance framework. A small company may also consider establishing an additional advisory board without formal decision-making responsibilities, as an intermediate step to an effective main board. In view of the legislative changes brought about by CAMA 2020, it is now conceivable for a company to be run by a one-man board. In such instances, it would be desirable for the leadership to be subject to internal or external oversight. This would serve as an independent measure of leadership performance and the SME's overall wellbeing.

Principle 2: The board should meet regularly and be well abreast of the company's affairs

As a corollary to Principle 1, consideration must be given to the organisation of board meetings, where applicable. The exact number of meetings required by the board to fulfil its responsibilities would depend on the specific circumstances of the company. However, the board must meet at least once a year, and where possible, multiple times a year. This is crucial to ensuring that the company's affairs are handled timeously and proactively. Additionally, the board must ensure it makes informed decisions regarding the company's financial standing, indebtedness to creditors, revenue, and expenditure. This would further aid corporate decision making. In the context of a one-man board, there is no obligation to convene board meetings. However, such board member must endeavour to always have accurate, timely and clear information about the company. This is to ensure that the SME's business affairs are diligently and competently handled. Keeping abreast of the company's affairs would also minimise the risk of an SME becoming insolvent/distressed through inadvertence of its leadership.

Principle 3: The board is responsible for risk management and should create a sound internal control system to protect the company's assets and shareholder investment

The crux of this principle is that the board should identify/outline the company's risks and ensure that they are properly managed. The board should oversee risk supervision and all board members should have a feeling for the main business risks. Policies should be developed regarding business continuity, records management, regulatory compliance and health and safety compliance, amongst others. It is also worthwhile for the board to periodically assess the need to create a formal internal control structure to mitigate risks. Procedures to support an effective internal control system could include (but are not limited to): authorisation limits, budgetary control, account reconciliation and cash flow monitoring. In owner managed SMEs, risk issues can be addressed in a relatively informal manner; for instance, by using a SWOT

(strengths, weaknesses, opportunities, and threats) framework or risk mapping, to help focus decision-making.

Principle 4: There should be clear division of responsibilities between the running of the board and the running of the company's business, with no individual having unfettered decision-making powers

The essence of this principle is that there should be a clear division of responsibilities between the running of the board and the running of the company's business. The chairman plays a crucial role on the board, and s/he coordinates efforts to ensure that the executive/management is subject to sufficient oversight, Thus, there is an appreciable danger that the executive team/management of the company would be subject to considerably less oversight if the chief executive also plays the role of chairman; in essence, his or her role as chairman will be compromised. Furthermore, the division of responsibilities between the chairman and chief executive should be set out in writing and clearly established.

This principle can be applied with relative flexibility in more closely held SMEs, such as family firms and one-man companies. In such closely held SMEs, both roles may be exercised by the same individual. However, where such overlap exists, it is essential that the individual(s) in whom significant managerial powers are vested is subject to some oversight, such as Auditors in the financial reporting process. Additionally, public funded boards, which scrutinise high-net or key stakeholder decisions on a mandatory basis could be beneficial in ensuring high standards in day-to-day and financial governance of closely held SMEs. This would ensure that no single individual has unfettered managerial power or financial control of over the company.

Principle 5: The board should ensure transparency and honesty in presenting the company's position to stakeholders and the public

Under this principle, the board of the SME would be required to publish an annual report (on the company) tailored to shareholder and stakeholder needs. Such disclosure improves public

understanding of the company's structure, activities, environmental/ethical standards, and its relationship with the wider society. The annual report may include the following details (as applicable to the SME in question):

- A statement of the company's vision and values
- A narrative outline of the company's business strategy and the likely risks associated with that strategy.
- A review of the company's activities and performance, and a forward-looking assessment of its business environment.
    - A statement of its corporate governance principles and the extent to which it has complied with a specific corporate governance code, with additional governance information, such as: a statement of how the board operates, including a high-level statement of which types of decisions are to be taken by the board and which are to be delegated to management;
    - the names of all the directors, including the chairman, the chief executive, and the chairmen and members of the nomination, audit and remuneration committees (if relevant);
    - details of how any evaluation of the board, its committees, and its directors has been conducted.

In one-man companies and closely held SMEs, it is conceded that the requirement to publish annual reports could lead to undesirable compliance costs. Hence, statement of affairs detailing the firm's corporate objectives and financial position of the firm should suffice. This would be useful in ensuring transparency and accountability regarding the affairs of SMEs. Transparency and accountability – particularly in relation to the company's financial affairs – are vital to secure the external investment necessary for business growth.

Principle 6: Closely held companies and family firms should establish mechanisms that promote mutual understanding, and reconcile the relationship between family governance and corporate governance

Admittedly, this principle applies in a limited sense to companies that are family-owned/controlled or have close relationships (though it must be noted that majority of them are SMEs). Nevertheless, in such companies, there must be a clear distinction in governance status between the family institutions and the company's formal governance structures. Family members must fully understand the role of the board, shareholder meetings and other corporate structures. Notably, the choice of family governance process would depend on the size of the business and other specific circumstances (such as the size of the family and degree of family involvement in the business). However, family governance mechanisms, such as a family council, could be useful in promoting mutual understanding and providing a forum for family members to discuss the family and the family business.

While the aforementioned principles are not exhaustive, this thesis finds that they adequately cover the field in relation to SME corporate governance. Arguably, the principles are most apposite to the operation of SMEs. More importantly, they are not overly prescriptive or onerous – thus avoiding the pitfall inherent in the Code of Corporate Governance 2018. However, it is important to reiterate that the above is merely a proposal to regulate SME governance in Nigeria. Hence, it is neither infallible nor bereft of shortcomings and limitations. Nevertheless, the above proposition provides a solid basis for future reform.

3.11. Corporate Governance and Quality Financial Reporting

Cohen posits that one of the most crucial functions of corporate governance is to ensure the quality of the financial reporting process.[142] This view is consistent with empirical evidence.

[142] J. Cohen et al, 'The Corporate Governance Mosaic and Financial Reporting Quality' (2008) 23(1) Journal of Accounting Literature 87.

Indeed, studies have shown that there is an association between weak corporate governance and poor financial reporting.[143] Conversely, quality financial reporting is inextricably linked to good corporate governance. This point merits further consideration within the context of SMEs. Nigerian SMEs are required to maintain accounting records which, in addition to disclosing the true financial position of the SME, must enable directors to prepare financial statements in the prescribed form.[144] The Companies Act 2006 equally mandates the keeping of accounting records. However, in addition to the two reasons stipulated in CAMA[145] for maintaining accounting records, the Companies Act requires UK companies to keep proper records to show and explain the company's transactions.[146]

3.11.1. The case for audit committees

Both CAMA and the Companies Act 2006 require private companies (many of which are SMEs) to have their financial records audited every year by auditors appointed for that purpose.[147] The broad statutory duty of the auditor is to investigate the company's accounting records prepared by the company's management.[148] Notwithstanding, under the Companies Act 2006, the Board may resolve that audited accounts are not likely to be required.[149] The newly enacted CAMA adopts a similar position, as it seeks to exempt small companies from the requirement of including audited accounts in their annual returns.[150] The auditors are

[143] P. Dechow et al, 'Causes and Consequences of Earnings Manipulation: An Analysis of Firms Subject to Enforcement Action by the SEC' (1996) 13(1) Contemporary Accounting Research 1, 3; see also J. Krishnan, 'Audit committee quality and internal control: an empirical analysis' (2005) 80(2) The Accounting Review 649, 651.
[144] CAMA, s 377. Under Section 377(2), the financial statements must include: (a) the balance sheet as at the last day of the year (statement of financial position); (b) a profit and loss account; (c) the notes on the account; (d) the auditors' reports; and (e) the directors' report.
[145] CAMA, s. 374(2) – to disclose with reasonably accuracy, at any time, the financial position of the company; and to enable directors ensure that any financial statements prepared, complies with the requirement of the Act as to the form and content of the company's financial statements.
[146] Companies Act 2006, s 386.
[147] CAMA, s 401; Companies Act s 485.
[148] The auditors are given access the company's books, accounts and vouchers at all times and may require from the company's office such information and explanations as they think necessary for the performance of their duties. See for example Section 407 of CAMA.
[149] Companies Act, s. 485 (1).
[150] CAMA 2020, s. 402

appointed by the Shareholders at the annual general meeting though the Board may exercise the power of appointment at any time before the next annual general meeting to fill a casual vacancy.[151]

The statutory requirement of constituting a statutory audit committee is not applicable to SMEs in Nigeria. Arguably, if the SME in question is a public company, this exception would no longer apply. [152] In practice, shareholders typically rely on the Articles in creating a Board committee which will be required to carry out functions similar to those of the statutory audit committee.[153] The newly enacted CAMA seeks to introduce a new level of responsibility relating to financial reporting by requiring the chief executive officer and chief financial officer of SMEs (other than a small company) or persons performing similar functions to certify every audited financial statement.[154] The OECD Principles recommend the formation of an audit committee that will provide oversight of the internal audit activities of UK companies.[155]

Notably, audit committees are applicable to SME companies because they are typically a committee of the board of directors. In terms of their value, audit committees undoubtedly have a massive impact on raising funds. By ensuring the quality of financial reporting, they facilitate financial transparency and enable a company to determine its true financial position. McMullen and Raghunandan explain that financial certainty and transparency are crucial to raising capital.[156] Thus, if a company has a poor corporate governance structure in this respect, it could struggle to raise capital.[157] Nevertheless, the effectiveness of audit committees depends, inter

[151] CAMA 2020, s.401 (1) & (3); Companies Act, s. 485 (3) (a).
[152] CAMA, s. 404 (2).
[153] Glynis B. Morris and Patrick Dunne, 'Audit Committee' in *Non-Executive Director's Handbook* (2nd Edition, CIMA Publishing, 2008)
[154] CAMA, ss 405 (1) and (2). The certification required include those to the effect that the signatories to the audited financial statements have reviewed same, and based on their knowledge, the audited financial statements do not contain any untrue statement of material fact or omit to state a material fact, which would make the statements misleading, in the light of the circumstances under which such statement was made.
[155] OECD *G20/OECD Principles of Corporate Governance* (2015), (OECD Publishing, Paris) 43
[156] D. A. McMullen and K. Raghunandan, 'Enhancing Audit Committee Effectiveness' (1996) 182(2) Journal of Accountancy 79, 81.
[157] ibid.

alia, on the availability of resources to carry out their broad functions[158] and qualification of members. Arguably, the scope of functions of audit committees is extensive and this potentially renders them expensive and onerous,[159] more so for SMEs.

The NCCG 2018 recommends that each company create a Board audit committee comprising NEDs, majority of whom should be INEDs.[160] This is to ensure that members of the Board audit committee are able to discharge their duties effectively. At first glance, the requirement would seem to be at variance with the practical realities of SMEs (which are often owner-managed and/or family firms). However, the Code itself is aimed at companies of different sizes and complexities across industries.[161] Thus, it is potentially applicable to SMEs. The NCCG recommends the appointment of persons who are financially literate and capable of understanding financial statements - one of these should be a financial expert with current knowledge in accounting and financial management.[162] The Board's audit committee is meant to ascertain that the company's accounting and reporting policies are compliant with relevant regulatory requirements.[163] The NCCG imposes other responsibilities on the Board audit committee with a view to guaranteeing the integrity of SMEs financial and accounting processes.[164]

Furthermore, the OECD Principles recommend the setting-up of ad-hoc committees to support the Board in performing its functions, particularly as it relates to audit".[165] The Nigerian CG

[158] V. Ekundayo, 'Measures of Audit Committee Effectiveness in Nigeria' (2019) 10(10) Research Journal of Finance and Accounting 111
[159] F. T. DeeZort et al, 'Audit Committee Effectiveness: A Synthesis of the Empirical Audit Committee Literature (2002) 21 Journal of Accounting Literature 38, 40.
[160] The Nigerian CG Code, principle 11.4.
[161] ibid recital C
[162] ibid 11.4.2.
[163] ibid 11.4.6.
[164] ibid 11.4.7. Some of the additional responsibilities of the Board audit committee include: (a) developing policies on the nature, extent and terms under which the external auditors may perform non-audit services; and (b) reviewing the independence of the external auditors in line with the policy referred to in paragraph (a) of this footnote prior to the appointment to the external auditor in order to ensure that where approved non-audit services are provided by the external auditors, there is no real or perceived conflict of interest, or other legal or ethical impediment.
[165] OECD (n 3) 52.

Code also recommends the establishment of an internal audit function ("IAF") whose purpose, authority and responsibility should be clearly defined in a charter approved by the Board.[166] The purpose of the IAF is to provide assurance to the Board on the effectiveness of the governance, risk management and internal control systems.[167] However, where the Board is unable to establish the IAF, it must disclose in the company's annual report, sufficient reasons on how it has obtained assurance on the effectiveness of the company's internal processes and systems such as risk management and internal control.[168]

3.12. Minority Shareholder Protection

The preceding section examined the importance of sound financial management by directors of SMEs. This is particularly important in light of the statutory duties owed by the directors under the UK Companies Act and CAMA.[169] Further, Mezetti understands that the presence of a controlling shareholder can dramatically alter best corporate governance practices.[170] Andersson notes the existence of minority shareholders in SMEs, particularly non-family firms and companies that are less closely held.[171] In particular, where such majority shareholders also act as agents of the company i.e. directors, it could result in less protection for the minority shareholders.[172] This is because they have the opportunity to engage in oppressive behaviours, such as refusing to consent to value-enhancing proposals or misusing corporate assets for their benefit.[173] What follows, therefore, are further exemplars of corporate governance frameworks

[166] The Nigerian CG Code 18.1.
[167] ibid 18.2. CAMA recommends the appointment of an auditor at every general meeting and excludes certain people (such as officers and servants of the company) from appointment as auditors. CAMA, s. 401 and 403.
[168] ibid 18.2.
[169] Companies Act 2006, s. 171 - 176
[170] L. M. Mezetti, D. Schlimm and B. S. Sharfman, 'Corporate Governance and the Impact of Controlling Shareholders' (2010) 18(1) Corporate Governance Advisor 1,3
[171] J. Andersson, 'Minority shareholder protection in SMEs: A question of information ex post and bargaining power ex ante?' in M. Neville and K. E. Sorensen (eds) Company Law and SMEs (Thomson Reuters, 2010) 192.
[172] S. Rachagan and E. Satkunasingnam, 'Improving Corporate Governance of SMEs in developing economics: A Malaysian experience' (2009) 22(4) Journal of Enterprise Information Management 468, 470
[173] ibid

in the companies legislation of both jurisdictions, to protect minority shareholders from majority shareholders.

3.12.1. Personal action

In Nigeria, any member of a company may institute a personal action to enforce a right due to them personally.[174] Such member, upon application to the court, may be entitled to damages for any loss incurred on account of the breach of that right; or a declaration or injunction to restrain the company from carrying out certain acts which affect the personal rights of the applicants.[175] Notably, where the Court finds the directors liable for any wrongdoing, the director(s) could also be personally liable in damages to the aggrieved member of the company.[176] Furthermore, where a member institutes such personal action, the Court may award costs to him personally whether or not his action succeeds.[177] Evidently, these provisions would avail a minority shareholder, enabling them to sustain an action where their personal rights have been infringed upon.

The UK Companies Act is silent on the commencement of personal actions. However, the UK is firmly committed to the "no reflective loss" rule, to the effect that a shareholder cannot bring an action or recover damages where their loss merely reflects the loss suffered by the company.[178] However, the law is now settled that the reflective loss principle does not apply to claims made in other capacities, such as by an employee or creditor.[179] Nevertheless, as regards personal actions, the UK Law Commission has stated in its consultation paper that a

[174] *N.I.B. Invest W.A v Omisore* (2006) 4 NWLR (Pt. 969) 172 at 199 – 200, paras. H – F; *Ojora v. Agip (Nig.) Plc* (2014) 1 NWLR (Pt. 1387) 150 at 190, paras. E – G.
[175] CAMA, s. 344.
[176] ibid, s. 344 (2).
[177] ibid, s. 344 (3).
[178] *Prudential Assurance v Newman Industries* (No. 2) [1982] 1 Ch 204; *Johnson v Gore Wood & Co.* [1999] B.C.C. 474, 487; *Johnson v Gore Wood & Co.* [2002] AC 1; *Perry v Day* [2004] EWHC 3372 (Ch)
[179] *Sevilleja v Marex Financial Ltd* [2020] UKSC 31.

shareholder is entitled to commence an action on his own behalf if he wishes to enforce a statutory right, that is, a right conferred by the Companies Act 1985.[180]

3.12.2. Derivative Claims

Ordinarily, where someone causes loss to the company, the directors authorise the company to initiate proceedings to recover that loss. However, where such loss is caused by directors themselves, they are unlikely to authorise legal action against themselves. Derivative claims enable a shareholder to bring a claim in relation to a breach of duty by a director. In *Afribank v. NDIC & Ors.,* the Nigerian Court of Appeal described a derivative action as a suit brought by a shareholder against an insider of the company such as a director or executive officer.[181] Notably, derivate claims are brought on behalf of the company (not the shareholder), and it is the company that derives the benefit of these claims. Nevertheless, they aid in protecting the interest of minority shareholders and deterring directors from managerial misconduct.[182] This may prove useful for SMEs where, for instance, majority shareholders acting as directors, undertake acts that are in flagrant breach of their duties.

A Shareholder of a UK SME may, with the permission of the Court, commence a derivative claim in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company.[183] Since the action is commenced in the interest of justice, the petitioner could recover from the company the cost incurred in remedying the wrong.[184]

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[180] The Law Commission, 'Shareholders Remedies' <http://www.law.com.gov.uk/app/uploads/2015/03/cp142_Shreholder_Remedies_Consultation_pdf> accessed 27 July 2019. Reference to the Companies Act 1985 is a tacit reiteration of the fact that certain aspects of the Companies Act 1985 have not been replaced by the Companies Act 2006 and are still therefore in force.
[181] (2017) LPELR-43498.
[182] O. Fadahunsi, 'Minority Shareholders' Protections under Nigerian and Canadian Corporate Law: A Comparative Analysis' (2019) Electronic Thesis and Dissertation Repository 6677 1, 27.
[183] Companies Act, s 260 and s. 261
[184] *Clark v. Cutland* [2003] 2 BCLC 393

A prerequisite for initiating a derivative claim is seeking permission or leave to apply. In the UK, the stakeholder must have more than a prima facie case, but not a strong case, for permission to continue a derivative action.[185] The court in *Saatchi v. Gajjar*[186] allowed a derivative claim to be brought against the respondent who owned the company equally with the applicant but was the sole director. The claim was brought on the ground that the respondent had misappropriated the company's assets, by taking out director's loans amounting to £190,000, purchasing cars, making payments to the joint venture he had with his wife, making payment to a cricket club etc. The court granted the application as on the facts of the case, a person acting in accordance with duty to promote the interest of the company as contained in s. 172 would attach importance to continuing the claim. Thus, on the facts, it gave rise to a derivative claim.

In Nigeria, for a derivative claim to be sustained, the court must be satisfied that the wrongdoers are the directors who are in control and will not take necessary action;[187] that the applicant has given reasonable notice to the directors of his intention to apply to the Court;[188] that the applicant is acting in good faith;[189] and that it is in the company's best interest be brought/prosecuted.[190] Furthermore, the stakeholder bringing the claim must fall under the persons who may bring the claim under the statute.[191] Derivate claims under Nigerian law enable wrongs against minority shareholders to be rectified, especially where the wrongdoers are in control of the company.[192] The provisions of the recently enacted CAMA are detailed

[185] *Iesini v. Westrip Holdings Ltd* [2009] EWHC 2526 (Ch)
[186] [2019] EWHC 3472 (Ch)
[187] Unipetrol (Nig.) Plc v. Agip (Nig.) Plc (2002) 14 NWLR (Pt. 787) 312 at 332-333, paras. G–A.
[188] CAMA, s. 346(2)(b).
[189] CAMA, s. 346(2)(e).
[190] CAMA, s. 346(2)(f).
[191] CAMA, s. 352; persons include (a) the registered holder or a beneficial owner and a former registered holder or beneficial owner, of a security of a company (b) a director or an officer or a former director or officer of a company (c) the Commission (d) any other person who in the discretion of the Court, is a proper person to make an application.
[192] Agip (Nig.) Ltd v. Agip Petroli Intl (2010) 5 NWLR (Pt. 1187) 348 at 392, paras. D–F.

and provide useful guidance on derivative claims in Nigeria. It is hoped that the courts interpret the legislation favourably, to enable minority shareholders derive the benefit of its protection.

3.12.3. Relief on Grounds of Unfairly Prejudicial and Oppressive Conduct

A minority shareholder of a UK SME may commence a claim against the company on the basis of unfair prejudice.[193] As held in *Re a Company*, the minority shareholder must show that the conduct in question is both prejudicial to the relevant interests and also unfair.[194] For instance, in an SME, a majority shareholder may also serve as the director. In that regard, he occupies a critical controlling role in the company. In *Re Stratos Club Ltd*,[195] the minority shareholder's loan account was drawn at intervals without consent or approval. The majority shareholder also paid himself excessive salary and made unjustifiable payments to his family and friends as well as personal payments which were not business expenses. The director of the company possessed excessive powers to veto share transfers and held the powers to pass ordinary and special resolution. The court found that M, the director breached his duty of care and skill in not keeping proper books of account and transferring the business to another company. The court therefore held that the interest of the minority shareholder was unfairly prejudiced.

The position in Nigeria is generally the same as the UK.[196] However, unlike in the UK where such actions may only be commenced by members of the company,[197] the action may be initiated in Nigeria by (a) a member; (b) a director or officer or former director or officer of the company; (c) a creditor of the company; (d) the CAC; or (v) any other person who, in the

[193] By Section 994 of the CA 06, a member of a company may apply to the court by petition for an order on the ground – (a) that the company's affairs are being or have been conducted in manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including an act or omission on its behalf) or (b) that an actual or proposed act or omission of the company (including the act or omission on its behalf) is or would be so prejudicial. By Section 994(2) of the CA 06, where shares have been transferred or transmitted to a person who is not a member of the company, the person can premise an action on the ground.
[194] Re A Company (No 005685 of 1988) ex p Schwarcz (No. 2 [1989] BCLC 427
[195] [2020] EWHC 3485 (Ch)
[196] CAMA, s.354
[197] Nonetheless, in the SME context, members may be directors of the company.

discretion of the court, is the proper person to make such application.[198] What amounts to unfairly prejudicial conduct was articulated by the Nigerian Court of Appeal in *DYS Trocco Valessia Limited v. Sanyaolu & Ors.*[199] The Court held that when those in a dominant position in a company act over a period of time in a manner that is unfair, burdensome, harsh and wrongful and lacking in probity to the minority, then, it can be said that the affairs of the company are being conducted in an oppressive manner. In *Ijale Properties Ltd v. Omolulu Mulele*[200], the Nigerian court granted this remedy where the minority shareholders alleged that the company had not held any annual meeting or filed annual returns with the CAC years after the company was incorporated. Also, it was alleged that the majority shareholders failed to disclose the true financial position of the company to the minority shareholders.

Fadahunsi argues that this remedy allows minority shareholders in Nigeria to bring an action against unfair conduct which violates their rights.[201] It has been noted that the broad scope of persons that could bring an action for unfair prejudicial conduct in Nigeria serves to protect the interests of minority shareholders (particularly in SMEs), who do not have the resources to initiate an action against the company.[202] The oppressed minority shareholders may apply to the Corporate Affairs Commission to initiate an action on their behalf.

3.13. Corporate Governance and Risk of Insolvency

Zhu argues that firms with good corporate governance are consistently associated with both lower cost of equity and cost of debt capital.[203] She posits that the association between corporate governance and the cost of equity is more pronounced in countries with strong legal

[198] CAMA, s. 353 (1)
[199] (2016) LPELR - 40423
[200] [2000] FWLR (Pt. 5) 709
[201] O. Fadahunsi, 'Minority Shareholders' Protections under Nigerian and Canadian Corporate Law: A Comparative Analysis' (2019) Electronic Thesis and Dissertation Repository 6677 1, 60
[202] ibid 55
[203] F. Zhu, 'Corporate Governance and the Cost of Capital: An International Study' (2014) 14(3) International Review of Finance 393, 396.

systems, extensive disclosure practices, and good government quality.[204] Conversely, the relation between corporate governance and the cost of debt is stronger in countries characterised by weak legal protection, low transparency, and poor government quality.[205] Ashbaugh, Collins and Lafond suggest that firms with better corporate governance present less agency risk to shareholders resulting in lower cost of equity capital.[206] Similarly, Byun's study reveals that sound corporate governance practices work favourably to lower the cost of external debt financing.[207] This is because good corporate governance enables creditors find necessary information about a business concern, as at when needed - thus resulting in lower transaction costs for the creditor.[208] This is consistent with the idea that good corporate governance reduces the risks faced by both shareholders and creditors, lowering the costs at which they are willing to offer capital. Thus, corporate governance is instrumental to accessing cost-effective finance and raising capital.

Akintola notes that companies are dependent on capital to survive and that they can only succeed where there is access to capital required to conduct their business.[209] As corporate governance is linked to lower cost of capital,[210] the failure to adopt sound corporate governance would likely mean that a firm struggles to access finance and raise capital. By extension, the inability to raise capital may lead to adverse financial consequences such as insolvency. As noted in Chapter 2,[211] insolvency arises when a company cannot afford to pay its debts as they

[204] ibid
[205] ibid.
[206] H. Asbaugh, D. Collins and R. Lafond, 'Corporate Governance and Cost of Equity Capital' (2004) <w4.stern.nyu.edu/accounting/docs/speaker_papers/fall2004/Hollis_Ahbaugh_10-20-04-nyu-emory.pdf> accessed 24 February 2021
[207] H. Byun, 'The Cost of Debt Capital and Corporate Governance Practices' (2007) 36(5) Asia-Pacific Journal of Financial Studies 765, 768
[208] J. Saravia and S. Saravia, 'Corporate governance and transaction cost economics: A study of equity governance structure (2016) 12(1) Corporate Board: Role, Duties & Composition 33
[209] K. Akintola, *Creditor Treatment in Corporate Insolvency* (Edward Elgar Publishing, 2020). See discussions at 1.01 and 1.04, p.2 and 4.
[210] S. Claessens, 'Corporate Governance and Development', (2006) 21(1) The World Bank Research Observer 91–122.
[211] See discussion 2.12 in Chapter 2.

fall due, or when its liabilities exceed its assets. In *Re Purpoint Ltd*,[212] a small sized company (by definition) had failed, *inter alia*, to keep proper accounting records.[213] This failure, in addition to an overreliance on debt without adequate capitalisation, triggered liability eventually resulted in the company going into insolvency. The major director of the company, Mr. Meredith, was also found guilty of wrongful trading. This case aptly illustrates the danger of failing to adopt sound corporate governance practices. Had the director of the company kept proper accounts, he would have been able to ascertain the company's true financial position and possibly averted insolvency. Consequently, it is important for SMEs to enthrone good corporate governance practices thereby positioning themselves to access the requisite funding for their continued existence. The governance of distressed SMEs will be examined in greater detail in chapter 5.

3.14. SMEs In the Wake of COVID-19

Aptly described as a 'global humanitarian challenge,'[214] the coronavirus (COVID-19) pandemic has had serious implications for people's health, as well as a significant impact on businesses and the economy. Undoubtedly, the pandemic poses an unprecedented challenge for SMEs. A recent study found that one in five UK SMEs may not survive past August 2020.[215] Furthermore, the restrictions imposed by governments across the world, raise significant corporate governance challenges. For instance, the pandemic would affect the holding of AGMs and other board-level meetings that are crucial to the driving the focus and success of

[212] [1991] B.C.C. 121
[213] ibid
[214] McKinsey & Company, 'COVID-19: Briefing note, June 1, 2020' <www.mckinsey.com/~/media/McKinsey/Business%20Functions/Risk/Our%20Insights/COVID%2019%20Implications%20for%20business/COVID%2019%20May%2027/COVID-19-Facts-and-Insights-June-1-vF.pdf > accessed 25 September 2020
[215] M. Albonico, Z. Mladenov and R. Sharma, 'How the COVID-19 crisis is affecting UK small and medium-size enterprises' (McKinsey & Company, June 2020) <www.mckinsey.com/~/media/McKinsey/Industries/Public%20Sector/Our%Isnights/How%20the%20COVID%2019%20crisis%20is%20affecting%20UK%20small%20and%20medium%20size%20enterprises/How-the-COVID-19-crisis-is-affecting-UK-small-and-medium-size%20enterprises.pdf> accessed 25 September 2020

SMEs. As businesses attempt to adapt to the current climate, it is evident that the pandemic has imperilled SMEs both on an economic and practical level.

Arguably, the ability of many businesses to carry on as going concerns greatly depends on their continued occupation of business premises. Thus, any eviction by landlords will severely affect the survival of many businesses. To forestall such occurrence and to keep SMEs afloat, the UK government put some initiatives in place. For tenants of commercial premises, the government suspended landlords' right to forfeiture. S. 82(1) of the Coronavirus Act states that a landlord cannot take an action to forfeit the lease for non-payment of rent, or any other financial sums due under the lease. This measure was initially in place between 26 March and 30 June 2020,[216] but subsequently extended till 31 December 2020, and thereafter till 30 June 2021. On 16 June 2021, the moratorium was further extended till 25 March 2022.[217] Therefore, if a small business misses rent payment during this period, they will be protected from eviction. This is, however, not an exclusion of liability but rather a postponement. SME owners would therefore have to justify the utility and more importantly the cost of such business premises.

The UK Government has also put in place protections to cushion the impact of the pandemic on the ability of businesses to meet debt obligations. The Corporate Insolvency and Governance Act 2020 (CIGA) introduced temporary restrictions on creditors, such as the restriction on winding up petitions where debt is unpaid due to Covid-19.[218] Thus, a winding-up petition may not be issued unless the creditor has reasonable grounds for believing, and can provide evidence, that the coronavirus pandemic has not had a financial effect on the debtor company.[219] This measure is in place until 30 September 2021 and would provide respite to SMEs struggling to meet their debt obligations due to the pandemic.

[216] Coronavirus Act 2020, s. 82
[217] GOV.UK, 'Eviction protection extended for businesses most in need' (GOV.UK, 16 June 2021) <https://www.gov.uk/government/news/eviction-protection-extended-for-businesses-most-in-need> accessed 30 July 2021.
[218] CIGA, Schedule 10.
[219] ibid

Additionally, the Government has set up a number of schemes to assist SMEs continue their business operations during the pandemic.[220] For example, it set up the Coronavirus Business Interruption Loan Scheme (CBILS), which helps SMEs[221] to access government-backed loans and other forms of finance up to £5 million;[222] and the Coronavirus Bounce Back Loan (BBLS) which allows SMEs to borrow between £2,000 and 25% of their turnover – to a maximum of £50,000.[223] Similarly, the Small Business Grant Fund entitles small businesses which pay little or no business rates to a one-off cash grant of £10,000 from their local council.[224] However, while these initiatives are beneficial in boosting SMEs' access to finance and liquidity, they are largely subject to eligibility criteria such as turnover, business viability and solvency.

Hence, "businesses in difficulty" – that is, businesses with accumulated losses greater than half of their share capital, do not qualify for these schemes. Similarly, businesses with financial difficulties preceding the pandemic do not qualify for these schemes. One could argue that such businesses would have adopted – albeit to varying degrees – poor corporate governance practices in the first place. To illustrate, a hypothetical SME's inability to stay solvent can be attributed to poor financial governance, which is a subset of corporate governance.

Conversely, however, SMEs that practiced good corporate governance pre-pandemic, are better placed to survive the current climate although this comparative advantage should not be overstated. Furthermore, the pandemic serves as a stark reminder of the importance of having in place, strategic management processes to identify potential threats, advance planning and the safeguarding of critical business functions in the event of disruption. Arguably, a large

[220] See chapter 4 of a further discussion of the schemes
[221] SMEs with a turnover of £45 million or less.
[222] GOV.UK, 'Apply for the Coronavirus Business Interruption Loan Scheme' (23 March, 2020) <https://www.gov.uk/guidance/apply-for-the-coronavirus-business-interruption-loan-scheme> accessed 21 June 2020.
[223] GOV.UK, 'Apply for a coronavirus Bounce Back Loan' (27 April, 2020) <https://www.gov.uk/guidance/apply-for-a-coronavirus-bounce-back-loan> accessed 20 June 2020.
[224] GOV.UK, 'Check if you're eligible for the coronavirus Small Business Grant Fund' (1 April, 2020) <https://www.gov.uk/guidance/check-if-youre-eligible-for-the-coronavirus-small-business-grant-fund> accessed 22 June 2020.

proportion of the SMEs that would survive the pandemic are those whose corporate governance practices adequately equip them to deal with negative eventualities.

Notably, insolvency statistics during the pandemic generally reveal historically low figures.[225] This is, in part, attributable to the temporary measures put in place by the UK Government to cushion the adverse impact of the pandemic. However, most recent statistics reveal a gradual increase in insolvency figures.[226] This suggests that the government measures to provide financial support during the pandemic might have only suppressed insolvencies and preserved anaemic companies.[227] A strong possibility arises, therefore, that as temporary government measures are eased off, more companies would inevitably face the risk of insolvency.[228]

3.15. Conclusion

This chapter examined the corporate governance structures employed in Nigeria and the UK as well as the enforcement of these structures in both jurisdictions. Indeed, good corporate governance is critical to enhancing investors' confidence and, in turn, improving SMEs' prospects for accessing funding and raising capital. Undoubtedly, poor governance practices expose SMEs to avoidable shareholder suits and potentially edge the company closer to insolvency. Against this background, the chapter proposed an ideal corporate governance framework for SMEs in Nigeria, based on six key principles and a "Comply or Explain" philosophy. A case was also made for audit committees in SMEs, although the limitations of such proposition were highlighted.

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[225] Office for National Statistics, 'Business insights and impact on the UK economy: 28 January 2021' (ONS, 11 February 2021) <https://www.ons.gov.uk/businessindustryandtrade/business/businessservices/bulletins/businessinsightsandimpactontheukeconomy/28january2021> accessed 2 August 2021,

[226] GOV.UK, 'Monthly Insolvency Statistics, July 2021' (GOV.UK, 17 August 2021) <https://www.gov.uk/government/statistics/monthly-insolvency-statistics-july-2021> accessed 18 August 2021. There has been a 13% increase in registered insolvencies when compared to the number registered last year in July 2020, although the figure remains 24% below pre-pandemic levels.

[227] K. Akintola, 'Pro-commerce outlooks: the bane of English corporate insolvency law?' (2021) 34(1) Insolvency Intelligence 6.

[228] Euler Hermes, 'Calm before the storm: Covid-19 and the business insolvency time bomb' (Euler Hermes, 16 July 2020) <https://www.eulerhermes.com/en_global/news-insights/economic-insights/Calm-before-the-storm-Covid19-and-the-business-insolvency-time-bomb.html> accessed 1 August 2021.

The chapter considered protections available under UK and Nigerian law to minority shareholders in SMEs. To buttress the importance of good corporate governance practices, this was undertaken on the impact of the COVID-19 pandemic. It was noted that SMEs are particularly vulnerable in the current business climate. However, it was also suggested that SMEs with good corporate governance practices are best placed to mitigate their losses, obtain government-backed funding, weather the pandemic and continue operating as business concerns. It was further noted that poor corporate governance practices hamper a company's ability to obtain finance and raise capital to sustain its operations. This, in turn, increases the likelihood of insolvency.

Chapter 4

4. Funding SMEs

4.1. Introduction

Small and Medium Enterprises (SMEs) are considered a source of dynamism, innovation and flexibility.[1] As established in the previous chapters, SMEs, like other business types, need capital to attain and sustain commercial growth. Funding SMEs is important, as the SME vehicle is the usual starting point for entrepreneurship, due to its efficiency, flexibility, individual creativity and its innovative entrepreneurial spirit.[2] Amongst the governance challenges encountered by SMEs, access to finance is significant.[3] Thus, a key issue for SMEs is how to secure start-up and growth capital at a reasonable cost.

This chapter undertakes a more detailed explanation of the issue of funding as a governance challenge for SMEs. It starts by exploring the importance of capital to a business in this instance. It then proceeds to discuss why commercial banks may be reluctant to extend loans to SMEs and where they so do, why such loans may be on unfavourable terms to SMEs. Thereafter, it explores various sources of finance available to SMEs, their merits and demerits with particular focus on debt and equity financing. Furthermore, invoice/receivable financing, crowd funding will also be explored as sources of finance in the alternative finance market. This is followed by a discussion of the role of the UK and Nigerian government in making finance available to SMEs and an assessment of the effectiveness of the mechanisms provided. Notwithstanding these government mechanisms and typical finance options available to SMEs, it is argued that access to finance for SMEs especially in Nigeria remains minimal.

[1] C. P. Nwosu & E. R. Ochu, 'Small and Medium Enterprise financing in Nigeria: Benefits, Challenges and way forward' (2017) 8 Journal of Economics and Sustainable Development 178

[2] M. B. Shettima, 'Impact of SMEs on employment generation in Nigeria' (2017) 22 Journal of Humanities and Social Science 43

[3] P. Lader, *The Public/Private Partnership* (Springs, 1996); see discussion 2.5 & 2.6 in chapter 2 for some of the challenges facing SMEs

Accordingly, this chapter concludes by proffering some recommendations on practical ways to make finance options available to SMEs for them to attain maximum productivity.

4.2. Importance of Access to Capital

Capital has been described to be the lifeblood of any business.[4] Businesses require capital to stay afloat – purchase tools and machinery for production and to ensure efficient delivery of their services.[5] Financially distressed companies also require further capital to preclude insolvency or facilitate insolvency rescue. Within the wider economy, when there is access to capital, there is the propensity for the emergence of new firms, which leads to increased development in certain sectors and higher growth amongst these new firms.[6] Sufficient capital also spurs job creation, as the availability of capital allows for the expansion of businesses, which in turn creates more employment opportunities.

The importance of access to finance by SMEs cannot be downplayed, as it facilitates market entry, aids in the growth of companies, reduces risks such as insolvency, increases innovation, and entrepreneurial activity.[7] Mazani and Fatoki suggest that for SMEs to grow, there is the constant need to be operating in a supportive financial environment,[8] marked by access to sufficient capital. Thus, capital plays a significant role in the running of SMEs. For an SME to be productive and successful, there should be sufficient inflow of capital for the running of the business.

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[4] R. A. Cole, 'The importance of relationships to the availability of credit', (1998) 22 Journal of Banking & Finance 959, 962; E. K. Ron & G. Stephen, 'Is there a right level of working capital'? (2011) 4 Journal of Corporate Treasury & Management 137, 183

[5] S. Marriotti & C. Glackin, '*Entrepreneurship: starting & operating a small business'* (3rd Edition, Pearson, 2013)

[6] P. Aghion, Thibault Fally & Stefano Scarpetta, 'Credit Constraints as a Barrier to the entry and Post-Entry Growth of Firms' (2007) 22 Economic Policy 731.

[7] ibid

[8] M. Mazani & O. Fatoki, 'Perceptions of start-up small & medium sized enterprises (SMEs) on the importance of business development service providers (BDS) on improving access to finance in South Africa' (2012) 30 Journal of Social Science 31, 40.

However, the wake of the financial crisis in 2008 made commercial banks withdraw lending to SMEs, thus leading them to put growth plans on hold.[9] That said, lack of SME lending could also affect the sustainability of commercial banks.[10] This inevitably has a knock-on effect on the economy. Due to the difficulty instigated by inadequate access to finance, SMEs achieve slower growth and fail to attain maximum productivity. The following section of this chapter explores why commercial banks are reluctant to extend loans to SMEs.

4.3. SMEs Access to Bank Finance

Commercial banks act as a bridge between savers and the business community desirous of obtaining loans for investments. They provide long and short-term loans to the business at an interest rate that is agreed by both parties. However, commercial banks are reluctant to extend loans to SMEs due to information opacity, perceived lack of stability and scepticism about SME prospects. Thus, even when SMEs secure loans, they are typically granted on onerous and unfavourable terms.

In Nigeria the percentage interest rate for commercial loans is a substantial 15.04%.[11] Conversely, in the UK, the base rate by the Bank of England is at 0.1%[12] while the interest rate for business loans fluctuates between 7.1% and 7.6% depending on prevailing economic circumstances and the banks.[13] A comparison of the loan structure and interest rate in both jurisdictions reveals that the interest rate in Nigeria has the propensity to discourage SMEs from seeking bank loans, as the high amount payable as interest can be reinvested in the

[9]Close Brothers, 'Banking on growth: closing the SME funding gap' (2016) <https://www.closebrothers.com/system/files/press/Banking-on-Growth-Closing-the-SME-funding-gap.pdf> accessed 27 December 2018

[10] F. O. Olokoyo, 'Determinants of commercial bank's lending behaviour in Nigeria', (2011) 2, International Journal of Financial Research 61, 64

[11] Trading Economics, 'Nigeria's Interest Rate' Available at: <https://tradingeconomics.com/nigeria/interest-rate > accessed 14 June 2020

[12] Trading Economics, 'England's Interest Rate' Available at: < https://tradigneconomics.com/united-kingdom/interest-rate > accessed 14 June 2020

[13] HSBC Group Management Services Limited, 'Finance and Borrowing' Available at: <https://www.business.hsbc.uk/en-gb/interest-rates/interest-rates-finance-borrowing > accessed 14th June 2020; Santander Business Banking, 'Santander Small Business loan' Available at: < https://www.santander.co.uk/uk/business/borrowing-finance/business-loans > accessed 14th June 2020

business. Arguably, this disparity is indicative of the fact interest rates reflect not only the cost of capital but also the cost of doing business. Thus, in a country like Nigeria where lenders individually provide their own power, security and infrastructure, some of the cost is passed on to businesses in the form of high interest rates. Nnabugwu opines that the issue of high-interest rates is a major impediment for SME development in Nigeria.[14] Whilst this reason advanced for the high-interest rate often relates to the cost of doing business, this thesis argues that this is not an ideal situation, especially for SMEs, considering the role they play in nation building.[15] Even in the UK, where SMEs have access to lower interest rates, studies suggest a relative lack of finance to SMEs, which comes at great cost to the UK economy.[16] Some reasons for this include, but are not limited to: the inability of businesses to afford the cost of taking out finance; lenders' lack of understanding of the SME sector, and lenders' lack of understanding of individual borrowers' needs. Thus, the issue appears more nuanced than interest rates. Additionally, there is the issue of information asymmetry and security, which are subsequently discussed.

4.3.1. Information Asymmetry

Stiglitz and Weiss note that credit market experience disequilibrium where the borrower possess more knowledge about its prospects than the financing institution.[17] The situation is called asymmetric information. Information asymmetry occurs when there is "an imbalance between two negotiating parties in their knowledge of relevant factors and details".[18] As a

[14] F. Nnabugwu, 'High interest rates, bane of SMEs development: Oyofo' (Vanguard, 6 October 2014) available at: <https://www.vanguardngr.com/2014/10/high-interest-rates-bane-smes-development-oyofo/> accessed 3 January 2019

[15] D. Olowookere, 'Why bank charges high interest rates on loans: Emefiele' (Business Post Nigeria, 30 July 2017) available at: <https://businesspost.ng/2017/07/30/banks-charge-high-interest-rates-loans-emefiele/> accessed 3 January 2019

[16] Close Brothers [n 9] – it was estimated that lack of access to finance to SMEs cost the UK economy as much as £2.9 billion over five years.

[17] J. E Stiglitz, & A Weiss, 'Credit rationing in markets with imperfect information' (1981) American Economic Review 71, 393

[18] Techtarget Network 'Information Asymmetry' <https://whatis.techtarget.com/definition/information-asymmetry> accessed 30 May 2020

result, the party with more information enjoys a competitive advantage over the other party. In the context of the Bank-SME lending relationship, information asymmetry refers to a situation where the banks do not have enough information about the SMEs.[19] It also means when one party has better and more accurate information than the other party which affects the successful outcome of the loan, at his expense.[20]

It has been opined that in the small finance market, SMEs and banks operate within a principal-agent relationship,[21] wherein SMES are agents of the finance provider which undertake to generate returns from investment project(s) on behalf of the principal (the finance provider). Under perfect market conditions, all relevant information both past and present needed by the parties involved will be available to them without each bearing any cost of obtaining the information, thus enabling them to make sound economic decisions. In that case, the principal-agent relationship suffers no information asymmetry. However, information itself is neither perfect nor without cost in reality.[22] Summarily, the SME finance market is an imperfect market and as such is characterised by information asymmetry.

Information asymmetry prevents banks from extending loans to SMEs for several reasons. For one, risk and uncertainty about future business and economic conditions exist in the SME finance market. For example, the bank might have incomplete information regarding the essential quality of the project as well as the management of the small firm.[23] Ang also observes that owners may be reluctant to disclose detailed financial information owing to the fact that the identity of small business owners and their firms are usually closely linked. In most cases,

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[19] See discussion 3.11 in Chapter 3 on the ideal corporate governance framework that may remedy the problem

[20] M. Abdelhafid and S. Mohammed, 'The Impact of Information Asymmetry on the Bank Financing of SMEs in Algeria: An Econometric Study' (2019) International Journal of Inspiration & Resilience Economy 3(1), 19 <www.sapub.org/global/showpaperpdf.aspx?doi=10.5923/j.ijire.20190301.03> accessed 14 June 2020

[21] M. Binks and T. Ennew, *Financing small firms*, In P Burns and J Dewhurst, (eds), *Small Business and Entrepreneurship* (2nd Edition, Macmillan, 1996)

[22] Abdelhafid and Mohammed (n 20) 18

[23] A. Emuwa, 'Barriers to SME Lending in Nigeria, Finding Context-Specific Solutions' (Doctor of Business Administration Thesis, The Nottingham Trent University 2015), 23 <https://pdfs.semanticscholar.org/d8c4/5f8713367899298993f658ab6d2f59693cda.pdf> accessed 14 June 2020

the management structure of the SMEs is not clear-cut as in listed companies. He further identifies that unfavourable taxation might make SMEs reluctant to fully disclose the extent of their business activity.[24]

Furthermore, it makes it difficult for the firm to prove the quality of its investment projects to the bank. Generally, SME owners do not possess the financial expertise and sophistication that big businesses have. In addition, there might be incomplete information about the creditworthiness of the SMEs, particularly new start-up SMEs, which may be unable to provide a track record of good financial performance.

Therefore, the failure to provide such vital information usually leads to a rejection of loan application as banks have nothing to rely on. When this information asymmetry occurs, undesirable outcomes manifest. First, the lack of incomplete information on the bankability of the SME leads to the adverse selection problem. Banks will find it difficult to distinguish "good-risk SMEs" from "bad-risk SMEs."[25] This discourages the well-performing SMEs from approaching the bank as the conditions might seem unfair to them. The implication is that the high-risk SMEs approach the banks for loans, gradually erasing the well-performing SMEs out of the market. Second, the moral hazard problem[26] arises because it is too costly for the banks to effectively monitor the performance of the SMEs. It therefore results in equilibrium credit rationing and a reduction in the debt provision to such SMEs. [27]

In practical terms, this thesis argues that banks have responded to the problem of information asymmetry in three ways. First, they may choose to ration loans, which involves reducing the supply of loan contracts and making them more complex. Credit rationing is used by lenders

[24] A. James, 'On the Theory of Finance for Privately Held Firms' (1992) 1 Journal of Small Business Finance 187

[25] For a discussion on the adverse selection problem caused by information asymmetry, see G. A. Akerlof, 'The Market for "Lemons"; Quality Uncertainty and the Market Mechanism' (1970) 84(3) The Quarterly Journal of Economics 488.

[26] Emuwa (n 23) 20

[27] Stigilitz and Weiss (n 17)

to limit or deny the supply of credit to borrowers because of the borrower's creditworthiness;[28] notably SMEs in countries with efficient judicial systems and greater levels of trust are less likely to be credit rationed.[29] In addition, information asymmetry increases the need to effectively monitor the loans thereby increasing the bank's transaction costs. Therefore, although the loan application is accepted, it is accepted at a higher risk-adjusted rate. This, in particular, stems from issues associated with adverse selection. Secondly, because of moral hazard, the banks may prescribe strict security requirements for loans granted to SMEs. The third, is an outright rejection of the loan application, which is a consequence of moral hazard, market concentration, centralisation of lending decisions, and the increase in the use of automated credit-scoring. These have an impact on access to credit from banks to SMEs, although it should be noted that other facilities apart from fixed term loans (such as credit cards and overdrafts) may be utilised. Nevertheless, lenders such as merchant banks have overcome this problem by taking equity in such SMEs.

4.3.2. The Issue of Security

Owing to structural issues facing SMEs, banks may be reluctant to grant loans to them.[30] Studies reveal that insufficient collateral or guarantees are key reasons for the denial of credit applications.[31] Research further indicates that only about 30% of credit facilities are granted credit on a no security basis.[32] This effectively means that majority of the credit facilities accessed by most companies are backed up by security. In *Bristol Airport v Powdrill*[33] the court asserted that "security is created when a *person ('the creditor') to whom an obligation is owed*

[28] A. McNamara, S. O'Donohoe and P. Murro, 'Lending infrastructure and credit rationing of European SMEs' (2020) 26(7) The European Journal of Finance 728
[29] ibid.
[30] D. Badulescu 'Collateral in SMEs Lending: 'Banks requirements vs customers' expectations' (2011) 1(13) The Annals of The "Ştefan cel Mare" University of Suceava. Fascicle of The Faculty of Economics and Public Administration 11, 256.
[31] A. F. Pozzolo, 'Secured Lending and Debtors' Riskiness' (BIS, March 2002) <https://www.bis.org/publ/cgfs19bdi1.pdf> accessed 21 January, 2020
[32] ibid
[33] [1990] 2 WLR 1362

by another ('the debtor') by statute or contract, in addition to the personal promise of the debtor to discharge the obligation, obtains rights exercisable against some property in which the debtor has an interest in order to enforce the discharge of the debtor's obligation to the creditor."[34] Put simply, the primary repayment device is in the primary agreement, while security is a secondary repayment device. Therefore, to access credit facilities, businesses often have to give security.

Furthermore, securities are particularly useful in solving the moral hazard that banks are likely to experience after the loan is granted. This is because securities are seen as instruments to ensure that borrowers put on good behaviour for the duration of the loan. Essentially, bank use collaterals to contract the information gap between banks and the SMEs.[35] Failure to provide adequate security therefore hinders SMEs from accessing finance from Banks. Arguably, the SME-lending market is largely transactional. As such, the availability of security largely determines the financial decisions of banks. Unfortunately, young and innovative SMEs which require high level of finance to operate, may not readily have security to offer for loans. However, the requirement to provide security could be obviated by the provision of personal guarantees by directors. Notably, for a guarantee to be enforceable, it must be in writing and signed by a person with requisite authority.[36] The courts have shown flexibility with these requirements, holding that a series of emails could constitute a valid guarantee.[37]

In Nigeria and the UK, lack of adequate or absence of security is a major reason why banks do not extend loans to SMEs. A joint report by the International Finance Corporation (IFC) and Central Bank of Nigeria (CBN) identifies that security is the missing link between the SMEs

[34] ibid per Browne-Wilkinson VC at 1372.
[35] A.N. Berger and G.F. Udell 'A more complete conceptual framework for SME finance' (2006) 30 Journal of Banking & Finance 2945
[36] Statute of Frauds 1677, s. 4.
[37] *Golden Ocean Group Ltd v Salgaocar Mining Industries Pvt Ltd* [2012] EWCA Civ 265.

and the banks in accessing capital needed for growth.[38] Understandably, the request for security is significant from the bank's perspective as it enables them to easily repay or offset those loans in case of default or insolvency. Furthermore, 82% of financial institutions believe that inadequate asset base is the single biggest challenge to bank lending to SMEs.[39] Undoubtedly, the failure of most SMEs to provide assets to serve as security for loans has made banks deem lending to SMEs as highly risky. In fact, of the 840 SMEs surveyed, only 31% had obtained a loan from a bank or microfinance institution.[40] Hypothetically, if SMEs have assets, lenders may view them as liquid and not require security to obtain credit. Nevertheless, a key governance point arises in the context of finance, vis-à-vis the company's gearing ratio (which is a measure of how much of its operations are funded using debt versus funding from shareholders as equity). Good corporate governance may arguably promote sensible gearing ratios in SMEs; that is, lower debt and higher equity.

In Nigeria, common assets required by banks include land and other immovable properties. However, this turns out to be a costly and complex process due to several reasons. The complex land tenure system under the Land Use Act in Nigeria renders most of the land in Nigeria as dormant assets. A recent PwC Report reveals that 95% of household dwellings in Nigeria have no title or contestable title.[41] This is further exacerbated by the fact that it is complex to register title to land in Nigeria.[42] Thus, when assets both movable and immovable are not properly registered and described, it becomes difficult for SMEs to leverage them as security to access funding from Banks.

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[38] Central Bank of Nigeria and International Finance Corporation 'The Credit Crunch: How the use of movable collateral and credit reporting can help finance inclusive economic growth in Nigeria' (February 2017) <https://www.ifc.org/wps/wcm/connect/0c620b40-37ab-4edc-93d9-8255378be2c4/Nigeria+Financial+Literacy+Baseline+Survey+28+2+17_Single+Pages.pdf?MOD=AJPERES&CVID=lGl8d.t> accessed 21 June 2020

[39] ibid

[40] ibid

[41] PwC Nigeria, 'Bringing Dead Capital to Life- What Nigeria should do' <www.pwc.com/ng/en/publications/bringing-dead-capital-to-life.html> accessed 9 June 2020.

[42] ibid, Nigeria ranks 184 in the world in terms of property registration.

The Secured Transactions in Moveable Asset Act 2017 ("STMA") was enacted in Nigeria to aid SMEs in accessing secured financing using movable assets.[43] Notably, movable assets are broadly defined under the Act to include tangible or intangible property other than real property.[44] This is beneficial for SMEs, as it provides a broad range of assets to be potentially used a security for credit. The STMA also establishes a National Collateral Registry, to receive, register and store information about security interests.[45] This complements the regime for registration of charges/mortgages under CAMA.[46] It is hoped that these provisions are utilised to achieve their intended effect of widening access to credit for SMEs, Nevertheless, it has been argued that in developing countries with lesser financial development and weaker property rights, firms get less efficient financing from banks.[47] Against this background, the following section highlights the value of typical and alternative sources of finance available to SMEs.

4.4. Finance Options Available to SMEs

Sourcing and securing funds needed for a business is a difficult task especially in developing countries like Nigeria where there is arguably insufficient protection afforded to investors and creditors; coupled with the fact that the country is still recovering from a recession and the impact of the COVID-19 pandemic.[48] Petit and Singer note that the capital structure of smaller companies is determined partly by the owner's interaction of risk-return preferences, the characteristics of the company and the cost of various types of financing.[49] SMEs utilise

[43] STMA, s. 1(c).
[44] STMA, s. 63.
[45] STMA, s. 11(a).
[46] CAMA, s. 222.
[47] T. Beck, A. Demirguc-Kunt, V. Maksimovic, 'Financing patterns around the world: Are small firms different?' (2004) World Bank, Working paper. 1 <https://core.ac.uk/download/pdf/6465386.pdf > accessed 21 June 2020
[48] International Monetary Fund, 'Nigeria out of recession and looking beyond oil' (March 15, 2018) <www.imf.org/en/News/Articles/2018/03/15/na031518-nigeria-out-of-recession-and-looking-beyond-oil> accessed 15 November 2018
[49] R. R. Petit & R. F. Singer, 'Small business finance: A research agenda' (1985) 14 Financial Management 47, 52

different types of finance to grow their businesses at different stages. Broadly, SMEs may use debt/credit or equity financing. However, the type of financing may depend on the size of the SME. Larger SMEs may use retained earnings whilst smaller SMEs may utilise personal savings and angel investment in exchange for equity. Whichever form of financing an SME utilises, there is a demonstrable impact on its corporate governance, specifically financial governance and the role which directors or other stakeholders may play in controlling the company's affairs in fulfil the obligations which accrue from the financing method.

One of the reasons why smaller SMEs rely on personal finance is the fact they may not have sufficient assets within the business to secure commercial bank loans.[50] This undoubtedly leaves them with fewer options for finance and potentially renders them more reliant on personal savings to grow their business.

Furthermore, SMEs have different financing needs, which are largely dependent on their stage of operation in the business. Nevertheless, it is important that they are adequately informed about financial products/options that would best suit their unique circumstances. This then begs the question of where and how SMEs can secure finance. Whilst taking this into consideration, it is important to determine the type of finance sought to be obtained. The following section analyses sources of finance to SMEs, their mode of operation, along with their merits and demerits.

4.4.1. Personal Finance

Personal savings refers to the amount left after subtracting a person's consumer expenditure from their disposable income in a given period.[51] This source has kick-started and funded different businesses around the world and has been described as equity provided by the owner

[50] Berger and Udell (n 35) 2949.

[51] U. R. Etuk, R. G. Etuk & M. Baghebo, 'Small & medium scale enterprises (SMEs) & Nigeria's Economic Development' (2014) 7 Mediterranean Journal of Social Sciences 90

of the business.[52] This entails the owner of the business utilising their savings, pension, earnings etc. to commence or keep the business afloat.

4.4.2. Credit Financing

The Cork Report of 1982 described credit as the 'lifeblood of the modern industrialised economy and the cornerstone of the trading community'.[53] Credit is a very important industry especially in the running of businesses, as it channels excess money i.e., money of those that have no use for it, to those that need it for businesses.[54]

Debt/credit financing entails borrowing money without giving up ownership.[55] As will be seen below, there are a number of credit variants. Essentially, a lender lends money to an SME that will eventually be paid back with an agreed interest. Under this form of finance, the SME retains total control of how the money is utilised and can select what it intends to finance. Thus, it is arguable that debt financing accords SMEs some flexibility. However, it is important to note that in rare instances, lenders impose certain restrictions or conditions on the use of the funds.[56]

Examples of such terms include the restriction on selection of management team, appointment of new directors and issuance of new shares. In such instances, the lender can be impliedly regarded as a shadow director in the company, which has implications before and during insolvency such as jointly liability for wrongful trading during insolvency.[57] However, this would largely depend on different factors such as whether such party was portrayed as a director or assumed responsibility for an aspect of the business. Courts are usually reluctant to

[52] ibid
[53] K. Cork, *Report of the review committee on insolvency law practice* (Her Majesty's Stationery Office, London, 1982, Cmnd 8558)
[54] F. Tolmie, *Corporate and Personal Insolvency Law*, (2nd Edition, Cavendish Publishing, 2003) 15
[55] Marriotti and Glackin (n 5) 28.
[56] J. Hecht, 'Debt v Equity Financing: Which way should your business go?' Available at: *Entrepreneur* June 2016 <www.entrepreneur.com/article/278430> accessed 3rd January 2019
[57] A shadow director is a holder of stock of a private company and does not openly participate in the firm's governance, but whose directions or instructions are routinely complied with by the employees or other directors.

attribute director status to a lender because generally, a lender and the management of a borrowing company often deal at arm's length. The Court in *Re Hydrodan (Corby) Ltd*[58] set out a four-way test to establish credit directorship. Firstly, it must be established whom the directors of the company are, i.e. de jure directors or de facto directors.[59] Secondly, the court considers if the putative shadow director gave directions to the directors. Thirdly, if the directors acted on those directions or instructions. Fourthly, if the directors are accustomed to acting in accordance with the directions or instructions of the putative shadow director (in this case, the creditor).

Similarly, in *Buzzle Operations Pty Ltd (in Liquidation) v Apple Computer Pty Ltd*,[60] it was held that reliance could not be placed on the activities of Apple to be considered shadow directors in Buzzle. The court considered their actions to be steps and the operations of the business and things which the directors were, in any event, going to do. Arguably, both cases indicate that courts are usually reluctant to hold a shadow director liable because s/he is a lender. Further, it is arguable that if a lender must be categorised as a shadow director, they must have exerted a substantial degree of control in running the business. In such an instance, this thesis argues that if such a business becomes insolvent, then it is fair that such a shadow director be held partly liable.

SMEs also finance their business through personal bank overdrafts. Bank overdrafts are agreed sums that a customer withdraws from his/her current account and the balance goes below zero.[61] It serves as a source of short-term finance to help a business with a seasonal shortage of funds that does not require a long-term solution. The charge varies and is linked to the bank

[58] [1994] 2 BCLC 180

[59] *De jure* director is a director formally appointed and registered as a director
De facto director is a director who acts as a director but has not been appointed nor registered as one

[60] (2010) 77 ACSR 410

[61] M. Scott & R. Bruce, 'Five stages of growth in small business', (1987) 20 Long Range Planning 45, 49. See also Devaynes v Noble (Clayton's Case) (1816) 1 Mer 572 where the court considered the effect of an overdraft.

rate.[62] It ensures perpetual cash flow; however, the interest rate can be high especially to smaller businesses, furthermore, when a business' overdraft limit is exceeded, the bank may also refuse to pay cheques to creditors and hit the business with hefty charges. Commendably, in the UK, new rules which came into effect April 2020 stipulate that a bank can only charge for overdraft a simple annual interest rate with no daily or monthly fees charged.[63] This makes cost of overdraft considerably less.

4.4.2.1. Bank of Mum and Dad

In this form of finance, the parents of the business owner are the source of financial support. They either provide the start-up funds or subsequently provide funds that are used to keep the business running.[64] It is usually interest-free and has no designated date for repayment. It is a popular form of finance utilised not only by SMEs but in other sectors. For instance, a recent report revealed that in 2017, Bank of Mum and Dad put up a substantial 6,500, 000, 000 Pounds into the property ladder.[65] This is reported to be a 30% increase from the preceding year.

4.4.2.2. Recognised Security Options

Under the provisions of the Insolvency Act 1986 (IA 1986) recognised security options in the UK includes pledges and liens (possessory security), mortgages and charges (non-possessory security).[66] Possessory security are security agreements that pass the possession of the secured asset to the creditor to fasten the security. Conversely, with non-possessory security, the debtor retains possession of the secured assets at all material times during the subsistence of the agreement. Non-possessory security agreements are arguably more convenient

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[62] ibid
[63] FCA, 'Changes to Overdraft Charges' (FCA, January 2020) <https://www.fca.org.uk/data/changes-overdraft-charges> accessed 13 November 2020
[64] T. Bates, 'Entrepreneur human capital inputs & small business longevity' (1990) 72 The Review of Economics & Statistics 551, 553
[65] Legal & General Assurance Society, 'The Bank of Mum & Dad', (2017) Legal and General Assurance Society, 1 <https://www.legalandgeneral.com/retirement/_resources/documents/more-money-in-retirement/reports/bank-of-mum-and-dad-report-2017.pdf> accessed 3 May 2019
[66] IA 1986

notwithstanding the fact that mortgage requires the debtor to transfer title to the creditor. The idea of transferring title is arguably a legal fiction to fasten the security.[67] More interestingly, a charge as a non-possessory security does not require transfer of title. Accordingly, in the UK, charges are the most utilised security devices.[68]

Furthermore, of the various forms of charges, the floating charge is the most convenient and flexible. A floating charge as a security device is a broad security agreement. It was devised by chancery lawyers in response to the inconvenience of other security agreements to corporate and commercial life. Under a floating charge, the company gives extensive security to its creditor, usually over all its assets (present and future). In exchange, the company retains the right to continue to deal with the asset in the ordinary course of business.[69] A floating charge gives the debtor the freedom to deal with the assets which are the subject matter of the security until the charge "crystallises" (i.e., converts to a fixed charge). The charge crystallises on the occurrence of an event of default in accordance with the terms of the loan agreement. Upon crystallisation, the chargor loses authority to deal with the charged assets without the chargeholder's consent. Arguably, crystallisation has a limited effect on insolvency. The Insolvency Act defines a floating charge as a charge which, as created, was a floating charge.[70] Thus, crystallization will generally not affect how a floating charge is characterised for the purposes of charge holder's priority. Under Nigerian law, a floating charge crystallises when the chargeholder enforces his right under the debenture, or the court appoints a receiver/manager of the charged assets upon application by the charge holder, or the company goes into insolvent liquidation.[71] Notwithstanding the foregoing, SMEs need security to obtain

[67] This is because the transfer of title, does not fully ascribe legal or equitable ownership to the creditor; *Swiss Bank v Lloyds Bank* [1980] 2 All ER 419, [1981] 2 All ER 449

[68] Charges are not dependent on title to or possession of the asset which is the subject matter of the charge. A charge entitles its holder to take the charged assets in certain circumstances and to apply its proceeds in satisfaction of the debt.

[69] See *Re Spectrum Plus Ltd* [2005] UKHL 41 for the distinction between a floating and a fixed charge

[70] Insolvency Act 1986, s. 251.

[71] CAMA, s. 203(1).

credit and a floating charge will be instrumental in this regard. Akintola confirms that, the floating charge has played a cardinal role in the provision of debt finance to companies.[72]

In Nigeria, every company may borrow money and mortgage or charge its undertaking, property or uncalled capital or any part thereof and in pursuance of which it may issue debentures, debenture stock and other securities which may be outright or as security for any debts, liability or obligation of the Company or of any third party.[73] Furthermore, in Nigeria, the STMA: (a) provides for the creation of security interests in movable assets[74] and the execution of legal documentation creating the security interest which document is required to set out the rights and obligations of the counterparties;[75] (b) stipulates the procedure for perfecting security interests in movable assets;[76] (c) establishes the National Collateral Registry ("NCR");[77] and (d) sets out the criteria for determining priority of competing interests in secured assets.[78] Overall, the Act aims to enable the ease of doing business in Nigeria by improving the access to credit for SMEs in Nigeria.[79]

An important discussion on debt financing is the introduction of Limited Liability Partnership in the CAMA 2020. Limited Liability Partnership (LLP) is a hybrid of company and partnership.[80] It combines the separate legal personality, perpetual succession and limited liability of a company with flexibility in the internal regulation of a partnership.[81] As a business vehicle with limited liability for partners, it is potentially attractive for SMEs. More notably,

[72] K. Akintola, 'What is left of the floating charge? An empirical outlook' (2015) Butterworths Journal of International Banking and Finance Law 404, 406.
[73] CAMA, s. 191
[74] Secured Transactions in Moveable Asset Act 2017 s.8(1)
[75] STMA 17 s.13(1).
[76] STMA 17 s.8-9.
[77] STMA 17 s.10.
[78] STMA 17 s.23.
[79] For instance, S. 54 of the STMA Act excludes the applicability of the Stamp Duties Act Cap. S8 LFN 04 to all transactions under the STMA.
[80] CAMA, s. 746
[81] U. Gandhi and R. Thakur, 'A Study on Limited Liability Partnership as an Emerging Business Form for Entrepreneurs' Institute of Law, Nirma University 301, 302 <https://1library.net/document/z34dxjdy-study-limited-liability-partnership-emerging-business-form-entrepreneurs.html> accessed 1 August 2021

the introduction of LLPs potentially helps SMEs to raise debt finance. SMEs organised as business names and ordinary partnerships have had difficulty in raising funds because of the lack of separate legal personality of such business vehicles. However, by forming an LLP, it might become easier for SMEs to get loans as creating floating charges over assets become possible.[82] It must be acknowledged that the partners may be subject to regular liability rules. However, unlike an ordinary partnership, partners in an LLP do not risk personal loss in the event of misconduct or death of any partner.

A debt/credit facility allows the borrower to retain complete control of the company. However, as earlier discussed, this depends on the terms of the loan covenant and the nature of security utilised. Nevertheless, obtaining such finance generally does not transfer ownership rights to the lender, though it may raise the issue of gearing ratio such that it becomes pertinent to consider how much of the company's operations is being funded by debt.[83] Further, it is seen to be cheaper option because it is tax deductible thus making the company pay smaller portion of its profits as tax.[84]

However, securing loans is not always a seamless process. In this instance, securing a loan might prove to be a daunting task because SMEs, in most cases, do not have collateral or reputational capital to an entity or an individual willing to grant them any credit facility.[85] Furthermore, in the event of a default, there is the likelihood that the lender would move to enforce against the company.[86] Nevertheless, it can be argued that proper planning would, to a considerable extent, ensure that SMEs pay back the amount borrowed.[87]

[82] ibid 314
[83] E.P. Davies, *Debt, financial fragility & systemic risk,* (1st Edition, Oxford University Press 1992) 5, 7
[84] F. Modigilani & M.H Miller, 'Corporate income taxes and the cost of capital: A correction' (1963) 53 American Economic Association 433, 439
[85] Berger and Udell (n 35) 3832.
[86] ibid
[87] Close Brothers (n 9)

Furthermore, an issue with debt financing is the use of debts as a means of corporate control by lenders. Schiavone points out that debt can be used as a form of corporate control.[88] Three techniques identified are collateral, covenant, and equity participation.[89] The use of collateral is a means of managing risk. Control is exerted on the company to the extent that the assets used as collateral are not freely disposable by managers. Another notable way of exerting control over a borrower is through the provision of restrictive covenants in the loan agreements. The aim of the covenants is to safeguard against actions that may result in the dilution of the lender's claim against the borrower. For instance, a borrower could be contractually bound by a negative pledge clause, which is an undertaking not to pledge or create security interests over its assets. This gives the lender control over the borrowing company by preventing it from creating security over its assets in favour of other creditors, at its expense. Moreover, since 2013, negative pledge clauses have been registrable in the UK.[90] Thus, third parties such as subsequent lenders would have constructive notice[91] of the existence of negative pledges. In Nigeria, CAMA provides for the prioritisation of fixed charges over floating charges, except where the floating charge includes a negative pledge.[92] The CAC is required to enter a notice of a negative pledge for a floating charge in its register of particulars of charges.[93] Registration of a negative pledge with the CAC puts a third party on constructive notice.[94] The lender may also acquire equity in the indebted company and sit on its board (in order to influence the repayment of the loan) depending on the firm's equity size. This form of corporate control represents a hybrid of debt finance and equity financing which will be discussed later in this thesis.[95] However, as the primary motive in seeking debt finance is to prevent any form of

[88] A. Schiavone, 'Debt as a device for corporate control – the case of countries in transition' (2001) 16(2) Journal of International Banking Law 48, 49
[89] ibid
[90] By virtue of the Companies Act 2006 (Amendment of Part 25) Regulations 2013.
[91] *Wilson v Kelland* [1910] 2 Ch 306.
[92] CAMA, s. 204.
[93] CAMA, s. 223(1).
[94] CAMA, s. 222(1).
[95] See discussion on hybrid financing at 4.4.4.1

control in the business, it becomes unsatisfactory from the SMEs' viewpoint to access debt finance options with control terms. Therefore, it is important for SMEs to accurately assess their funding needs depending on life-cycle stage.

From the perspective of SME lenders, debt finance is advantageous. As earlier mentioned, the risk profile of SMEs and their lack of asset base make it difficult for banks to offer finance to SMEs. Thus, the decision of banks to offer debt finance to SMEs after provision of collateral as security is motivated by strong reasons. First, the security limits the potential partial or total loss that a lender suffers from the loss of resources of an SME.[96] This protective function is coupled with the capacity of the provided finance to generate returns. More important, debt finance also serves the SME lenders interest in the case of insolvency.[97] Arguably, collateral puts the lender in a privileged position as it may guarantee priority over competing stakeholders.[98] However, it is important to note that security does not guarantee the realisation of debt. Realisation is dependent on the availability and value of assets upon enforcement (especially in the context of non-possessory security that permits a borrower to deal with charged assets i.e., floating charge.

4.4.3. Equity Financing

Equity financing entails issuing shares to an investor.[99] The SME, in this instance, trades ownership of its business to an angel investor or venture capitalist[100] in return for capital. Equity is ideal for certain industries and businesses, particularly those desirous of growing into multinationals.[101] This stems from the fact that an SME giving out the equity (in its business) in exchange for finance, would increase its available capital. Further, the expertise and

[96] B. Balkenkol, H. Schutte, 'Collateral, Collateral Law and Collateral Substitutes' (2001) ILO Working Paper No. 26 Social Finance Programme, <https://www.ilo.org/wcmsp5/groups/public/---ed_emp/documents/publication/wcms_117987.pdf> accessed 7 May 2019
[97] ibid
[98] See *Re Lehman Bros* [2017] UKSC for a discussion on priority issues.
[99] Stocks in this instance would mean having a percentage ownership in the company.
[100] See 4.4.3.1 of this chapter for definition of angel investor and venture capitalist.
[101] Petit and Singer (n 49).

networks of the equity financiers as part-owners of the business may be valuable; the financiers may have a vested interest in ensuring that the business succeeds.

However, Lund and Wright suggest that equity plays only a small role in the financing of smaller businesses.[102] This may be because of the restriction of transfer of shares in the articles of association of private companies.[103] Also, any prior loan covenant may restrict issuance of new shares. This thesis aligns its argument with the findings of this research.

Conversely, in some instances, outside investors seeking equity desire a large fraction of the business, and this is usually attained by the company issuing new shares in a process known as dilution. Dilution, which could either be dilution of control or financial dilution, has different effects, amongst which are reduction of the value and ownership of existing shareholders' stake in the company. Asquith and Mullins have described the issuance of new equity as a mechanism that reduces the stock price of a company.[104] This serves the benefit of investors that are liquid as they may utilise the opportunity to own a substantial part of the business by taking advantage of shareholders with smaller portions of the company. Paradoxically, existing shareholders view this as unnecessary and disadvantageous, as (their) ownership of the company is reduced. Nevertheless, dilution may not be entirely bad, especially in instances where a company seeks boost its finance. Moreover, in certain situations, existing shareholders have first right to buy these new shares that are issued.[105]

There is also the scope for SMEs to utilise equity markets such as the Alternative Investments Market (AIM). Such equity markets play an important role in enabling SMEs to grow and scale their business. They enable SMEs to raise equity finance whilst providing existing shareholders

[102] Melanie Lund & Jane Wright, 'The financing of small firms in the United Kingdom' (1999) Bank of England Quarterly Bulletin 195, 199

[103] See s.755(1) of the Companies Act 2006 & s.22(2) of CAMA 2020. However, in the absence of restriction in the articles, a shareholder has the right to transfer their shares without the consent of anyone else.

[104] P. Asquith & D.W. Mullins, 'Equity Issues and Offering Dilution' 15 (1986) Journal of Financial Economics, 62- 86

[105] H. Drinker, 'The pre-emptive right of shareholders to subscribe to new shares' (1930) 43 Harvard Law Review 586; R. La Porta, F. Lopez-de-Silanes, A. Shleifer, R. Vishny, 'Law and Finance' (1998) 106 The Journal of Political Economy 111

such as venture capital houses with a means of realising their investments. Arguably, going public would be greatly aided by an effective corporate governance system.[106] In other words, the introduction of good corporate governance practices in an SME, would enable it to be prepared for going public. Conversely, however, going public could translate to an increased burden of corporate governance compliance for SMEs, such as the recruitment of additional (independent) directors and compliance with more extensive disclosures to comply with the regime for public companies.[107]

Private equity (PE) is another subset of equity financing for SMEs. PE investors provide financing to SMEs in return for equity in the business. However, unlike equity markets, the equity in SMEs is not publicly traded, but instead held in private hands. PE investors typically invest for a period of three to seven years, with the expectation of generating financial returns upon exiting the investment.[108] They are significantly more involved than investors in equity markets such as the AIM, and actively participate either directly on the board of directors or in partnership with management. They also bring knowledge and expertise to the companies in which they invest.[109] However, it has been noted that private equity is dependent on well-developed public markets for liquidity and exit.[110] Moreover, PE investors tend to target larger or more established enterprises. Thus, the reality remains that PE financing is somewhat limited in the SME context, particularly in developing countries such as Nigeria.

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[106] J. Abor and N. Biekpe, 'Corporate governance, ownership structure and performance of SMEs in Ghana: implications for financing opportunities' (2007) 7(3) Corporate Governance 288.
[107] G. Y. Dunay and S. Apak, 'Comparison of Public and Non-public SMEs' Corporate Governance Strategies in Turkey' (2014) 150 Procedia – Social and Behavioral Sciences 162.
[108] S. Divakaran, P. J. McGinnis and M. Shariff, 'Private Equity and Venture Capital in SMEs: The Role for Technical Assistance' (2014) World Bank Policy Research Working Paper 6827 <https://openknowledge.worldbank.org/bitstream/handle/10986/17714/WPS6827.pdf?sequence=5&isAllowed=y> accessed 8 August 2021.
[109] ibid
[110] S. Bonini and S. Alkan, 'The political and legal determinants of venture capital investments around the world' (2012) 39(4) Small Business Economics 997.

4.4.3.1. Venture Capital and Angel Investors

Venture capital can be regarded as private equity finance, though it could also take the form of part debt and part equity. Further, in recent times and owing to innovations in the fintech industry, some venture capital platforms are now online.[111] It is often used in the early stages or later stages of developing a new business especially where the risk of failure is high, but the possible earning is similarly high.[112] It is sometimes structured as a hybrid form of finance for the venture capitalist, as it is a loan in exchange for equity which is eroded gradually by repayment. Venture capitalists[113] invest large sums of money in return for a share in the firm's equity with the expectation of some form of dividends when the company gets some profit.

SMEs capable of securing venture capital have the likelihood of receiving further funding, as initial investor interest in the business depicts its potential to be successful. However, it is important to highlight the fact that getting a deal with a venture capitalist may be an arduous process as it requires a detailed business plan and financial projections, which may require some professional help. Also, there is the propensity for the venture capitalist to require a large portion of the company especially in instances where the capitalist is providing the initial capital or the running costs. Like other forms of equity financing, SMEs are generally resistant to new governance structures in that they are unwilling to dilute their ownership and decision-making authority.[114] A typical example would be Dragons Den.[115] Venture capital is also provided by merchant banks and online funding platforms.

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[111] P.A Gompers, 'Optimal Investment, Monitoring and the Staging of Venture Capital' (1995) 50 Journal of Finance 1461. Examples of online platforms for Venture Capital include FundersClub (<https://fundersclub.com/>) and Gust (<https://gust.com/>)

[112] ibid

[113] Venture capitalists provide capital for start-up of businesses or provide funds to expand the business or keep it afloat.

[114] D. Shanthi, P. J. McGinnis, and M. Shariff, 'Private Equity and Venture Capital in SMEs in Developing Countries. The Role for Technical Assistance.' (2014) Policy Research Working Paper 6827, World Bank, Washington, DC

[115] A British television programme that allows several entrepreneurs to present their business idea to five wealthy potential investors. The Whole idea is that the entrepreneur would be pitching for financial investment whilst offering a stake of the company in return.

However, there are some downsides to venture capital funding for SMEs. Most venture capital firms focus on high growth business in their early stage of growth. They usually commit to high risks and as a result, demand very high returns on their investments, normally about 50% or 60%.[116] As such, they target businesses with high growth prospects and more than average profitability. Arguably, therefore, venture capital financing might not be possible for SMEs running regular businesses.[117]

Furthermore, SMEs in developing countries like Nigeria may have little knowledge about the fund management industry and the firms operating in the market.[118] This is debatable, however, as the private equity market in Nigeria is on an upward trajectory.[119] Nevertheless, many SMEs lack awareness of how private equity transactions are structured and do not have the capability to seek external advisors to provide adequate counsel on such matters. As such, the nascent state of the venture capital industry in Nigeria and the information barriers make it difficult to conduct an adequate valuation of the SMEs.

It has also been observed that venture capital funding for SMEs in emerging markets constitute only a small portion of the overall private equity investment.[120] This is due to the disparity between the regulatory environments in developed and developing countries exists. Before the introduction of the newly enacted CAMA, the difference was attributed to the absence of a legal framework for Limited Partnerships (LPs), a form of business association commonly used

[116] Shanti, McGinnis and Shariff (n 99)
[117] A. W Abbasi, D. A Abbasi, 'Potential Sources of Financing for Small and Medium Enterprises (SMEs) and Role of Government in Supporting SMEs' (2017) 5(2) Journal of Small Business and Entrepreneurship Development 39-47
[118] I, O. Abereijo and A. O. Fayomi, 'The Attitude of Small and Medium Industrialists to Venture Capital Financing in Nigeria' (2007) 1(1) Global Journal of Business Research 127.
[119] C. Tamunowariye and O. D. Elisha, 'Economic Development Benefits of Private Equity in Nigeria' (2021) 9(2) European Journal of Research in Social Sciences 14, 21.
[120] D. Adeniken, E. Oki and S. Maimako, 'Venture Capital and Growth of Small and Medium Scale Enterprises (SMEs) in Lagos, Nigeria (2020) 4(1) International Journal of Advanced Research in Accounting, Economics and Business Perspectives 154.

by venture capital funds and private equity funds.[121] However, with the introduction of LPs under CAMA, there may be a resultant increase in investment funds. LPs are a suitable legal vehicle for raising equity finance as the owner may bring other investors on board who may not take part in the management of the business.[122]

A notable feature of the LP vehicle is limited liability, particularly for limited partners. Thus, while general partners are liable for the debts and obligations of the firm, limited partners are liable only to the extent of their agreed contribution to the capital of the firm.[123] However, the limited partner must not take part in the management of the partnership business, else he loses his limited liability status.[124] This brings to the fore a critical governance issue in the context of LP/venture capital and SMEs. It is expected that because of the information asymmetry and other peculiarities of SMEs, LP investors would desire a form of management control in the business. Thus, the relevant question is: at what point will the limited partner be deemed to have taken part in the control of the business?[125] Put differently, what degree of participation will necessitate the piercing of the veil of limited liability for limited partners? This is an important consideration because investors in LPs need protection from business loss, and at the same time, require some involvement in the overall direction of the business especially in SMEs.[126]

In fact, the LP structure in the UK has been faulted for placing financial and administrative burdens on private equity and venture capital firms.[127] Hence, the government reformed the

[121] Udo-Udoma & Belo-Osagie 'Private Equity in Nigeria: market and regulatory overview' <https://www.uubo.org/media/1362/private-equity-in-nigeria-market-and-regulatory-overview.pdf > accessed 14 June 2020

[122] T. Nykiel, 'Limited Partnership: What It Is and When It's Best for Your Business' (Nerd Wallet, October 15 2020) <https://www.nerdwallet.com/article/small-business/limited-partnerships> accessed November 5 2020

[123] CAMA s. 795(4); Limited Partnerships Act 1907, s. 4(2A).

[124] ibid s. 806(1); Limited Partnerships Act 1907, s. 6(1).

[125] E. Deards, 'Limited partnerships: limited reforms?' (2003) Journal of Business Law 435, 448

[126] N. Guthrie, 'Some Lacunae in the Law of Limited Partnerships' (2009) 88 La Revue Du Bureau Canadien 147, 156.

[127] HM Treasury, 'Legislative Reform Order on the Limited Partnership Act: explanatory document' (2017) <https://www.legislation.gov.uk/ukdsi/2017/9780111153208/pdfs/uksied_9780111153208_en.pdf > accessed 5 November 2020

limited partnership structure in 2017,[128] to allow for the designation of an investment fund as a Private Fund Limited Partnership. Of particular relevance is the provision of a list ("White list") of actions that limited partners may take without being deemed to partake in the management of the business.[129] However, the list is not exhaustive, and the listed actions are subject to the provisions of the partnership agreement. Nonetheless, in the UK, there is largely regulatory clarity on what can make a limited partner lose his limited liability status especially in private funds. Nigeria could arguably benefit from a more detailed legal framework[130] on the remit of management control of limited partners. This will ensure the ease of governance and investing in SMEs by venture capital funds.

4.4.3.2. Capital Market Financing

Capital market financing is a form of equity finance for SMEs, as debt finance sources might be unsuitable for SMEs looking to grow or in need of long-term financing.[131] Listing in the alternative market is a substitute to the main stock exchanges. Nigeria has the Alternative Securities Market (ASeM) while the UK has the Alternative Investment Market (AIM).

The AIM provides long-term finance for SMEs through the issuance of equity securities with less stringent rules and regulatory requirements. As such, it caters to emerging companies with high-growth potential and reduces their compliance costs.[132] This is unlike the main stock exchanges which have high average transaction costs, onerous listing requirements and complex regulatory frameworks.[133]

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[128] Legislative Reform (Private Fund Limited Partnerships) Order 2017
[129] ibid, Article 2, Paragraph 5
[130] Admittedly, s. 806(1)(a) of CAMA allows limited partners to inspect books of the firm; examine the state/prospects of the partnership and advise thereon. However, this is arguably a more restricted scope for managerial control than a venture capitalist investor (as limited partner) might require.
[131] D. Peterhoff, J. Romeo, P. Calvey, 'Towards Better Capital Markets Solutions for SME Financing' (Oliverwyman 2014) 4 <www.oliverwyman.com/content/dam/oliver-wyamn/global/en/files/insights/financial-services/2014/July/FINAL3_betterCapitalMarketMechanismsSMEs.pdf> accessed 10 January 2021.
[132] J. Hornok, 'The Alternative Investment Market: Helping Small Enterprises Grow Public' (2015) 9 The Ohio State 323, 342.
[133] ibid at 326.

Furthermore, as the securities of SMEs listed on these alternative markets are tradable, their prices reveal information about their performance and value.[134] The transparency in price mechanism is attractive. Their continued survival on the market also signals to potential investors that the SMEs are worthy of investment. Listing on the AIM also enhances their adherence to corporate governance practices[135] whilst improving their financial reporting and disclosure culture.[136] Financial risk is also reduced, as the financial burden is shared among shareholders. Further, these alternative platforms have designated advisers that provide professional guidance to the listed SMEs, to help navigate compliance requirements.[137] However, a notable drawback of the AIM for SMEs, is its strong association with low survival. AIM-listed companies are more likely to fail than companies on other exchanges.[138] This arguably suggests that the AIM is not necessarily viable for SME success.

The Alternative Securities Market (ASeM) in Nigeria has not achieved its full potential in terms of listings[139] when compared to the UK, where over 850 companies are listed on the AlM with a market capitalization of £104billion.[140] For a start, very few SMEs have a knowledge of finance or how the capital markets work, and they lack adequate information about the Alternative Securities Market.[141] Furthermore, as is the case with equity sources of finance,

[134] Peterhoff (n 131) 8.
[135] Since 2018, AIM-listed companies have been mandated to apply a recognised corporate governance code. Most companies have opted to apply the Quoted Companies Alliance (QCA) Corporate Governance Code, as it meets the needs of small and medium-sized quoted firms. See Quoted Companies Alliance, 'AIM companies to be required to apply a recognised corporate governance code' (QCA, 9 March 2018) <https://www.theqca.com/news/briefs/141126/aim-companies-to-be-required-to-apply-a-recognised-corporate-governance-code.thtml> accessed 21 July 2021.
[136] See Principle 10 of the QCA Corporate Governance Code 2018, which requires companies to make disclosures on their corporate governance practices in their Annual Reports.
[137] Securities and Exchange Commission, 'Capital Market Financing for SMEs' (2016) <http://sec.gov.ng/wp-content/uploads/2016/02/SEC_SME_Capitalmarket_Financing_report_by_Dr-Hassan_982016.pdf> accessed 10 January 2021
[138] J. Gerakos et al, 'Post-Listing Performance and Private Sector Regulation: The Experience of the AIM' (2013) Chicago Booth Research Paper 13-14 <https://ssrn.com/abstract=1740809> 10 June 2021
[139] Nigerian Stock Exchange, 'Alternative Securities Market' (Nigerian Stock Exchange 2021) <www.nse.com.ng/Listings-site/equitylisting-site/asem-site> accessed 2 March 2021
[140] London Stock Exchange, AIM (London Stock Exchange 2021) <https://www.londonstockexchange.com/raise-finance/equity/aim> accessed 22 January 2021
[141] Securities and Exchange Commission (n 137)

SMEs are skeptical of losing their ownership in the company. Thus, the potentials of this form of finance may not be fully harnessed by Nigerian SMEs.

Public equity is advantageous because if an SME business fails, the proprietors are not required to pay back, as the financier is also a part owner of the business and bears some liability.[142] Moreover, SMEs in this instance are not required[143] to pay interest on capital obtained;[144] this obviates the need to direct profits made to liquidate debts.[145] It also translates to more available funds to grow the business, which is essential for SMEs that are desirous of growing into larger companies. However, equity comes with the burden of payment of dividends to the shareholders. The payment of dividends is however not as of right; it depends on making of profits and is at the directors' discretion.[146]

In terms of disadvantages, the shared ownership of the business could increase bureaucracy in decision-making and disagreements over the company's direction. Furthermore, SME owners ought to have adequate understanding of the mechanisms available to protect the company in the long run vis-à-vis its growth stage. Therefore, the importance of legal advice cannot be overestimated. In the UK, a recent survey revealed that SMEs have been underserved by the legal industry and about £13.6billion is lost annually due to the absence of legal advisory services on matters such as disputes and loans.[147] Specifically, lack of adequate review, documentation and execution of relevant agreement(s) could render any equity investment void. In Nigeria, many SMEs pay little attention to the implication of equity financing.[148] For

[142] Berger and Udell (n 35)
[143] While there is no requirement to pay interest on capital, VC investors might expect to receive dividends as shareholders. This is however not a right, and non-payment of dividends is justifiable where, for instance, profits are used as retained earnings.
[144] This advantage makes it distinguishable from debt financing; see discussion in 4.4.2.
[145] ibid
[146] CAMA, s. 426; Companies Act 2006, s. 830.
[147] Lawbite, 'The financial impact of SMEs failure to take care of their Legal Business' <www.lawbite.co.uk/resources/cost-to-smes-survey/general-report/ > accessed 13 June 2020
[148] D. Odupe 'Nigeria: Lessons: Issues and Practical Considerations in Equity Financing in Nigeria' (2020) <www.mondaq.com/nigeria/shareholders/908306/lessons-issues-and-practical-considerations-in-equity-financing-in-nigeria > accessed 10 June 2020

instance, in *Rajco International Ltd v. Le Cavalier Motels & Restaurants Limited*,[149] an investor allegedly paid for shares acquired in a company without executing a Share Purchase or Share Subscription Agreement. The Nigerian Court of Appeal held that the payment of money without the execution of an agreement and the fulfilment of other conditions prescribed by the Articles of Association of the investee company invalidated the transaction.[150]

Arguably, an interrelationship exists between the financing options discussed so far and the governance of SMEs. For instance, good corporate governance practices increase the likelihood of an SME obtaining debt financing on favourable and cost-effective terms. This is because governance indicators such as a firm's gearing (debt to equity ratio) are associated with bankruptcy risk and the probability of defaulting on loans.[151] Hence, an SME's practices in relation to such governance indicators enable lenders to ascertain its creditworthiness.[152] By extension, they influence the cost and the terms upon which debt financing is provided to SMEs.[153] Moreover, lenders occasionally impose conditions on loans, which serve to ensure that the borrowing companies are well governed vis-à-vis financial governance. Thus, there is a positive relationship between corporate governance and debt financing. SMEs are best placed to obtain cost-effective debt financing with good corporate governance practices.

Furthermore, with equity financing, an SME would likely be required to adapt its corporate governance practices and align them with the expectations of external investors. This is because external investors typically require assurances with respect to governance issues such as the board of directors, ownership structure, disclosure routines and financial reporting standards.[154] From a practical governance perspective, equity/capital markets financing might require an

[149] (2016) LPELR-40082 (CA)
[150] ibid at p. 20.
[151] D. Parnes, 'Corporate Governance and Corporate Creditworthiness' (2011) 1 Journal of Risk and Financial Management 1, 7.
[152] ibid 28.
[153] From a lender's perspective, higher risk SMEs may be required to provide security for loans. See discussion at 4.4.2.2.
[154] M. Dowling et al, 'Trust and SME attitudes towards equity financing across Europe' (2019) 54(6) Journal of World Business 1.

SME to have a wider circle of board members and be receptive to new influences regarding its strategic orientation and management.[155]

Overall, the type of finance that an SME obtains at its formative stage (and subsequent stages in its lifespan), is important.[156] SMEs therefore need to be diligent when seeking finance to commence and run their business, as the route taken could potentially have far-reaching effects on the running of the business. Accordingly, this thesis recommends that the following should be taken into consideration by SMEs when seeking finance.

4.4.4. SME Finance: Equity or Debt?

Firstly, the timeframe within which the SME is seeking to obtain the finance should be considered. This is an important determinant because if the money is required urgently, there is likely to be an element of desperation and as such, it is advisable to take out debt instead of equity. This would prevent the SME from ceding a substantial part of its business whilst seeking finance urgently as it may be their only option.[157]

It is important to note however, that unlike equity, debt must be repaid, failing which it may trigger a default that will place the assets of the company up for possession. However, cost of equity may be high for SMEs particularly in austere economic climates. Further, a company is only obliged to make dividend distributions out of profits available for purpose.[158] Profit available for purpose in this instance is accumulated profit that is not previously used as dividends or capitalisation, less accumulated losses not previously written off in a reduction or reorganisation of capital duly made.[159] This particular provision may discourage equity

[155] OECD, *Growth Companies, Access to Capital Markets and Corporate Governance* (OECD Report to G20 Finance Ministers and Central Bank Governors, September 2015) <https://www.oecd.org/g20/topics/financing-for-investment/OECD-Growth-Companies-Access-to-Capital-Markets-and-Corporate-Governance.pdf> accessed 14 July 2021.
[156] In reality, many companies (including SMEs) utilise a mix of sources.
[157] This argument as highlighted above usually has the lender seeking for a large fraction of the business in return for the finance.
[158] Companies Act 2006 s. 829
[159] *Ibid* s. 830; *Global Corporate Ltd v. Hale* [2018] EWCA Civ 2618

investors as returns are not guaranteed. Often, close associate financing is in form of credit rather than equity as there is no guaranteed returns on equity investments.

There are similar provisions in the Nigerian CAMA, which provides that dividend can only be claimed when so declared and shall not be paid when it appears that upon payment, the company would be unable to pay its liabilities when they become due.[160] Although there is the argument that smaller companies make dividends payments out of their net earnings. Since the payment of dividends is at the directors' discretion and usually contained in the by-laws, this form of finance may arguably be advantageous because directors are involved in running the company and would appreciate the need for the company to remain liquid.

As highlighted above,[161] accessing debt finance is not always an easy route for SMEs because of the inability to meet the criteria for accessing debt from financial institutions.[162] Banks may be reluctant to give SMEs credit because they may be seen as high-risk organisations that tend to make bad investment decisions.[163] Abdulsaleh and Worthington likened this to the issue of information opacity that is more severe in SMEs which typically makes them issue additional equity to satisfy their financial needs which more often would lead to a dilution in ownership and control.[164] Notwithstanding these limitations, this thesis recommends obtaining debt finance as against equity, when finance is required urgently and not for the long-term investments. This is because SMEs usually have the preference for commercial lenders, especially institutional lenders that act as a source of short-term debt financing that can be renewed for long-term debt. Further, as information asymmetry has been noted to be more

[160] Companies and Allied Matters Act 2020, s. 428

[161] See discussion at 4.4.2.2.

[162] P. Cook, 'Finance and small and medium-sized enterprise in developing countries' (2001) 6 Journal of Development Entrepreneurship 17, 22

[163] A. N. Berger & G. F. Udell, 'The economics of small business finance: the roles of private equity & debt markets in the financial growth cycle' (1998) 22 Journal of Banking & Finance 613, 619

[164] A. Abdulsaleh & A. Worthington, 'Small and Medium-Sized Enterprises Financing: A review of literature', (2013) 8 International Journal of Business & Management 36, 42

acute in SMEs than in large firms, long term lending relationships are more desirable for SMEs to deal with the resultant agency problems.[165]

Secondly, the amount required is also a major determinant. If the amount being sought is relatively affordable,[166] then debt finance is recommended, as it would be easier to pay the interest rate with the principal sum. However, when the amount sought is substantial and rate of interest on debt finance is high, this thesis recommends securing equity finance to make relative cost savings.[167] Although, it should be noted that if the company is a private company, it cannot issue shares to the public at large[168] and there may be restrictions on transfer of shares such as pre-emption rights[169] and the board of directors' refusal to register new shares.[170] These are methods used to prevent the shares of the company from getting into undesirable hands as the existing shareholders are offered the opportunity to buy the new shares first or the directors exercising their discretion not to register new shares.[171] Also, in some instances, the directors exercise their right to decline to register a transfer of shares.

Thirdly, if beyond money, a company is looking to benefit from expertise and contacts, then equity might be more suitable as a relationship is formed, which could have a meaningful positive impact on the business.[172] It is however important to highlight that the issue of equity is often tied to the cash consideration. The expertise and contacts would be extra benefits that cannot be enforceable. However, because the equity finance makes the investor part owner of the company, there is the likelihood of an experienced investor – like a venture capitalist - extending its expertise and contacts with the intention of making the company successful.

[165] ibid, see 4.4.1 for the discussion on information asymmetry
[166] Having regard, inter alia, to the company's financial base and projected income.
[167] Berger and Udell (n 32).
[168] Companies Act 2006, s. 755 and 756; also see discussion in D. Milman, *The company share: legal regulation and public policy* (Edward Elgar Publishing Limited, 2018) 47.
[169] s. 22(2) of the Companies and Allied Matters Act provides that the restriction on the transfer of shares by private companies should be stated in the Articles of Association. See also *Dixon and Anor v Blindley Health Investments Ltd* [2015] EWCA Civ 1023
[170] CAMA s.152(3)
[171] Companies Act 2006 s. 770
[172] *Ibid*

Consequently, the company may be properly run/governed through the pooling of resources, expertise and contacts towards its growth.

Fourthly, closely following from the above, it is important the SME consider if it is willing to give up a stake in the company and have a co-owner. If the SME is not opposed to this, then securing equity finance would be ideal. However, if the SME is not desirous of sharing ownership, debt/credit financing should be pursued. The importance of the type of finance that an SME secures is very important, as it aids in commencing the business, and subsequently in running the business. However, it should be noted that most companies (SMEs inclusive) deploy a mix of both debt and equity financing, although research shows that debt is the more dominant form [173]

4.4.4.1. Hybrid Financing

This form of financing combines the elements of 'debt' and 'equity'. There are quite a number of hybrid financing tools that SMEs can deploy. They include the preference share, convertible preference share, convertible debt, debt with an attached warrant, subordinated debt, mezzanine finance.[174] A preference share, unlike an ordinary share, entitle the holders to a right of fixed annual dividend and/or a return of a fixed principal amount. Alongside the rights of a normal preference share, holders of convertible preference share are entitled to convert it at some point in the future to ordinary share.

Through a convertible debt, debt capital can be raised such that the investor may convert the debt to company shares in future. Closely related to this is debt with an attached warrant; this differs from a convertible debt in that the exercise of the warrant does not bring the debt instrument to an end. Further, subordinated debts prescribe that the principal amount of the loan and sometimes interest are not to be paid until some (or all) of the company's other debts

[173] Gbandi and Amissah (n 12).
[174] E. Ferran and L. C. Ho, *Principles of Corporate Finance Law* (2nd Edition, Oxford University Press 2014) 56.

or senior debt holders have been paid in full. Mezzanine finance is a mixture of debt and equity securities. It possesses higher risks than loans but lower risks than equity finance. They are often structured to meet the individual financing needs of a business.[175]

The decision to use a type of hybrid financing is influenced by the growth level of the business, its financing needs of the business and the goals of the investors. For instance, for protection of their position in case of insolvency. A common thread is that in the event of insolvency, holders of hybrid securities rank below other senior creditors but rank above equity investors. In addition, a convertible debt, for instance, may be used to the advantage of the company. This happens where the financing instrument gives the company the option to convert the debt and there is growth which makes the SME choose not to dilute the company's equity. On the flipside, the investors, where given such option, may benefit when the company experiences capital growth.

While some financing options are suitable for SMEs due to their small shareholding structure, some are not. For example, mezzanine finance, may be costly for SMEs as there are monitoring and oversight obligations and the requirement of a significant amount of time in setting it up.[176] The cost of financing for some, like the subordinated debt is high as the company may pay a higher rate of interest than it would pay on unsubordinated debt so as to compensate for the higher risk.[177] As such, they are often used by medium-sized companies. Generally, hybrid finance is suitable for SMEs where they need capital injection but cannot increase their leverage or where the owners do not want a dilution of the equity control.

[175] OECD, 'New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments' (OECD Report 2015) <www.oecd.org/cfe/smes/New-Approaches-SME-full-report.pdf > accessed 21 June 2020
[176] ibid
[177] ibid

4.5. Government Intervention in SME Finance

There are several mechanisms and initiatives that the Federal Government of Nigeria have put in place to guarantee to a considerable extent that SMEs have access to finance. Amongst these are the establishment of the Nigerian Bank for Commerce and Industry (NBCI) in 1973; agreement with World Bank for a $41 million (Forty-One Million Dollars) SME loan in 1984,[178] Structural Adjustment Programme[179] that led to obtaining World Bank SME II Loan Scheme of $270, 000, 000 (Two Hundred and Seventy Million US Dollars).

Furthermore, the Federal Government of Nigeria post-independence established different schemes such as the Industrial Development Centre's (IDCs) in 1962, Small Scale Industries Credit Scheme (SSICS) in 1971, and the Small-Scale Industries Fund (SSIF). The government also issued policy initiatives aimed at addressing the peculiar needs of the SMEs through existing commercial banks amongst which are: The Rural Banking Scheme (1977), National Economic Reconstruction Fund (NERFUND),[180] Community Banking Scheme 1991[181] and the Bank of Industry.[182]

Further, other policies and schemes have been formulated towards the growth and financing of SMEs in Nigeria. They include: Small and Medium Enterprises Equity Investment Scheme (SMEEIS)[183] ; Small and Medium Enterprises (SME) Credit Guarantee Scheme (SMECGS);[184] N200 Billion Refinancing/Restructuring Facilities to Small and Medium

[178] Nwosu and Ochu [n 1] 182. This scheme was supervised and administered by the NBCI.
[179] Structural Adjustment Programmes essentially are economic policies that countries must follow in order to qualify for new World Bank and International Monetary Fund (IMF) loans and help them make debt repayments on the older debts owed to commercial banks, governments and the World Bank
[180] Established in the mid 1980's to assist SMEs adjust to the Structural Adjustment Programme. It provided a long-term loan support (5-10years) to SMEs at concessionary interest rate
[181] Established with the objective of rural development and providing start up facilities for small holders
[182] Established with the principal objective of providing credit to the industrial sector including SMEs at an interest rate of 10%
[183] The scheme requires banks to set aside 10% of their Profit after Tax (PAT) annually in support of equity investment in small and medium enterprises
[184] Aimed at fast tracking the development of manufacturing and SME sub-sector by providing 80% guarantee for bank credits. See Y. Kolawole, 'Banks shun N200 Billion SME Credit Guarantee Scheme, CBN', (*Vanguard*, 26th September 2010) Available at: < https://www.vanguardngr.com/2010/09/banks-shun-n200bn-sme-credit-guarantee-scheme-cbn/> accessed 23rd December 2018

Enterprises/Manufacturing (RRF);[185] Entrepreneurship Development Centres (EDCs) that are established to develop strong SMEs that can compete globally and contribute to national growth and development; International Bank for Reconstruction and Development (IBRD) credit to SMEs to increase access to finance a $500, 000, 000 (Five Hundred Million US Dollars) for SMEs.[186] Principally, this is aimed at providing term funding to eligible financial intermediaries to lend to SMEs.

The following section highlights the role of the UK Government in attempting to provide mechanisms that create the access to finance for SMEs.

4.6. Mechanisms in the UK creating access to finance

Notably, SMEs in the UK are not exempt from the problems associated with access to finance. Furthermore, Brown and Lee opine that the lack of external finance to SMEs is a significant contributory factor behind the UK's slow economy's recovery from the global financial crisis.[187] In the UK, the 2012 budget introduced some schemes and initiatives that are designed to assist SMEs access to finance.[188] Further, one of the government's initiatives to tackle the issue of refusal of finance to SMEs led to the formation of designated finance platforms for SMEs (Finance Platforms) Regulations announced in the 2016 budget.[189] With this, it is reported that in the future when High Street banks reject finance to SMEs, they should refer such SMEs to these designated platforms. Some of these schemes are discussed in turn.

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[185] Aimed at fast-tracking the development and revitalisation of ailing SMEs in Nigeria through refinancing and restricting of Deposit Money Banks (DMBs) existing loan portfolio.

[186] The World Bank, 'World Bank Supports Increased Financing for Medium and Small Businesses in Nigeria (September 25, 2014) <http://www.worldbank.org/en/news/press-release/2014/09/25/world-bank-supports-increased-financing-for-medium-small-businesses-in-nigeria> accessed 2 January 2019

[187] R. Brown & N. Lee, 'Funding issues confronting high growth SMEs in the UK', (2014) ICAS The London School of Economics Research 33

[188] UK Debt Management Office, 'Guarantee Schemes' <www.dmo.gov.uk/responsibilities/guarantee-schemes/national-loan-guarantee-scheme/> accessed 2 January 2019

[189] A. Pekmezovic & G. Walker, 'The global significance of crowdfunding: solving the SME funding problem and democratizing access to capital'(2016) Maryland Business Law Review 347, 352

There is the National Loan Guarantee Scheme (NLGS) which helps businesses access cheaper finance by reducing the cost of bank loans under the scheme by up to 1 percentage point.[190] Also, Enterprise Finance Guarantee (EFG) was introduced as a loan guarantee scheme designed to facilitate additional lending to viable SMEs lacking the security or proven track record for a commercial loan.[191] Further, Business Finance Partnership (BFP) is designed to create access to new private sector sources of lending for SMEs so as to fill the gap created by the reduction in bank lending.[192] The Start-up Loan programme provides support through loans and mentoring to young people between 18-30 to help them start up their own business after meeting certain criteria.[193]

Project Merlin was an agreement between the British Government of David Cameron and four major High Street banks in 2011. The agreement covers aspects of banking activity notably lending, pay and bonuses, with the intention of promoting lending to businesses particularly SMEs.[194] It is however important to highlight that this project was considered to have failed as the banks could not meet their required targets.[195] Lastly, British Business Bank is a state-owned economic development bank established by the UK Government. Its primary function is aiding persistent increment in the supply of credit to SMEs as well as providing business advice and it charges a fixed interest rate of 6% per annum. The aforementioned schemes highlight the importance accorded to SMEs.

[190] ibid (n 119)
[191] G.F. Allinson, P. Robson & I. Stone, 'Economic evaluation of the enterprise finance guarantee (EFG) scheme' (2013) Project Report Department of Business, Innovation & Skills, London
[192] GOV.UK, 'Business Finance Partnership creates nearly £1 billion of new lending' available at: <https://www.gov.uk/government/news/business-finance-partnership-creates-nearly-1-billion-of-new-lending> accessed 4th January 2019
[193] A. Hughes, 'Finance for SMEs: a UK Perspective', (1997) 9 Small Business Economics 151
[194] H. Macartney, 'From Merlin to OZ: The strange case of failed lending targets in the UK', (2014) 21, Review of International Political Economy 820, 827
[195] ibid

4.7. Government Finance Interventions during COVID-19

The Covid-19 virus was declared by the World Health Organisation (WHO) as a global pandemic on March 11, 2020.[196] In order to curb the spread, most governments enforced physical distancing measures and a shutdown of economic activities. The massive reduction in economic activities has therefore had an unprecedented impact on the global economy. Particularly, it has affected the hospitality, airline, and manufacturing/value addition sectors. With respect to SMEs who operate brick-and-mortar offices, more funds are needed to cope with the decline in demand and to invest in technological solutions. Additionally, supply chains of SMEs have been affected. In Nigeria, for instance, 89% of respondents to a survey indicated that it has been difficult to source raw materials for production as well as transport their goods to the customers.[197]

Furthermore, as consumer spending levels decreased, SMEs lack access to enough working capital and subsequently cut down production. Arguably, some SMEs are also experiencing difficulties in meeting up with debt obligations due to poor cash flow prospects. Owing to the financial downturn caused by the pandemic, SMEs will also witness a general reduction in the level of credit they receive. Research shows that many small businesses are becoming financially weak as 93% reported a decline in income and embarking on staff layoffs.[198] Due to the highly important roles that SMEs play in the economy, any threat to them is a threat to the economy. Therefore, the UK and the Nigerian governments have set out some schemes to help SMEs during the economic crisis.

[196] Coronavirus disease (COVID-19) outbreak <www.euro.who.int/en/health-topics/health-emergencies/coronavirus-covid-19 > accessed 30 May 2020
[197] L. Falokun 'Impact of Covid-19 on Micro, Small and Medium-Sized Enterprises in Nigeria' (12 May 2020) Available at <https://smetoolkit.ng/articles/17096-impact-of-covid-19-on-micro-small-and-medium-sized-enterprises-in-nigeria > accessed 30 May 2020
[198] ibid.

4.7.1. COVID-19 Interventions for SMEs in the UK

As a result of the pandemic, the UK Government rolled out a number of schemes targeted at making SMEs access finance, keep their employees and stay afloat.[199] An important scheme to support SMEs is the Coronavirus Business Interruption Loan Scheme (CBILS). The CBILS is a lending facility for businesses with a turnover of up to £45million.[200] The finance terms cover term loans, asset finance, revolving facilities and invoice finance. Although the government provides guarantee for 80% of the facility, the borrower remains 100% liable for the debt.[201] Also, the government set out to rescue the jobs of many employees of the SMEs through the job retention scheme. Businesses including SMEs who carry on their business activities in the UK and are on the UK PAYE scheme are eligible to participate in the scheme.[202] The Grant support covered up to 80% of reference salary plus associated costs of anyone who did not work due to the lockdown but whose job has been retained.[203]

The UK Government has also scrapped business rates and SMEs undertaking intensive Research and Development (R&D) activities are to benefit from £750 million grants and loans.[204] Banks and building societies with incentives linked to lending SMEs are also provided with a term loan facility under the Term Funding Scheme with additional incentives for SMEs (TFSME).[205] As retail, hospitality and leisure business are particularly hit by the pandemic, a

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[199] Deloitte, 'Covid-19 – Government Funding (Summary of Announced Schemes in the UK)' (Updated 11 June, 2020) < www2.deloitte.com/content/dam/Deloitte/uk/Documents/corporate-finance/deloitte-uk-covid19-government-response-110620.pdf > accessed 14 June 2020

[200] British Business Bank, 'Coronavirus Business Interruption Loan Scheme (CBILS)' < www.british-business-bank.co.uk/ourpartners/coronavirus-business-interruption-loan-scheme-cbils-2/ > accessed 21 June 2020

[201] ibid.

[202] UK Government, 'Coronavirus Job Retention Scheme: Step by step guide for employers' <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/884664/Coronavirus_Job_Retention_Scheme_step_by_step_guide_for_employers.pdf > accessed 21 June 2020

[203] ibid.

[204] GOV.UK, 'Billion pound support package for innovative firms hit by coronavirus' (20 April 2020) <www.gov.uk/government/news/billion-pound-support-package-for-innovative-firms-hit-by-coronavirus > accessed 21 June 2020

[205] L. Mulreany, 'Bank of England's TFSME – Help for Lenders and SMEs during COVID-19' (20 May 2020) <www.mondaq.com/uk/financing/937350/bank-of-england39s-tfsme-help-for-lenders-and-smes-during-covid-19 > accessed 21 June 2020.

£25,000 grant is also available for them as well as a 100% discount on business rates for their venues.[206]

Interestingly, the government also provided for a deferral for VAT payments due from VAT registered businesses for 3 months.[207] There is also the Bounce Bank Loan scheme which is 100% guaranteed by the government and targeted at small businesses in the UK.[208] Loans from £2,000 to £5,000 or maximum of 25% of their turnover.[209] The loans will be for up to 6 years and there will be no interest for the first 12 months.[210] This thesis argues that, the various schemes have the cumulative effect of ensuring that SMES have access to the much needed finance during the pandemic to stay afloat.

4.7.2. COVID-19 Interventions for SMEs in Nigeria

The Nigerian government also introduced some measures to cushion the effects of Covid-19 on SMEs. As such, the Federal Government of Nigeria through the Central Bank of Nigeria set up an intervention fund, a ₦50 billion-naira Targeted Credit Facility (TCF).[211] SMEs in specific sectors that are impacted by the pandemic as well as those with bankable plans are eligible for the fund.[212] The fund is in form of loans which will be disbursed based on the business' operations, cash flow and industry/segment size of the beneficiary. The working capital to be provided is the maximum of 25% of the average of the previous 3 years' annual turnover.[213]

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[206] BBC, 'Budget 2020: Business rates suspended for shops and cafes' (March 2020) <www.bbc.com/news/amp/business-51836256 > accessed 21 June 2020
[207] GOV.UK, 'Deferral of VAT payments due to coronavirus (COVID-19)' (26 March 2020) <www.gov.uk/guidance/deferral-of-vat-payments-due-to-coronavirus-covid-19 > accessed 21 June 2020
[208] British Business Bank, 'Bounce Back Loan Scheme (BBLS)' <www.british-business-bank.co.uk/ourpartners/coronavirus-business-interruption-loan-schemes/bounce-back-loans/ > accessed 21 June 2020
[209] ibid.
[210] ibid.
[211] CBN Guidelines for the Implementation of the ₦50 billion Targeted Credit Facility, s.1 <www.cbn.gov.ng/Out/2020/FPRD/N50%2520Billion%2520Combined.pdf > accessed 21 June 2020
[212] ibid, s. 3
[213] ibid, s. 7(3)

However, where the enterprise is not up to 3 years in operation, 25% of the previous year's turnover will be suffice.[214] Importantly, s. 8 of the Guidelines stipulates that the interest rate of the loans is 5% per annum up to February 28, 2021 after which it will be charged at 9% per annum. The maximum amount of loan that can be given to an SME is ₦25 million. In the application, the SMEs must provide proof of business registration and business plan with clear evidence of opportunity or adverse impact as a result of the Covid-19 pandemic.[215] This requirement is commendable as it not only makes the facility available for struggling SMEs but also SMEs who have the opportunity to scale during the pandemic.

Other forms of governmental responses are some fiscal policies such as a 1-year extension of a moratorium on principal repayments for CBN intervention facilities.[216] This policy helps affected SMEs who have benefitted from CBN intervention facilities through the Bank of Industry (BOI), Bank of Agriculture and Nigeria Export-Import Bank. There is also the reduction of the interest rate on intervention loans from 9 percent to 5 percent;[217] The Central Bank also affirmed its drive to strengthen of the Loan to Deposit ratio policy which ensures that more credit is extended to the private sector and SMEs.[218] A three-month repayment moratorium for all TraderMoni, MarketMoni and FarmerMoni loans was also introduced.[219] This measure is targeted at micro-enterprises who might have been adversely affected the pandemic. As such, they have more funds to plough back into the business. Moratorium is also

[214] ibid
[215] ibid, s. 10(1)
[216] C. Olisah, 'CBN suspends intervention-loan repayment for one year' (March 16, 2020) < www.businessamlive.com/cbn-suspends-intervention-loan-repayment-for-one-year/amp/ > accessed 21 June 2020; KMPG, 'Nigeria: Response Measures to Covid' < https://home.kpmg/xx/en/home/insights/2020/04/nigeria-government-and-institution-measures-in-response-to-covid.html > accessed 14 June 2020
[217] ibid
[218] K. Sanni, 'Buhari orders three-month moratorium on TraderMoni, MarketMoni and FarmerMoni loans' (Premium Times Ng March 30, 2020) < www.premiumtimesng.com/news/top-news/384807-buhari-orders-three-month-moratorium-on-tradermoni-marketmoni-and-farmermoni-loans.html > accessed 21 June 2020
[219] Central Bank of Nigeria, 'CBN Policy Measures in Response to Covid-19 Outbreak and Spillovers' <www.cbn.gov.ng/Out/2020/FPRD/CBN%2520POLICY%2520MEASURES%2520IN%2520RESPONSE%2520TO%2520COVID-19%2520OUTBREAK%2520AND%2520SPILLOVERS.pdf > accessed 21 June 2020

to be given to all Federal Government funded loans issued by the Bank of Industry, Bank of Agriculture and the Nigeria Export-Import Bank.[220]

4.8. An Assessment of the Effectiveness of Government Interventions

The above are some of the major formal financial institutions that provide monies to SMEs to commence their business. They are more effective in developed countries like the UK than in developing countries like Nigeria. This is potentially because of the poor corporate governance practices as well as the operation and presence of corruption. Correlatively, this is also largely accountable for the development capacity of the country, as SMEs which should ordinarily bolster economic development are not properly funded.

Notwithstanding the enactment of these schemes highlighted above, there are complaints that these schemes are yet to meet expectations.[221] For example, in Nigeria, it is reported that some of these schemes such, as the SMEEIS, has been underutilised. Despite accumulating over N20, 000, 000, 000 (Twenty Billion Naira),[222] it is reported that only N8, 000, 000, 000 (Eight Billion Naira)[223] has been disbursed. There are several reasons attributable to this, amongst which are: lack of information and awareness, lack of infrastructure and weakness in the legal and regulatory framework. Furthermore, the dominant role played by the government both as the sole owner of these financial institutions as well as a major provider of the financing contributes to the ineffectiveness of the schemes.[224]

In Nigeria, SMEs are not as productive as they ought to be, and several factors have been held accountable for this low productivity. Principal amongst these is the fact that SMEs operate

[220] KMPG, 'Nigeria: Response Measures to Covid' < https://home.kpmg/xx/en/home/insights/2020/04/nigeria-government-and-institution-measures-in-response-to-covid.html > accessed 14 June 2020
[221] Nwosu and Ochu (n 1) 182
[222] Equivalent of 30 million Pounds Sterling as of 14th February 2020
[223] Equivalent of 12 million Pounds Sterling as of 14th February 2020
[224] Nwosu and Ochu (n 1) 182

outside the scope of formal regulation and have no access to finance.[225] The lack of adequate financial resources places significant constraints on SMEs development, especially in developing countries like Nigeria. This is further accentuated by the fact that a substantial number of SMEs do not have access to adequate and appropriate forms of credit and equity or even financial services.[226]

Furthermore, in Nigeria, small-scale entrepreneurs have to provide all the facilities at their industrial sites like roads, electricity, water and sometimes security. Arguably, this forms a major deterring factor as the capital required to provide the infrastructure before the commencement of business is a lot. This has the propensity to discourage budding entrepreneurs or individuals with innovative ideas. Also, the initiatives highlighted above ultimately failed due to political instability, lack of fiscal discipline, inconsistent macroeconomic policies by the government, as well as inadequate management skill and entrepreneurial activity.

In relation to the schemes, most of the schemes provided by the Nigeria government were sent to their early grave while those in operation are ineffective. This is largely due to the fact that the requirements to be qualified to receive these funds are stringent and may not suit the purpose for the smaller SMEs. For instance, most of the schemes provide that to be qualified to be a beneficiary of the scheme, the SME must be registered as a limited liability company.[227] There are a few SMEs that possess registered companies' status, thus excluding the companies not registered from benefitting from schemes. This thesis argues that for these schemes to effective, in terms of reaching out to various SMEs in the country, it is imperative that the current eligibility criteria be revisited. The criterion should reflect and include all SMEs

[225] P.A. Igwe, A. Amuga, O. Ogundana, O. Egere & J. Anugbo, 'Factors affecting the investment climate, SMEs productivity & Entrepreneurship in Nigeria', (2018) 7 European Journal of Sustainable Development 182, 187.
[226] R. Parker, R. Riopelle & W. Steel, 'Small Enterprises adjusting to liberalisation in Five African Countries', (1995) World Bank Discussion Paper No. 271 African Technical Department Series The World Bank
[227] This is a type of company where the owners are legally responsible for its debt only to the extent of capital it contributed towards to the business.

because providing for only medium sized SMEs defeats the purpose of these schemes. However, this thesis recognises the possible argument in support of the need for beneficiary companies to be registered as it makes enforcement in the event of a default possible and avoidance of any dealing with fraudulent entities.

Nonetheless, it is recommended that the requirements to be a beneficiary should include registered business names, limited partnerships, and limited liability partnerships. This recommendation is due to the fact that most SMEs that are registered, are done as business names. Additionally, it is common for SMEs at commencement are registered as business names and subsequently registering as limited liability company.[228] There are different benefits of registering as a business name as it is cheaper to register, and it is less bureaucratic with fewer requirements when compared to registering a limited liability company. Thus, it is postulated that if business names can be beneficiaries of these schemes, the funds will be better spread to the different tiers of SMEs.

Furthermore, this thesis recommends the adoption of the practice in the UK that requires banks to refer SMEs to alternative lenders if their application for loans is unsuccessful. This scheme that was developed by the Competition and Markets Authority that gave birth to the Bank Referral Scheme.[229] This scheme was enacted to reduce the over-dependence on the mainstream bank sector. The Competition and Markets Authority have different platforms that they approve that these SMEs are referred to in the event of their loan application not going through. It is important to note that recommendation to this scheme is not mandatory as the SMEs have the option to opt out of it. Reports indicate that 40% of SMEs have utilised this

[228] G. Eze and N. Johnny, 'Small and Medium Enterprises Investment Vehicles in Nigeria: The Challenges and Prospect' (2020). 6(1) South Asian Journal of Social Studies and Economics 14.
[229] Competition & Markets Authority, *Retail banking market investigation* (Final Report, 9 August 2016) https://assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigation-full-final-report.pdf accessed 2 August 2021

scheme of referral.[230] This system practised in the UK is highly commendable, and it is recommended that it should be adopted in Nigeria and be made mandatory. Although it is arguable that such mandatory provision might impose an unnecessary burden on the banks, while potentially taking away their business. Nonetheless, it could be argued that based on the importance of SMEs to the development of the economy, it is pertinent that such measures are put in place to ensure that they obtain the necessary finance required. This, coupled with the lack of awareness of these schemes and financial illiteracy in the country, makes a good case for making such recommendation mandatory. However, for this to work efficiently, it must be applied in conjunction with a more tailored and nuanced approach to lending across the industry.

Nevertheless, this thesis commends the efforts put in place by the government to ensure that SMEs are adequately funded. It is recommended that the efforts should not be withered, as the continuous effort will encourage individuals with innovative business ideas to venture into such businesses without the attendant burden of raising capital. Ultimately, this has the potential to foster economic development.

Furthermore, any country desirous of developing its SME sector to attain international standards should ensure that there are mechanisms/schemes that would ensure that SMEs have access to finance to enable it to run effectively and efficiently. However, it is important to note that access to finance is not the only a problem faced by SMEs in Nigeria, but it occupies a central role amongst other problems such as bribery and corruption amongst others as discussed in chapter 2 of this thesis.[231] In concluding this chapter, this thesis proffers recommendations that will make it a less daunting process to obtain finance by SMEs in Nigeria, most especially from financial institutions.

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[230] N. Slomin, 'UK banks required to refer rejected SME loans, but would it work here? (*Smart Company*, 11 November 2016) <https://www.smartcompany.com.au/finance/uk-banks-required-refer-rejected-sme-loans-work/> accessed 14 April 2019

[231] See discussion 2.5 and 2.6 in Chapter 2

4.9. Recommendations

4.9.1. Establishment of Credit Risk Database

One of the requirements before a formal institution such as a bank can grant a loan may be a check of the borrower's data that is held by Credit Rating Agencies (CRA).[232] More often than not, SMEs do not possess the requisite requirement to give them good ratings for a loan to be extended towards them.[233] This thesis recommends the establishment of entities referred to as Credit Risk Databases (CRD) that can rate SMEs based on financial and non-financial data. Furthermore, because it is usually difficult to access the financial and non-financial accounts of SMEs, such credit rating databases can make this available.[234] The difference between CRAs and CRDs is the fact that CRDs utilise different types of data that can be used to rate SMEs through statistical analysis as against CRAs that assesses based on general terms, i.e. any outstanding obligations, previous default etc.[235] The CRD has member financial institutions that use scoring models to evaluate creditworthiness, check the validity of internal rating systems, and align loan pricing with credit risk.

The recommendation by this thesis is to the effect that such a CRD should be established specifically for the benefit of SMEs to facilitate fundraising for SMEs and to improve operational efficiency.[236] This database has been described to be effective in Japan, as different financial institutions have subscribed to it with its membership increasing from 73 institutions in 2002 to 181 by 2016.[237] In Nigeria, the closest that there is to a CRD is the Credit Risk Management System (CRMS) developed by the Central Bank of Nigeria (CBN) in 1990 and

[232] A credit rating agency is an agency that assesses the creditworthiness of a borrower in general terms with respect to a particular debt or financial obligation. Put simply, it is an agency that verifies to the bank if it is worth extending a loan to a prospective borrower as it analyses the likelihood of default by the entity seeking to borrow some money.
[233] M. Lund & J. Wright, (n 82)
[234] N. Yoshino & F. Taghizadeh-Hesary, 'Solutions for small & medium-sized enterprises' difficulties in accessing finance: Asian experiences' (2017) ADBI Working Paper 768 Asian Development Bank Institute 6
[235] ibid
[236] ibid
[237] ibid

redesigned in 2017.[238] The CRMS database was developed for the purpose of rendering the statutory returns or conducting a status enquiry on borrowers. It is aimed at strengthening the credit appraisal procedures of banks, storage and dissemination of credit data, monitoring of over-exposure to borrowers as well as facilitating consistent classification of credits.[239] Furthermore, a private Credit Rating Agency (Augusto and Co) launched its own Credit Risk Model Application (CRMA), which is an automated risk rating software that uses Augusto's rating model for obligor's, facilities and industries.[240] A substantial amount of profitable Nigerian businesses have utilised and benefitted from it via streamlining of credit processes and implementation of rating systems.

It is commendable that in a developing country like Nigeria these models are available. However, based on the importance of SMEs to the likely development of a country and the fact that they need sufficient funds to attain maximum productivity, this thesis opines that there should be a specialised Credit Risk Database that is developed solely for SMEs as practised in Japan. This could enable SMEs to have access to finance from financial institutions as any potential to default in the payment of the debt would have been analysed by the CRDs through the statistical analysis of both financial and non-financial data. Additionally, such a CRD through its association (financial institutions) can provide consulting services to support the management of SMEs on the assumption that if SMEs are better managed, it will reduce the credit risk for other financial institutions as well as strengthen SME business operations.[241] Additionally, as practised in Japan, it would be beneficial if consulting services would also be offered to member financial institutions. Therefore, this thesis argues that with the establishment of CRD solely for the benefits of SMEs, they would not only be able to raise

[238]Central Bank of Nigeria, 'Credit Risk Management System' <https://www.cbn.gov.ng/Supervision/crms.asp> accessed 17 January 2019
[239] ibid
[240] Augusto & Co, 'Credit Risk Management Solution' <https://www.agusto.com/credit-risk-management/> accessed 14 January 2019
[241] ibid (n 83)

funds from the banking sector, but also have the propensity to be properly managed, which in effect can lead to them gaining access to the debt market by securitising their claim.

However, accessibility and affordability are key issues if the design of the CRD in Japan is to be replicated in Nigeria. This is because most SMEs in Nigeria are business names. Thus, for them, the cost of registering in the Credit Risk Database may outweigh the perceived benefits from registering. This means that very few incorporated SMEs are the ones that may benefit from the CRDs. It is therefore recommended that any Credit Rating Database should be designed with business names and other business vehicles in mind.

4.9.2. Awareness

Another major reason for the lack of access to finance by SMEs is that they explore only one source of finance in their pursuit for finance to fund their businesses, i.e. the banks, and when they are not granted the loans, they give up in their search for funds. One of the reasons for this is because SMEs are not aware of other sources of finance available to SMEs. Different studies have recommended an active approach towards educating existing and prospective entrepreneurs about other sources of finance options available to SMEs.[242] This argument has the potential to go a long way in promoting SME development, poverty reduction, job creation and concomitantly economic growth. For this purpose, this thesis strongly recommends the government's formation of sustainable partnerships with the financial sector and specific state facilitated finance service providers to organise awareness education programmes for SMEs and other related stakeholders.

4.9.3. Establishment of Credit Guarantee Scheme (CGS)

[242] Z. B. Miasamari, 'Challenges of credit guarantee scheme for sustainable entrepreneurship in Nigeria' (2010) (1) The Intuition, 176 181; G. O. Evbuoma, A. E. Ikpi, V. O. Okoruwa, V. O. Akinyosoye, 'Sources of finance for small & medium enterprises in Nigeria' (2013) 1 19th International Farm Management Congress 1.

Owing to the significance of SMEs, this thesis proposes the need for the establishment of mechanisms that will ensure that SMEs receive stable finance. The development of CGS is an applaudable invention in the bid to ensure that SMEs are properly funded, and this is borne largely out of the fact that countries are desirous of enhancing their economies. In order to remedy the undersupply of credit to SMEs, developed, developing and emerging economies have developed a scheme referred to as the Credit Guarantee Scheme (CGS). It is described as a mechanism used to reduce the gap between supply and demand in SME finance and has been used in many countries to increase the flow of funds into targeted sectors and groups.[243] It is arguable that they make lending easier by absorbing or sharing the risks associated with lending to a targeted section. They have the propensity to increase the quality of loans available to SMEs as they guarantee to absorb a certain fraction of the loan serves as a collateral. Moreover, this helps to improve the quality of loans awarded.[244] The development of CGS is a laudable invention in the bid to ensure that SMEs are properly funded, and this is borne largely out of the fact that countries are desirous of enhancing their economies

However, despite the benefits highlighted above, guarantee schemes have a cost, which is usually charged in the form of fees. These fees are not cheap, and when it has been paid by the SME, it is an additional cost that the SME has to worry about. Although, it is important to highlight that in some instances, the government or a third-party institution may subsidise the fees. A CGS usually consists of at least three (3) parties, the borrower, the lender and the guarantor. The borrower is often the SME seeking debt capital, the lender is often a financial institution, and when the request for debt capital is turned down, the guarantor comes in, which is usually a government or trade association. They seek to facilitate access to debt capital by

[243] A. Valentin & B. Wolf, 'Credit guarantee schemes & their impact on SME lending: existing literature & research gaps' (2013) 5 International Journal of Entrepreneurial Venturing 391, 393

[244] R. Zander, R.C. Miller & N. Mhlanga, 'Credit guarantee systems for agriculture & rural enterprise development' Food & Agriculture Organization of the United Nations; Rome 2013

providing lenders with the comfort or a guarantee for a substantial portion of the debt.[245] This is laudable because if the SME defaults, there is usually an arrangement where the CGS covers a certain percentage of the debt so that the bank does not lose all its money.

This thesis recommends that credit guarantee practitioners should embrace this idea of CGS.[246] This suggestion is premised on the fact that the Credit Guarantee Scheme is usually an essential and pre-requisite fact worthy for entrepreneurial and economic integration. In Nigeria, there has been a handful of CGS such as the Small and Medium Enterprises Credit Guarantee Scheme (SMECGS) which set aside N200 Billion for access to credit by SMEs in Nigeria.[247] The guarantee cover for this scheme was up to 80% of the 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.[248] This is laudable as it depicts that the government is aware of the need for there to be guarantee extended towards SMEs so they can get loans from banks and other financial institutions.

The foregoing discussion suggests that the emergence of CGS is commendable and should not be limited to just the SMECGS. It recommends that private entities, Non-Governmental Organisations (NGOs) should actively participate in creating and maintaining CGS. Undoubtedly, with more CGS available to SMEs, there is the likelihood that they would seek these funds to enable their businesses to go forward. However, in a country like Nigeria, caution must be taken to ensure that the CGS available should be adequately managed to avoid mismanagement and operation of corrupt practices.

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[245] H. Samujh, L. J. Twiname & J. Reuteman, 'Credit guarantee schemes supporting small enterprises development: A review' (2012) 5 Journal of Business & Accounting 21, 32

[246] Abbasi and Abbasi (n 117).

[247] Central Bank of Nigeria, 'N200 Billion Small and Medium Enterprises (SME) Credit Guarantee Scheme (SMECGS)' (Development Finance Department Central Bank of Nigeria, Abuja. March 30, 2010) <https://www.cbn.gov.ng/Out/2010/publications/guidelines/dfd/GUIDELINES%20ON%20N200%20BILLION%20SME%20CREDIT%20GUARANTEE.pdf> accessed 31 May 2019

[248] Abbasi and Abbasi (n 117).

4.9.4. Diversification of finance outlets for SMEs

There is the need to diversify sources of SME finance. Recently, the Nigerian government introduced a medium through which the government extends loans to SMEs, in this instance to petty traders. In 2018, the Federal Government of Nigeria launched a new initiative under the Government Enterprises Empowerment Programme (GEEP) called Trader Moni that is targeted at empowering 2 million petty traders. Trader moni provides collateral-free loans of 10,000 naira to petty traders that are to be repaid within 6 months.[249] Under the scheme, beneficiaries of the initial loan can get a further higher loan of 15,000 up to 50, 000 naira after repayment of the first loan. This is applaudable as it is taking financial inclusion down to the grassroots, which unarguably contributes a good rate to the economic development, and this is also cognisant of the fact that the petty traders do not have what is required by commercial banks to grant loans. However, there are reports that the scheme has been improperly managed.[250] In view of this and the fact that Nigeria is known for widespread corruption, this thesis suggests that this scheme should be properly regulated with a consistent and transparent legal and regulatory framework to avoid such issues arising.

Furthermore, SMEs registered as companies and limited liability partnerships should consider different security instruments that can be used to access credit. Particularly, the floating charge as discussed in this chapter is a veritable instrument that encourages bank to give loans thereby ensuring access to finance.[251] SMEs can also make use of other financing sources like operational leases and finance leases. These forms of finance are especially useful for SMEs to fund the purchase of assets like cars, plant and machinery. SMEs instead of borrowing to

[249] The Guardian (Business), 'FG boosts financial inclusion with Trader Moni' (*The Guardian, Nigeria,* 6th March 2019) <https://guardian.ng/business-services/fg-boosts-financial-inclusion-with-tradermoni/> accessed 6 March 2019

[250] Africa Independent Television (AIT), ' INEC says no link between 'TraderMoni' scheme and outcome of 2019 election', (*AIT Online Nigeria*) <http://www.aitonline.tv/post-inec_says_no_link_between____trader_moni____scheme_and_outcome_of_2019_elections> accessed 5 March 2019

[251] See discussion 4.4.2.2 on Recognised Security Options

fund fixed assets may decide to access asset-based financing such as leasing. Leasing is an asset-based financing that is usually used to finance the purchase and use of equipment, motor vehicles and real estate by SMEs. It is particularly beneficial for SMEs who have current assets with which they can continually use to generate cash. This is because leasing depends on cash flow from business operations to meet regular payments and not the credit history of the SMEs.[252] Operating lease, which is a variant of lease can be used where the assets are needed for a shorter period of time and the lease is in operation for a short duration.

4.10. Conclusion

This chapter concludes by highlighting some of ways to improve the access of SMEs to traditional forms of finance. Undeniably, an effective credit reporting system helps to remedy the information asymmetry problem between SMEs and banks. Particularly, it addresses the adverse selection and moral hazard problems. Further, an enabling legal and economic environment is also needed for debt financing and equity financing means. As such, regulatory authorities especially in Nigeria should ensure the creation of an enabling legal regime that will ensure the following: access of venture capital to more private sector resources and consequently increase the lending to SMEs; effective operation of invoice financing, proper regulation of the crowdfunding sector and other alternative finance means; proper government support and monitoring through the intervention schemes.

Importantly, the World Bank recognises that good insolvency practices encourage lending to the SMES, although the evidence is insufficient to suggest that SME-friendly insolvency practices increase SME access to finance.[253] This is because most current insolvency frameworks, especially debt default recovery rules are not suitable in the SME lending market.

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[252] OECD, 'New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments' (2015) <www.oecd.org/cfe/smes/New-Approaches-SME-full-report.pdf > accessed 21 June 2020

[253] The World Bank 'Improving Access to Finance For SMEs: Opportunities through Credit Reporting, Secured Lending and Insolvency Practices' World Bank Group (May 2018) <http://documents.worldbank.org/curated/en/316871533711048308/Improving-access-to-finance-for-SMES-opportunities-through-credit-reporting-secured-lending-and-insolvency-practices >accessed 18 June 2020.

For instance, current insolvency laws have complex procedures that require the counsel of experienced insolvency practitioners and a significant amount of time and resources of the SMEs. This increases the SME bad debts and ultimately impacts the financing of the SMEs and might put the possible rescue of the business in jeopardy. The next chapter therefore addresses the governance of financially stressed SMEs.

Chapter 5

5. Governance of Distressed SMEs

5.1. Introduction

The governance of companies in financial distress has been an ongoing debate in terms of how to balance the interests of the various stakeholders of a company in insolvency. While it is important for business owners and company directors to have access to capital, the financiers (shareholders and creditors) of a company should ideally get a return on their investment; although, this is debatable because shareholders as equity investors, for instance, run the risk of loss of capital. These financiers must equally be protected against the abuse of limited liability by corporate agents. Further, most economies are dependent on businesses and most businesses are companies. This therefore suggests that most economies are largely dependent on companies, many of which are small private companies.[1] However, SMEs have a high failure rate; many SMEs set up and collapse within the first years of incorporation.[2] Therefore, one must understand the insolvency issues peculiar to SMEs. This chapter seeks to critically discuss corporate insolvency within the context of SMEs and its interrelationship with their governance.

The chapter unfolds with a discussion on the failure rates of SMEs. It then considers the concept of corporate insolvency and outlines the tests for determining insolvency under both UK and Nigeria law. The importance of insolvency will also be briefly discussed. The chapter then appraises and compares the insolvency procedures in both the UK and in Nigeria and draws a

[1] In the UK, 99.9% of businesses are SMEs. See Chris Rhodes and Matthew Ward, 'Business Statistics' (7 July 2020) 06152 House of Commons Library Briefing Paper 1, 5 https://researchbriefings.files.parliament.uk/documents/SN06152/SN06152.pdf accessed 14 July 2020

[2] G. McIntyre, 'What Percentage of Small Businesses Fail? (And Other Need-to-Know Stats)' (Fundera, November 11, 2020) <https://www.fundera.com/blog/what-percentage-of-small-businesses-fail> accessed November 15, 2020

link between insolvency and the governance of SMEs. Thereafter, it examines lending and security-related issues peculiar to SMEs vis-à-vis how the use of credit and security drives insolvency in terms of default and rationalisation of interest in insolvency.

Lastly, how SMEs in distress can procure finance within the limits of insolvency will be explored. Undoubtedly, how well capitalised a company is in the zone of insolvency determines the likelihood of such a company being rescued. Indeed, if financing is important pre-insolvency, then it is equally important if rescue is to be achieved. As will be shown, the rescue ideology is a contemporary concern of sophisticated insolvency regimes.

5.2. Overview

Despite the economic importance of small businesses, the failure rates of SMEs during the first couple of years of their life span is still high, and this is closely linked to the issue of finance.[3] Many businesses might be technically insolvent at different points in a year depending upon the nature of their business. For example, a manufacturer of winter jackets, whose core sales occur during the winter season, could face a potential cash flow problem during off-seasons. Financial/operational governance during these off-peak periods thus becomes crucial for survival. Most SMEs are precarious in terms of their financing and as such, they usually lack reserve money to deal with the inevitable crisis of life. Further, due to lack of access to public markets and lack of assets to offer as security for debt finance, they are susceptible to financial difficulty.

While many SME business owners are usually optimistic about the growth of their businesses, they face difficulties during the first years of incorporation. The Office of National Statistics estimates an 11% death rate out of the total businesses of which 99% are SMEs.[4] This could be due to the under-capitalisation of the business and a limitation on the amount of personal

[3] **See chapter 4 for a discussion** on cost and access to finance for SMEs.
[4] Office for National Statistics, 'Business demography, UK:2018' 19 November 2019 <www.ons.gov.uk/businessindustryandtrade/business/activitysizeandlocation/bulletins/businessdemography/2018#business-births-and-deaths-rates-2013-to-2018 > accessed 10 December 2019

wealth that can be put into the business. However, SMEs that weather the first few years of operation have strong prospects of long-term survival if properly governed.

Furthermore, Argenti's research revealed that a common cause of business collapse, is the failure to recognise the early signs of distress. This is because directors are usually overly positive about overcoming challenging financial times and have little incentive to file for insolvency. Moreover, insolvency law only penalises for filing too late.[5] Thus, directors are usually unwilling to file for insolvency early. Moreover, it has been suggested that in larger corporations, science might play a role in predicting distress[6] and the likelihood of insolvency.[7] Conversely, in SMEs, there is generally a lack of awareness of these diagnostic models, an inability to afford them, and an unwillingness to deploy them to a constructive effect. In *HRMC v Rochdale Drinks Distributors Ltd*, Rimer LJ when ordering that the company be placed on provisional liquidation, found governance and management failings when the company was in distress as a major cause of liquidation.[8] As Milman notes, an overly optimistic means of management stands as a barrier to effective governance as it denies the company the benefit of constructive criticism.[9] In recent times, there has been a rise in the provision of diagnostic and management tools for SMEs such as QuickBooks[10] to help them manage their accounts. However, lack of awareness about the tools is still a major issue for SMEs.

Notably, some SME directors are not savvy enough to use the electronic accounting software to detect financial distress. Any improper conduct in that regard may also make the director liable for a breach of his statutory duty. For instance, in *Henderson & Jones Limited v. Garry Patrick Price*[11], the SME director used electronic accountancy software for keeping records of

[5] Insolvency Act 1986, s. 214.
[6] T.E Cooke and Andrew Hinks, 'Wrongful trading-predicting insolvency' (1993) Journal of Business Law 338
[7] E.I Altman, 'Financial ratios, discriminant analysis and the prediction of corporate bankruptcy' (1968) 23 (4) Journal of Finance 589-609
[8] [2011] EWCA Civ 1116, [2011] BPIR 1604 [100] (Rimer LJ)
[9] D. Milman, *Governance of Distressed Firms* (Edward Elgar Publishing, 2013) 38
[10] A small business accounting software, available at: <https://quickbooks.intuit.com/uk/>
[11] [2020] EWHC 3276 (Ch)

its accounts. The director made a ledger entry as 'Director's loan' but could not prove the sum accepted and the sum in dispute and used the company's money at his sole discretion. The court found that the director breached the duty to exercise reasonable care, skill and diligence under s. 174 of the Companies Act due to poor financial practices. This underscores the importance of SMEs practising proper corporate governance practices vis-à-vis financial governance.

5.3. Evolution of Insolvency Law

Historically, insolvency law used to be draconian. The history of insolvency law in the UK is traceable to the 16th century. The first piece of insolvency legislation in the UK provided that *"Where divers and sundry persons craftily obtaining into their hands great substance of other men's goods do suddenly flee to parts unknown or keep their houses, not minding to pay or restore to any their creditors their debts and duties….the Lord Chancellor … shall have power and authority by virtue of this Act to take ... imprisonment of their bodies or otherwise, as also with their property… for true satisfaction and payment of the said creditors.."*.[12]

This was a personal insolvency legislation, which also applied to company insolvency for a long time. The rationale behind this law was to catch debtors who had incurred debt and failed dishonourably to honour their credit obligations. Further, the Statute codified for the first time in English Law the '*pari passu'* which is the equal treatment of creditors.[13] In these times, the idea of taking on debt was unattractive. It was primarily a debt-collection device for creditors and if a debtor defaulted in his credit obligations, he was seen as a failure and could consequently lose his life or limb.[14] Essentially, it was primarily creditor-driven, with a heavy bias against debtors as they were repressed in the insolvency procedure. Punishment and

[12] Statute of Bankrupts 1542, Preamble
[13] C. Bridge, 'Insolvency – a second chance? Why modern insolvency laws seek to promote business rescue' (2013) 4 Law in Transition 28, 31 <https://www.ebrd.com/documents/legal-reform/insolvency--a-second-chance.pdf> accessed 14 July 2020.
[14] ibid

imprisonment of debtors especially small debtors were typical outcomes. Further, the insolvency of companies was usually with recourse to the owners and shareholders and, as such, the liability of the directors was not limited in case of insolvent liquidation. This changed with the landmark case of *Salomon v. Salomon*[15]and the enactment of the Companies Act 1862 (which consolidated the Joint Stock Companies 1844 and Limited Liability Act 1855). They ushered in an era of liability of shareholders in the case of insolvent liquidation, contrary to the former position of unlimited liability of owners of the debtors. Judges grew frustrated over time about the incompatibility of personal insolvency rules with corporate insolvency. Hence, creating a different regime became imperative.

English insolvency Law has since moved from the Victorian roots to an insolvency regime centred on rescue.[16] The primary legislation is the Insolvency Act 1986, which was modelled on the 1982 Cork Report.[17] The hallmark of the Report was to advocate for modern insolvency laws to ensure that companies are capable of being rescued, and in turn, contribute to economic life. This report also led to the introduction of administration and corporate voluntary arrangements as insolvency procedures. Thus, a new regime focused on holistic corporate rescue was introduced. However, receivership was still utilised by secured creditors to realise the assets of debtors.[18] In 2001, the UK government published a report called "Insolvency – A second chance", which argued that distressed companies should be allowed a 'fresh start', given that 'in a dynamic market economy some risk taking will inevitably end in failure'.[19] The series of proposals in the Report culminated in the enactment of the 2002 Enterprise Act, which introduced a significant change to the insolvency law by expanding the administration

[15] [1897] A.C. 22
[16] Bridge (n 13).
[17] K. Cork, *Report of the review committee on insolvency law practice* (Her Majesty's Stationery Office, London, 1982, Cmnd 8558)
[18] Bridge (n 13)
[19] Department of Trade and Industry, 'Insolvency – A Second Chance' (2001) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file263523/5324.pdf > accessed 14 July 2020

procedure. As such, it has become the collective insolvency procedure under the Act. In 2015, the Small Business Enterprise and Employment Act introduced significant changes to the floating charges. Recently, the UK government enacted the Corporate Insolvency and Governance Act 2020, which introduced long-deliberated proposals like the standalone moratorium for companies and made significant changes to the UK insolvency landscape. English insolvency law has now moved from one that severely punished debtors (treated insolvency as sin) to one that sees insolvency as risk and economic failure. What was a majorly a creditor-driven process is now debtor-friendly.[20]

In the UK, there are two known tests for establishing insolvency. First, is the cash flow test and the combined provisions of s.122(1)(f) and s.123(1)(e) of the Insolvency Act 1986 (IA 1986) provides that insolvency is when a company is unable to pay its debts as they fall due.[21] The second is the balance sheet test, which denotes that the company's assets are less than its liabilities considering its future and contingents' liabilities.[22] However, the two statutory tests are not conclusive. In *BNY Corporate Trustees Services Ltd & Ors v Eurosail*[23] the court clarified that the mere fact that a company is balance sheet insolvent does not mean that the company is insolvent, as it may well be cash flow solvent. It was noted that the expression "balance sheet insolvency" should not be taken plainly and that whether the test of balance-sheet insolvency is satisfied depends on the circumstances and available evidence in each case.[24] Undoubtedly, the balance sheet insolvency test requires a commercial assessment of the company's assets and liabilities. Furthermore, assessing prospective and contingent liabilities will involve a painstaking contemplation of business and commercial realities including, but not limited to, the future liability's due date, inflation rate, exchange rate fluctuations etc.

[20] ibid
[21] Insolvency Act 1986 S.122(1)(f); S.123(1)(e)
[22] IA 1986 s.123(2)
[23] [2013] UKSC 28; See also the case of *Re Casa Estates (UK) Limited* [2014] EWHC 383
[24] ibid

Therefore, the court's interpretation of the two statutory test is that they are not conclusive on the point that a company is insolvent.

Pursuant to s.572(a)-(c) of Companies and Allied Matters 2020 (CAMA) the notion of corporate insolvency provides that, a company will be deemed to be unable to pay its debt if: (a) a creditor, by assignment or otherwise, to whom the company is indebted in a sum exceeding ₦200,000 then due has been served on the company… (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".[25] Udofia observes that nearly all cases of corporate insolvency in Nigeria are predicated on the inability to pay debt as provided in S.409(a) of the old CAMA 2004 (now s. 572(a) of CAMA 2020).[26] From the foregoing, it is apparent that the two tests for corporate insolvency in the UK are the inability of a company to pay its debt, as they fall due; or the existence of a situation in which the amount of the company's liabilities exceeding the value of its assets, taking into account its prospective and contingent liabilities. Meanwhile, Nigerian law is premised only on the 'inability to pay debts' yardstick.

It is worth stating that, CAMA regulates the formation of SMEs registered as private companies as well as Limited Partnerships and Limited Liability Partnerships. SMEs registered as such are governed by the insolvency provisions of CAMA. Conversely, SMEs registered under the Partnership Act, or the Partnership Laws of the respective States of the Federation of Nigeria are governed by the insolvency provisions under the Bankruptcy and Insolvency Act 2017[27] (BIA 2017) which also applies to individuals. This is because registered business names (and ordinary partnerships) do not have legal personality and are, therefore, regarded as one and the

[25] CAMA 2004 s.409(a)-(c); CAMA 2020 s.572(a)-(c)
[26] K. Udofia, 'Establishing Corporate Insolvency: The Balance Sheet Insolvency Test' (2019) SSRN <https://ssrn.com/abstract=3355248> accessed 20 January 2020
[27] Bankruptcy and Insolvency Act 2017

same person with their proprietors.[28] The existence of different legislations on insolvency and bankruptcy in Nigeria means that different laws apply to the different classes of SMEs in Nigeria. For incorporated SMEs, the statutory framework for distressed SMEs in Nigeria was just comprehensively updated under BIA 2017 and CAMA 2020.

5.4. Importance of Insolvency

In recent times, there has been a proliferation in the use and availability of credit. Therefore, the relationship between a debtor and a creditor necessitated a framework to manage their relationship once the debtor becomes unable to honour their credit obligations. Furthermore, insolvency can be described as an emotive issue because of its impact on the economy and individuals. One company going bust could mean the livelihood of thousands of people become at stake. Companies are crucial to the stability of any given economy. Thus, when businesses fail, or become insolvent there is a significant impact on the economy. The failure of one business can lead to the failure of many other businesses.

It is important to note that, when a company is in its trading phase, much of the benefit and focus goes to shareholders.[29] This is because shareholders are part of the company's management and can influence the company's decision through general meetings, specifically, voting in general meetings. Pre-insolvency, therefore, shareholders can play an active role in ensuring that the company is well governed. By monitoring and holding management accountable, they can potentially strengthen the corporate governance practices of the company and avert or minimise the risk of insolvency. Admittedly, the scope for this may be limited in closely held SMEs where ownership (shareholders) and control (management) is intertwined; nevertheless, in SMEs with less concentrated ownership, shareholders could positively

[28] In the case of *Adamu v. FRN* (2018) LPELR-46029 (CA)**,** the Nigerian Court of Appeal held that the legal implication of a registered business name, unlike a company is that the registered business name and its proprietor are regarded one and the same person. Hence, the management of the business name can never be transferred to another person because the business name has no legal personality of its own independent of the proprietor.
[29] Companies Act 2006, S. 172

influence the governance of the company. However, once the company starts to enter to the insolvency zone, both legislation and common law asserts that the directors have a duty to the company to have regard to creditors' interest[30] because much of insolvency is about rationalising creditor interest. During insolvency, the governance of the company, vis-à-vis its board of directors, is no longer exercised for the primary benefit of shareholders; the directors become duty-bound to govern the company with creditors' interests at the fore. Accordingly, they may be liable for misfeasance where they disregard or jeopardise creditors' interests.[31] This thesis supports the preference of creditors in the insolvency zone because the relationship between a shareholder and the company is an equity relationship. What this suggests is that the fate of the company and the shareholder is inter-twined; the shareholders become part of the ownership of the company by giving money in exchange for equity. So, if the business fails, they fail.

Additionally, insolvency law tries to rationalise the interest of the different stakeholders of a company when it becomes financially distressed. As the primary relationship in an insolvency scenario is between debtor and the creditor, insolvency law seeks to manage conflicting interests. This ties in with concept of corporate governance itself, which is concerned with managing these conflicting interests. Insolvency usually ensues because of financing issues and particularly financing by way of credit. Arguably, without the facility of debt, the need for insolvency law is obviated. As earlier stated, the White Paper that preceded the EA 2002 aimed at promoting entrepreneurship. This shows the movement of insolvency law in the UK from a creditor-oriented regime to debtor-oriented regime that now tries to give insolvent businesses a second chance. What this means is that there will always be insolvency issues because, if people want to do business, there is always going to be a need for credit and, at some point,

[30] CA 2006 S.172(3); *West Mercia Safetywear Ltd (in liquidation) v Dodd* [1988] BCLC 250; *Dickinson v. Nal Realisations (Staffordshire) Ltd and another* [2017] EWHC 28 (Ch); *Dickinson v Nal Realisations (Staffordshire) Ltd and another* [2019] EWCA Civ 2146.
[31] ibid *West Mercia Safetywear*

insolvency could occur. So, there must be a sensible framework that can manage the event and more importantly, within the procedure, the relationships that will in no doubt come in conflict. Therefore, the working definition of insolvency for the purpose of this thesis is 'a condition whereby a business is financially distressed'.

Both English and Nigerian insolvency law recognise various insolvency procedures,[32] namely: Liquidation, Receivership, Company Voluntary Agreements (CVAs) and Administration. As such, these procedures will be discussed vis-à-vis their implication(s) for SMEs.

5.5. Insolvency Procedures

5.5.1. Liquidation

Both in Nigeria and in the UK, a company may be wound-up, voluntarily or compulsorily. In Nigeria, the Federal High Court has jurisdiction to hear petitions for winding-up of companies.[33] S.571(d) of CAMA provides for a company to be wound up by the court on a number of grounds, including inability to pay debts.[34] The court will typically appoint a liquidator to conduct the winding-up proceedings.[35]

The liquidation procedure in the UK is substantially the same as that of Nigeria (save for the definition of inability to pay debts). In the UK, the High Court has the jurisdiction to wind-up companies registered in England and Wales, while the Court of Session has the jurisdiction to wind up companies registered in Scotland.[36] A solvent company may go into a members' voluntary liquidation (MVL), while an insolvent company goes into a creditors' voluntary liquidation (CVL). CVL as a procedure is the most utilised form of liquidation in the UK. CVL

[32] Notably, the Corporate Insolvency and Governance Act 2020 introduced a new standalone moratorium in the UK. Part 26A of the Companies Act 2006 also provides for arrangements and reconstructions for companies in financial difficulty; though this is not, strictly speaking, an insolvency procedure in itself, it may likely be used along with a formal insolvency procedure.
[33] CAMA, s.570(1)
[34] CAMA s.571(d)
[35] CAMA s.422582
[36] IA 1986 s.117(1); s.120(1)

is a relatively convenient procedure for SMEs.[37] It is preferable for SMEs with fused ownership and control, as they have an opportunity to nominate a liquidator.[38] This provides for their participation in the liquidation process. In addition, SMEs can save cost and ensure that the value of the business is maximised. This provides an avenue for effective governance of the company, based on its prevailing realities, to prevent further loss. On the contrary, since most SMEs are also directors and shareholders, it is the case that the SME owners are often passionately attached to the business. It then follows that CVL, which is a voluntary acceptance of reality by the owners, might not usually be a considered option. Failure to act properly on time, might subject a director's managerial acts prior to the CVL to scrutiny and if the director did not act in the best interest of the company, he is potentially liable to contribute to the company's debts based on the provision for wrongful trading.

Liquidation concludes the formal death of ailing companies.[39] Moreover, it has been argued that giving these zombie companies a chance to survive stand in the way of economic resources that could be reallocated to more efficient use.[40] Schumpeter has suggested that this reallocation is essential and an unavoidable characteristic of capitalism.[41] Moreover, the economy may benefit overall from weeding out inefficient businesses. However, as liquidation is a procedure that terminates the existence of a company and given the utilities of SMEs, this thesis argues that viable insolvent SMEs should be given a chance to be rescued, and liquidation should only come as a last resort when every attempt at rehabilitating a business has failed or applied immediately to economically hapless entities. Nevertheless, liquidation serves as a checking mechanism, to ensure that SMEs are well governed in the first instance.

[37] H. Anderson, 'An Introduction to Corporate Insolvency Law' (2016) 8 The Plymouth Law & Criminal Justice Review 16, 30
[38] ibid
[39] These companies are regarded as zombie companies.
[40] C. Elliot, 'The Zombie Budget Deficit' (2013) 6(2) Corporate Rescue and Insolvency 78; R3, 'UK 'Zombie Business' Numbers Drop to Record Low' (2018) <https://www.r3.org.uk/press-policy-and-research/news/more/29104/store/495029/page/3//> accessed 24 November 2020
[41] J. Schumpeter, Capitalism, Socialism and Democracy (2nd Edition, Harper & Brothers, 1942)

Arguably, SMEs carry out business in the hopes of achieving success and making profit. Conversely, liquidation (specifically creditor-initiated liquidation) signals business failure. Hence, good corporate governance becomes essential for SMEs to avert liquidation as an outcome.

5.5.1.1. Restriction on Winding-up Petitions

The Corporate Insolvency and Governance Act 2020 (CIGA) temporarily suspends the filing of winding-up petitions by creditors.[42] It covers winding-up petitions presented between 1 March 2020 and 30 September 2021.[43] This provision applies where the Covid-19 pandemic has had a financial impact on a debtor and the debtor is facing a cash flow insolvency which is a ground for the winding-up petition.[44] The effect of this provision is that if a creditor goes ahead to file a winding-up petition, s/he must prove to the court that the company's inability to pay its debt was not caused by the Covid-19 crisis. In addition, where a petitioner brought a petition before the Act came into force, but the requirement was not met, the Act allows the Court to make an order to restore the company's position.[45] Laudably, this provision positively affects SMEs whose finances have been severely impacted by the Covid-19 pandemic. It helps them to explore business rescue options without threat of winding-up petitions from creditors as proving that the company would have been worse if not for the coronavirus outbreak would indeed be a difficult task.

However, parties may enter into agreements that will reflect new commercial arrangements. In conclusion, directors must exercise caution in the operation of their businesses as they will still be subject to other liability regimes as will be discussed later. Nevertheless, the CIGA's

[42] Corporate Insolvency and Governance Act 2020, s. 10 2(1); Notably, the relevant period was extended by the Government.
[43] ibid
[44] ibid Sch 10 2(3)
[45] ibid Sch 10 (7)

suspension of winding up petitions arguably provides the SMEs with the breathing room to evaluate, and if need be, reorganise their affairs and governance practices.

5.5.2. Administrative Receivership

Administrative Receivership is a corporate insolvency procedure which secured lenders deploy in realising debts owed by insolvent corporate borrowers.[46] Administrative receivership is a private means of enforcement of security rights. Further, the type of security that gives birth to the institution of administrative receivership is the floating charge. This is because by default, the floating charge usually relates to the entirety of the companies undertaking. Therefore, an administrative receiver is a receiver of the whole or substantially the whole of a company's undertaken.[47] Understandably, secured lenders are keen to realise the security created in their favour, a process which could potentially result in the ultimate liquidation of the insolvent company. However, over the years, receivership became a contrary procedure thereby birthing a restriction.[48] With the institution of administrative receivership, there is a tussle between the collective principle of insolvency and individualism.[49] Insolvency law is a collective exercise, it is a forum for characterising a range of interest, and all the creditors of a company are collectively entitled to the insolvent estate. Therefore, this thesis argues that a procedure that is largely concerned with the interest of one creditor with a floating charge is at variance with the collective foundation of insolvency.[50]

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[46] K. V. Zweiten, *Goode on Principles of Corporate Insolvency Law* (5th Edition, Sweet & Maxwell, London 2018) 389

[47] IA 1986 s.29(2)

[48] Department of Trade and Industry, 'Insolvency – A Second Chance' (2001) Para 2.18 < https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file263523/5324.pdf> accessed 14 July 2020

[49] K. Cork, *Report of the review committee on insolvency law practice* (Her Majesty's Stationery Office, London, 1982, Cmnd 8558) para 495

[50] K. Akintola and D. Milman 'The rise, fall and potential for a rebirth of receivership in UK corporate law' (2020) Journal of Corporate Law Studies 99; see *Davey v Money* & *Anor* [2019] EWHC 997 (Ch) for comparison with administration.

Furthermore, the false agency of administrative receivership has been heavily criticised. An administrative receiver is appointed by the creditor of a company. However, the receiver is statutorily recorded to be an agent of the company.[51] Agency rule provides that an agent is accountable to and must act in the best interest of its principal. However, the primacy of the receiver's duty is deemed to be owed to the appointing creditor. The case of *Gomba Holdings v Homan*[52] further asserts this false agency as it was held that the receiver's primary duty is to recoup the debts of the appointing creditor. There is nothing in the statutory framework that mandates or commits them to rescue the company or any part of it. Administrative receivership is all about realising the debt through the appointment of a receiver who displaces the existing management. The floating charge is therefore seen as a means of control, and this can greatly influence the decision of secured creditors to rescue the company or liquidate it.

Moreover, the cost of receivership is said to be unreasonably high and hinders the prospects of rescue for an SME desirous of being rescued. Mokal posits that administrative receivership was abolished because it could potentially result in the liquidation of viable companies that could otherwise have been rescued. He opines that, in that regard, administrative receivership could not be regarded as a proper business-rescue option like administration.[53] Arguably, administrative receivership was designed to favour secured lenders whose loan to insolvent companies are secured by floating charges.[54]

Notwithstanding the criticisms of the administrative receivership, some have argued that it is a viable business rescue option. It has been shown that it has yielded more positive results than administration and corporate voluntary arrangements. Keith argues that while administration

[51] IA 1986 s.44 (1)(a)
[52] [1986] 1 WLR 1301
[53] R. Mokal, 'Administrative Receivership and Administration — An Analysis' (2004) 57 Current Legal Problems <https://ssrn.com/abstract=466701> accessed 30 January 2020
[54] J. Armour, A. Wen-Hsin Hsu and A. Walters 'Corporate Insolvency in the United Kingdom: The Impact of the Enterprise Act 2002' (2008) 5(2) European Company and Financial Law Review <https://ssrn.com/abstract=1151785> accessed 30 January 2020

and corporate voluntary arrangement only accounted for two per cent (2%) of business rescues in the UK in 1991 and 1992, administrative receivership accounted for about twenty-three per cent (23%) of all business rescues. However, this declined to fifteen per cent (15%) in 1995.[55] Nevertheless, it came as no surprise that the parliament looked at these issues closely as they were against the grains of rescue and thus enacted the Enterprise Act 2002 (EA 2002). The EA 2002 abolished administrative receivership subject to certain exceptions.[56] Post-enactment of the EA 2002, the utility of administrative receivership has been whittled down, as floating charge holders now have the right to appoint an administrator where the company defaults.[57] It has been observed that this was geared towards eliminating the powers of holders of floating charges to veto an administration order and abolition will enhance the use of administration as a proper business-rescue option.[58] However, administrative receivership is not dead yet; creditors with 'qualifying' floating charges that were created before the Act came into force can still enforce their security rights via the appointment of a receiver.

In Nigeria, receivership is principally regulated by CAMA. The right to appoint a receiver is statutorily implied with respect to legal mortgages of land, by the provisions of s.19 of the Conveyancing Act 1881[59] (applicable in Lagos and the former Northern and Eastern Regions of Nigeria) and by s.131 of the Property and Conveyancing Law 1959[60] (applicable in the states of the former western region of Nigeria). This is known as a fixed charge receiver. By s.559 of CAMA, the remedy is also guaranteed to debenture holders (and trustees) for the enforcement

[55] K. Pond, 'Rescuing Insolvent Companies via Administrative Receivership- Analysis of Qualitative Survey Data' (1997) Loughborough University Business School <https://ssrn.com/abstract=43880> accessed 29 January 2020.
[56] S.250 of the EA 2002 inserts a new s.72A -72GA in the IA 1986 Act listing the exceptions.
[57] IA 1986 Sch B1
[58] J. Armour and R. J. Mokal, 'Reforming the Governance of Corporate Rescue: The Enterprise Act 2002' ESRC Centre for Business Research, University of Cambridge Working Paper No. 289. (June 2004) <https://www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working papers/wp289.pdf > accessed 27 January 2020
[59] Conveyancing Act 1881
[60] Property and Conveyancing Law 1959

of mortgages as well as fixed and floating charges against a company.[61] Despite these implied powers, Nigerian security documents typically include express provisions for the lenders or the security trustee (acting on behalf of the lenders) to appoint a receiver with wide powers to manage and sell the secured assets. If the power of appointment is expressly specified in the security document, the terms of the said security document will govern the extent of the powers of the receiver.

With the partial abolition of administrative receivership in the UK, the Nigerian framework for receivership bears semblance with that of the UK. However, unlike the practice in the UK where receivers appointed by mortgagees/charge-holders are statutorily recorded as agents of the company, a receiver in Nigeria is deemed to be an agent of the mortgagee/charge-holder.[62] However, the receiver can also be appointed to be an agent of the company. Further, if the receiver is appointed manager of the whole or any part of the undertaking of a company, he is deemed to stand in a fiduciary relationship to the company and must observe the utmost good faith towards it in any transaction with it or on its behalf.[63] The distinction is highly significant in the sense that while the acts of the receiver bind the company (and not the mortgagee) in the UK, reverse is the case in Nigeria. In Nigeria, the acts of the receiver bind the mortgagees and the debenture-holders. However, in the case of, *Solar Energy Advanced Power System Limited v Ogunnaike & Anor,*[64] the Nigerian Court of Appeal reiterated the Supreme Court of Nigeria's position in *Intercontractors Nigeria Limited v U.A.C*[65] that the receiver/manager is usually appointed the agent of the Company as was done in the case. The importance of this decision is that a receiver may be deemed an agent of the company in Nigeria even if appointed for the

[61] CAMA s.559
[62] CAMA s.553(1)
[63] ibid
[64] (2008) LPELR-8470
[65] (1988) SCNJ 131

benefits of the mortgagees or the debenture-holders, particularly where this can be inferred from the instrument appointing the receiver.

5.5.3. Company Voluntary Agreements

Pursuant to Part I of the IA 1986, companies in financial distress may take benefit of a company voluntary arrangement (CVA). A voluntary arrangement is a proposal by directors of a company (other than one for which an administration order is in force) to the company and its creditors for a composition in satisfaction of its debts or a scheme of arrangement of its affairs.[66] A CVA is essentially a multi-party contract between a company and its creditors; a contract embodied in quite a sophisticated body. Although there are provisions in the legislation as well as the common law rules, it must be noted that this procedure is tied up with insolvency practitioner practice. Further, though, parliament has provided a vehicle, but its utilisation and fate are up to practitioners as well as the company or directors as to whether they decide to drive the vehicle.

For a CVA to be approved, the support of the holders of 75% of the debt is required. Also, there must be support from the holders of 50% of the independent debt. The key to getting creditors support for a CVA is to show that the loss suffered is across the board, and once the required majority is in support, it becomes binding. However, it is possible to challenge the majority votes. S.6 of the IA 1986 provides that unfair prejudice or material irregularity are grounds of challenge. There is also a 28-day window for a challenge to be brought under this provision. In determining who has a vote, this is left to the insolvency practitioner. The practitioner has the power to accept, query, refuse or reduce the debt. However, a major challenge in this area, is that often family business creditors do not put agreements into writing, and this affects their voting rights in a CVA proposal meeting. Arguably, these mechanisms embedded in the CVA voting rules is an attempt to curb fraud at the expense of other creditors.

[66] IA 1986, s.1

In comparison with other corporate insolvency procedures, CVAs manifests a debtor in possession (DIP) feature.[67] This is feature is of American origin and it is very much linked to the practice of the Chapter 11 procedure. This effectively means that if a company enters into a CVA, the directors remain in control of the business, subject to qualifications. An advantage of the DIP feature, particularly in SMEs, is that the director who sometimes may be the owner of the business has more interest in seeing the business survive again. This is in contrast with other insolvency procedures in the UK, like administration and liquidation which involves the appointment of an office-holder as prescribed by the statute. This characteristic of a CVA can also become dangerous when the director lacks the knowledge of handling insolvency related issues. Since the director is in control of the business when it becomes financially distressed, there might be no incentive for the director to make important decisions concerning the business. It has been observed that many SMEs directors do not keep proper accounts and as a result, fall into financial distress.[68] Also, the DIP feature may give rise to suspicion by the creditors about the rescue procedure. As such, the risk of the company trading as a phoenix company becomes heightened.[69]

Despite this attraction, statistics shows that CVAs are infrequently utilised.[70] A commissioned report by the R3 of the analysis of 552 CVAs commenced in 2013 involving companies in England and Wales showed that 65% were terminated before achieving their intended aims[71].

[67] I. F. Fletcher, 'UK Corporate Rescue: Recent Developments—Changes to Administrative Receiverships, Administration Company Voluntary Arrangements—The Insolvency Act 2000, The White Paper 2001 and the Enterprise Act 2002" (2004) 5 European Business Organisation Law Review (E.B.O.R.) 119.
[68] G. Cook and others, 'Small Business Rescue: A Multi-Method Empirical Study of Company Voluntary Arrangements' (London: Institute of Chartered Accountants in England and Wales (ICAEW), 2003).
[69] S. Ellina, 'Administration and CVA in corporate insolvency law: pursing the optimum outcome' (2019) 30(3) International Company and Commercial Law 180, 182
[70] Insolvency Service Official statistics <https://www.gov.uk/government/collections/insolvency-service-official-statistics> accessed 18 February 2020.
[71] P. Walton, C. Umfreville and L. Jacobs, 'Company Voluntary Arrangements: Evaluating Success and Failure' (2018) (Association of Business Recovery Professionals) 1, 12 <www.icaew.com/-/media/corporate/files/technical/insolvency/publications/cvas-evaluating-success-and-failure.ashx> accessed 14 July 2020.

Interestingly, 93% of companies entering CVAs were small or micro-enterprises[72]. Notably, there is a constant pattern of underperformance principally due to the failure of directors to act appropriately.[73] Further, practitioners can only deliver rescue if it comes at an opportune time. This issue is even more apparent in SMEs. Many SME owners and directors often have an emotional connection with their businesses and fail to acknowledge that the business is in distress.

Additionally, the lack of time limit makes a CVA procedure costly and complex. Ellina argues that if the procedure had a time limit attached to it, it could possibly alleviate the issue of high expenses and complexity.[74] Indeed, it has been identified that CVAs are often cut short before the end of the planned period because of missed contributions to creditors.[75] These could be considered extensive for SMEs as in most cases, there is limited cash flow to assist these businesses in using a CVA. This is because secured creditors are usually ready to fund for a procedure that displaces the management. The lack of finance for CVAs and its concomitant high expenses have therefore made CVAs ineffective in rescuing a business. Frisby records that only 10% of companies that completed CVAs continued trading.[76] Although the R3 Report recommends the limit of 3 years to be extended with good reasons, determining the optimum time in using a CVAs can be near difficult because of the commercial considerations involved. As such, there is no incentive for SMEs to utilise CVAs because of the high expenses involved. Due to the under-utilisation of this model, a new CVA with a protective moratorium for SMEs was introduced through the Insolvency Act 1986.[77] However, this moratorium is now abolished

[72] ibid
[73] T. Mocroft, "Companies cannot do it alone: An investigation into UK management attitudes to Company Voluntary Arrangements" (Centre for the Study of Financial Innovation (CSFI), 2004) available at: <http://www.csfi.org.uk/CSFI%20Mocroft%20FINAL.pdf> accessed 18 February2020
[74] Ellina (n 69)
[75] Walton, Umfreville and Jacobs (n 71) 3.
[76] S. Frisby and A. Walters, "Preliminary Report to the UK Insolvency Service into Outcomes in Company Voluntary Arrangements" (March 2011), SSRN available at: < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1792402 > accessed 18 February 2020
[77] IA Act 1986, Sch. A1, para 3

by the standalone moratorium introduced by the Corporate Insolvency and Governance Act 2020, which will be subsequently discussed in this chapter.

In Nigeria, the Companies and Allied Matters Act now recognises Company Voluntary Arrangements. The Act empowers directors of a company to make a proposal to its creditors for a composition in the satisfaction of debts or a scheme of arrangement of its affairs.[78] The CAMA provisions for CVA are substantially similar to the UK provision. Like the UK procedure, this form of business rescue under CAMA has a debtor-in-possession feature. This thesis therefore argues that the challenges to this procedure in the UK will materialise in Nigeria. This is particularly because Nigeria is still a developing country plagued with her unique issues. Therefore, it is imperative that caution must be exercised when transplanting western ideas into the country.

CVA as a rescue procedure can indeed be appealing for larger companies. However, for it be more utilised and successful within SMEs, this thesis suggests that directors must know when to press the legal panic button. Also, there should be a full and clear statement of the duties of the directors. Further, there should be cooperation between the key constituencies in insolvency and a statutory time frame for the implementation of the promises made by directors. For instance, in *Re-Interfirst Finance and Securities Ltd*,[79] the court held that there must be evidence of mutuality in the any arrangement proposed by the company. In the instant case, the company's proposals by which it would repay its debt were unilateral arrangement or compromises. There should also be a clear articulation of the duties of the Insolvency practitioner. If these suggestions are duly followed, this procedure might birth more successful recovery rates.

[78] CAMA, s. 434(1)
[79] (1993) FHCLR 421.

5.5.4. Administration

As a further attempt to promote rescue in the UK, the Cork Committee introduced the first version of administration.[80] This administration procedure was largely a court driven procedure. To initiate this procedure, any creditor of an insolvent company had to go to the court to get an administrative order. However, this procedure was not seen as effective primarily because of the institution of administrative receivership. This was due to the fact that floating charge holders had the right to block the appointment of an administrator by appointing an administrative receiver. As a result of this, administration was merely a statutory procedure on paper[81] but was not dominant in the rescue regime. In an attempt to address the under-utilisation of administration procedure, the parliament enacted the Enterprise Act 2002 (EA 2002) which produced a streamlined version of administration.

The new procedure is located in what is designated Schedule B1 of the 1986 Act.[82] Further, the purpose of administration has been made more transparent with a list of hierarchical objectives that should be pursued. If an administrator pursues the first objective, then such an administrator is trying to achieve a pure rescue as it will amount to the survival of the business or part of it as a going concern. The second objective will be pursued if the result will be better for the general body of creditors in administration than in liquidation where objective A is not realistically achievable. The third objective is an asset realisation tool; just like administrative receivership, it is a debt recovery tool.

The new administration regime has some impact on the governance of SMEs. It has been pointed out that the advent of a company into the administration process means that the shareholders of the company are 'residual claimants'.[83] This means that the shareholders are to

[80] Cork Report [n 44]; IA 1986 Part II s.8
[81] Although, administration as a rescue procedure was sometimes implemented. *Re Atlantic Computer System plc (No 1)* [1990] EWCA Civ 20
[82] IA 1986 Sch B1
[83] Armour and Mokal, (n 58).

benefit or lose from a change in the value of the firm. Also, it is most likely that the directors were responsible for the company's financial woes, and this may cast doubt on the board's competence. This therefore gives the administrator, who is often appointed by the company or directors, power over the appointment and removal of the directors. The administrator may choose to appoint a new board which displaces the former board. However, it could be argued that the management-displacement feature of the administration process is not the best option for SMEs whose owners/directors are knowledgeable about the company's business and markets. Although, a company may retain its management by using Light Touch Administration.[84]

As this is a debtor-in-management procedure, the directors should also maintain financial prudence as soon as financial status of the company takes a downturn as certain actions leading up to the administration may be challenged by the administrators. In *Saint George Investment Holdings Ltd (Dissolved, Re)*[85], Dr. Motta, the majority shareholder and the sole director of the dissolved company caused payments to be made to him which he used for his personal expenses from the overdrawn Director's Loan Account at the time when the company entered administration and before that time. He also made unjustifiable payments to his ex-wife, daughter and a company. An insolvency litigation financing company brought an action to recover the sum outstanding on the DLA as the debt was in existence at the time of the administration. In reaching its decision, the court held that the director had breached his duty to promote the success of the company by not regularising the financial position of the company over the years and that many of the personal expenditures were not connected with the company's interests. Also, the administrators may apply to court for an order to displace the director even without a special resolution of the company. In such a situation, the court would

[84] See discussion 5.5.4.2 for a discussion on Light Touch Administration; *Re Debenhams Plc* [2020] EWHC 1755 (Ch)
[85] [2020] EWHC 2965.

have the jurisdiction to grant an application for the removal of the director where it is urgent and necessary for the performance of the administrator's duties.[86]

Furthermore, unlike the original style administration, where the only way to get an administrative order was to go court, there are three different routes into the new style administration regime. First, an administrator can be appointed by the court.[87] However, this not a popular route as it may be costly and time-consuming particularly for SMEs aiming to be rescued. The second route is the appointment by a floating charge holder.[88] This can also be seen as a concession to the floating charge holders for the partial abolition of administrative receivership. As such, floating charge holders that their charge predates the EA 2002 have the right to either appoint an administrative receiver or an administrator out of court. The third route is an appointment by a company or its directors.[89] This is a more popular route as it helps the company to avoid the reputational issues linked to appointment by floating charge holders. In an attempt to replicate the rescue-oriented approach of the UK insolvency law in Nigeria, the new CAMA also introduced administration.[90] An administrator may be appointed by an order of court, the holder of a floating charge or the company or its directors. Like the UK provision, the administrator's primary object is to rescue the company. The objectives are similar to the hierarchical objectives in the new administration regime under UK law.[91] First, the administrator has the statutory objective of the managing the business or its affairs in order to rescue the company as a rescue; achieving a better result for the company's creditors; or realising property for creditors. The administrator who is to be an insolvency practitioner has a statutory duty to the general body of the creditors as a whole and he is deemed as an officer of the court whether appointed by the court or not.

[86] *Inspired Asset Management Ltd, Re* [2019] EWHC 3301 (Ch)
[87] IA 1986 Sch B1 para 10
[88] IA 1986 Sch B1 para 14
[89] IA 1986 Sch B1 para 22
[90] CAMA, s. 443
[91] ibid s. 444

It can be said that the new streamlined version of administration in the UK has gained more popularity and utilisation. Statistics suggest that administration procedure is currently more popular when compared to CVAs. In Q1 2020, there were 80 CVAs while the number of administrations reached 345.[92] This can also be attributed to the moratorium facility administration possess. However, directors abuse this facility by filing notices of appointing an administrator continuously without actually going into administration but with the aim of obtaining a long-term moratorium for the company.[93] The cases of *Re Cornercare*[94] and *Re Business Dream*[95] lend proof to this assertion. Further, the cost of hearing whether or not there was an abuse of the moratorium facility will be extracted from the assets of the company. This is extremely disadvantageous to for a small business looking to be rescued.

In 2016, there were consultations to introduce a standalone pre-insolvency moratorium.[96] This thesis argues that this could potentially endanger the interests of the general body of creditors and even the goodwill of the company. Moreover, it will be too costly for SMEs to utilise. R3 also confirms that this could lead to more complexities, costs, and value drainage.[97] Further, it can be argued that the standalone pre-insolvency moratorium could become a desperate lifeboat for zombie companies.[98] Therefore, rather than introducing a more complicated and expensive procedure, the existing moratorium should be revised and regulated.[99]

5.5.4.1. Pre-packed Administrations

[92] The Insolvency Service, 'Company Insolvency Statistics, Q4 October to December 2020' (30 April 2020) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/956872/Company_Insolvency_Statistics_October_to_December_2020.pdf> accessed 6 March 2021
[93] Ellina (n 69)
[94] [2010] EWHC 893 (Ch); [2010] B.C.C. 592
[95] *Re Business Dream Ltd* (In Liquidation) [2011] EWHC 2860 (Ch); [2012] B.C.C. 115; [2013] 1 B.C.L.C. 456
[96] The Insolvency Service, 'A Review of the Corporate Insolvency Framework response: A consultation on options for reform' (25 May 2016) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/525523/A_Review_of_the_Corporate_Insolvency_Framework.pdf >accessed 14 July 2020
[97] R3 Response, "A Review of the Corporate Insolvency Framework" (July 2016)
[98] ibid (n 96)
[99] Ellina (n 69) 186.

Pre-pack administration is 'an arrangement under which the sale of all or part of the company's business or assets is negotiated with a purchaser prior to the appointment of an administrator, and the administrator effects the sale immediately on, or shortly after, appointment.'[100] This suggests that pre-pack is commonly used in the administration process. However, it can be used when liquidation is proposed.[101]

Principally, pre-pack administration is used to achieve the statutory objective of company rescue.[102] In addition, it achieves a better and quick realisation for creditors than if the company were liquidated. The underlying logic behind the use of a pre-pack is, that a continuing business is worth more to the stakeholders that one that is already facing a liquidation process.[103]

The court in *DKLL Solicitors,*[104] endorsed pre-pack as a legitimate technique, and held that, in advance of the administrator's appointment, the administrator may adopt a method that will achieve a better realisation for the creditors than an insolvent liquidation. However, there exists a guidance for pre-packs in the UK called the Statement of Insolvency Practice.[105] It sets out the basic principles and important processes to be adopted by the insolvency practitioners when considering a pre-pack administration. Furthermore, the UK Government introduced the Administration Regulations in April 2021, which prescribe mandatory rules for sales to connected parties in administration.

Importantly, pre-pack helps to realise assets to make distributions to secured or preferential creditors.[106] This thesis opines that pre-packed administration is in the best interest of the floating charge holders who have extensive security over the company's assets. However, it is

[100] Statement of Insolvency Practice (SIP 16) para 1 <https://insolvencypractitioners.org.uk/uploads/documents/f30389ce35ed923c06b2879fecdb616a.pdf> accessed 14 July 2020
[101] M. Hyde and I. White, 'Pre-pack administrations: unwrapped' (2009) 3(2) Law and Financial Markets Review 134
[102] ibid
[103] ibid
[104] [2007] EWHC 2067 (Ch)
[105] SIP 16
[106] Hyde and White (101)

unsuitable for SMEs where the pre-pack involves significant expenses and a fixed charge holder has a large claim.[107] Yet, the costs of pre-pack are not as high as other insolvency procedures. This means that SMEs who could not afford the other insolvency processes could use pre-pack since there is a quick disposition of the business assets. As such, this thesis argues that SMEs can adopt this business rescue process as it ultimately ensures a better return for stakeholders.

However, though pre-pack ensures a good return for some stakeholders of the company, it does not benefit the unsecured creditors of the company.[108] While it helps to realise better returns for secured creditors, unsecured creditors usually do not get any payments, like other procedures. This is because, since they have no secured assets which have to be released for sale, they do not have to scrutinise any prospective pre-packs and as such, might be rendered disadvantaged. To prevent such harm from being done to the unsecured creditors, the SIP imposes an obligation on the administrator to make a detailed explanation and justification of why a pre-pack was considered and all the alternatives that were considered.[109] Nonetheless, directors are liable under wrongful trading rules where they do not minimise the loss to creditors under a pre-pack.

Furthermore, although the rapid sale of business assets is a noble intention for utilising pre-pack, this motive could be deliberately abused especially by company directors. Indeed, the major controversy of the pre-pack administration is the lack of transparency of the pre-pack process.[110] It is often challenged on the ground that such companies go on to trade as phoenix companies. This occurs where the old company is sold to connected parties like the directors. Hence, there has been a persistent negative public perception about pre-packs. Although, there

[107] Ellina (n 69) 188.
[108] Hyde and White (n 101) 136
[109] SIP 16 para 10
[110] INSOL International, 'Restructuring Options for MSMEs and Proposals for Reform' (2018) <www.insol.org/_files/Special%2520Report/MSME%2520report.pdf> accessed 14 July 2020

have been some regulatory responses to this criticism. The Graham Review proposed some changes to existing pre-pack process such as 'pre-pack pool' - independent organisation that reviews connected party pre-packs.[111] In addition to that, the SIP 16 provides a requirement for administrators to make some disclosures to the creditors on steps taken in relation to the pre-packs including the identity of the purchaser and any prior relationships with the directors, shareholders or secured creditors.[112] However, the explanation is to justify the pre-pack is post-sale and as such, unsecured creditors might be precluded from objecting. Crucially, the Governent has introduced the Administration (Restrictions on Disposal etc to Connected Persons) Regulations 2021. Under these regulations, an administrator will be unable to dispose of company property to a person connected with the company within the first eight weeks of administration, without either the creditors' approval or an independent written qualifying report. This would ensure that pre-packs to connected parties are appropriate, transparent and fair, without causing undue harm or prejudice to creditors.

5.5.4.2. Light Touch Administration

As a result of the management displacement feature of the administration procedure, directors are deprived possession of their businesses. While some may decide to trade as phoenix companies, there is also a significant fear in the owners/managers of losing control of the business. Fortunately, the law provides a way out for such owners/managers.[113] SME owners may opt for a Light Touch Administration (LTA) which is a tweaked form of administration.[114] It is essentially patterned after a Debtor-In-Possession approach in the US Chapter 11 Bankruptcy Code principles. The LTA is advantageous for SMEs because the managers know

[111] T, Graham, 'Graham Review into Pre-pack Administration' (June 2014) 10 <www.gov.uk/government/publications/graham-review-into-pre-pack-administration> accessed 14 July 2020
[112] SIP 16 para 7
[113] Paragraph 64(1) of Schedule B1 of the IA 1986 that allows the Administrators to consent and transfer management powers back to officers of a company.
[114] K. Sharma, 'Covid-19 and Insolvency: The Case for 'Light-touch' Administration' (Oxford Business Law Blog, May 8, 2020) <https://www.law.ox.ac.uk/business-law-blog/blog/2020/05/covid-19-and-insolvency-case-light-touch-adminstration> accessed 1 November 2020

their businesses best. From a governance perspective, LTA retains the control of function of the company in directors. This gives room for the possibility of the company's affairs being managed efficiently to satisfy its obligations. Arguably, there is a better prospect of business rescue as the managers operate business without losing control of the business. Also, as it is an administration, the company enjoys the moratorium against creditor action.

It has also been pointed out that this Light Touch Administration is beneficial for SMEs during the pandemic as the financial distress is due to uncontrollable causes.[115] It is an alternative insolvency procedure that allows the directors to retain day-to-day management of the business while being protected from creditor action.[116] However, this suggestion is premised on the ability of the administrators to take the necessary steps to rescue the business and thereafter fully hand over to the directors after the pandemic.

Nevertheless, there are governance concerns about the use of LTA by SMEs. The rationale behind administration and the displacement of the management is failed management. Therefore, entrusting the management powers to the erstwhile directors raises some concerns. In some cases, the motivation of the directors opting for LTAs may be questionable. Hence, LTA has been described as an unreasonable choice for SMEs that entered administration because of failed management.[117] Another concern is the potential risks that the administrators encounter by giving directors management powers. The administrator may be personally liable for things that go wrong with the LTA process. Further, an important concern is the reaction of the creditors. Creditors may be understandably skeptical about giving the managers who brought the company into the administration, powers of control over the business again. This

[115] C. Shuffrey 'light touch' administration as a rescue tool during the pandemic' (15 May 2020) <https://www.newlawjournal.co.uk/docs/default-source/article_files/nlj_2020_issue7886_may_specialist-covid-19-insolvency-shuffrey.pdf> accessed 1 November 2020

[116] Insolvency Lawyers Association 'Changing the narrative around administration" 26 March 2020 <www.ilauk.com/docs/ILA.v_.1.ChangingtheNarrativeAfter260320Call_.pdf > accessed 1 November 2020

[117] Sharma (n 113)

thesis opines that the necessary conclusion is, the success of LTA depends critically on the synergy between the creditors and the company.

5.6. Standalone Moratorium

The Corporate Insolvency and Governance Act 2020 introduced a free-standing and voluntary moratorium for businesses that are in financial distress.[118] The moratorium grants such businesses a breathing space to explore rescue and restructuring options for the business as well as seek new investment. Such companies, however, must not be subject to winding-up petitions and should not be an overseas company.[119] As well, it must not be excluded under the Act and must be unable to pay its debt or show that it is unlikely to pay debt, but such business must be rescuable. Effectively, this moratorium enables SMEs who are considering financial rescue plans to continue trading without creditor action for an extended period of time. To achieve this, the creditors are prevented from presenting winding-up petitions and appointment of office-holders except on the initiation of the directors.

The moratorium, among other things, prevents the company's creditors from enforcing security (except financial collateral or collateral security charges) liabilities arising from, among other things, loans, financial leases, securitisation contracts[120], crystallisation of floating charges etc.[121] The payment holiday on pre-moratorium debts therefore potentially benefits SMEs who have single lenders as compared to large businesses with bank loans. Also, any instrument creating a charge that seeks to triggers the crystallisation of the floating charge or impose any restrictions on the disposal of any property upon the commencement of a moratorium is void.[122] Under the Act, the moratorium is for an initial duration of 20 business days but can be extended

[118] Corporate Insolvency and Governance Act 2020, s.1
[119] ibid. Chapter 2, s. A3(1). Where a winding-up petition has not been brought against an English company, the company's directors can obtain a moratorium by filing relevant documents before a court. However, where an English company which is subject to a winding-up petition (or an overseas company), it must make an application to the court.
[120] ibid A20 (3)
[121] ibid A 21 (3)
[122] ibid A 22

by the company for a further 20 business days, or with the agreement of the creditors or the order of the court or in connection with a CVA or scheme of arrangement.[123] It is worthy of note that both secured and unsecured creditors can vote for an extension of the moratorium. Companies will generally be granted payment holiday on pre-moratorium debts – debts that became due prior to the commencement of the moratorium or that which becomes due during the moratorium but is incurred under an obligation prior to the moratorium.[124] However, the company is obligated to pay the debts incurred during the moratorium.[125] Importantly, if the debts cannot be paid, the supervisor who is called the monitor is required to bring an end to the moratorium.[126]

Notably, the moratorium is a debtor-in-possession process as the directors will remain in control of the company during the moratorium. This significantly alleviates the fears of most SME owners/directors of losing control of the business and incentivises them to deploy their management skills in the business rescue and explore restructuring plans. However, they are subject to the supervision of the monitor – a licensed insolvency practitioner who is to be appointed by the court.[127] Generally, the monitor has the duty to the company to protect the interest of the creditors and to assess whether the company has the prospects of being rescued during the moratorium and other things. Also, any decision of the directors that is not in the ordinary course of business has to be sanctioned by the monitor. It could therefore be argued that the monitor exists to ensure the compliance of the directors within the moratorium conditions in achieving the aim of rescuing the business as a going concern.[128] Crucially, however, the Act is silent on the exact nature of the involvement of secured and unsecured creditors and the power of a secured creditor with a qualifying floating charge. Parry and Garza

[123] ibid
[124] ibid A18
[125] ibid A18(3)
[126] ibid A38
[127] ibid A34
[128] ibid A35

also argue that the moratorium provisions are likely to be expensive for SMEs as they have a number of conditions to satisfy before being eligible for moratorium as well as the payment of the cost of the monitor.[129]

5.7. Restructuring Plan

The Corporate Governance and Insolvency Act introduces a new rescue procedure for distressed companies.[130] Similar to a scheme of arrangement, it is a restructuring plan that is available for solvent and insolvent companies to restructure their debts. While it is not an insolvency procedure, it may be used by a company in insolvency. Unlike a scheme of arrangement,[131] the plan can only be proposed where the company is facing financial difficulty that could affect it carrying on business as a going concern and where the restructuring plan has been proposed to eliminate, reduce, prevent, or mitigate any financial difficulty.[132] To facilitate this, creditors will be divided into the similarity of their rights, each with an opportunity to vote. However, where the company proposes the plan to its creditors and members, it may bind other creditors provided that a class approves the plan and, the plan is better than the next best alternative option. The plan becomes binding on all creditors and members.[133] The principle of horizontal equity/fairness in class meetings between creditors potentially arises as governance issue.

Arguably, the restructuring plan is suitable for companies with large scale balance sheets. In smaller companies where the shareholding structure is quite small, the cross-class cram-down mechanism may not make the plan preferable for SMEs especially considering unsecured creditors. On the flipside, the cramdown is based on prescribed criteria (such as the likelihood of financial distress and ensuring that a dissenting class does not frustrate the plan). These are

[129] R. Parry and S. Gwarza, 'Is the balance of power in UK insolvencies shifting?' (2019) 7 NIBLeJ
[130] Corporate Insolvency and Governance Act 2020, Part 26A
[131] A scheme of arrangement can be used by a financially distressed company or a completely solvent company
[132] Corporate Insolvency and Governance Act, sch 901A
[133] This is known as a cross-class cram-down. See CIGA sch 901G

not necessarily arduous or unworkable in the SME context. The 'next best alternative option' requirement and the sanction of the court may however be protection for unsecured creditors. Eventually, unsecured creditors may have no other option but to accept the plan especially where the company can prove that next best alternative option is liquidation. Nevertheless, due to court involvement and its comparatively high cost, this procedure may prove to be prohibitive for an SME, which is already bearing the cost of insolvency.

5.8. Directors' Liabilities in the Zone of Insolvency

In an insolvency zone, the directors of a company, as a result of their actions or inactions may face a number of consequences such as a disqualification under the Company Directors Disqualification Act 1986 (CDDA)[134], an action for misfeasance or breach of duty[135] or an action for fraudulent[136] or wrongful trading.[137] This undoubtedly gives rise to governance issues, particular as it relates to directors' duties. A 'director' includes any person occupying the position of a director by whatever name called.[138] Therefore, this means that this broad definition will not only cover those who have been formally appointed (de jure) but will also cover those who have not been fully appointed (de facto) and shadow directors too. The codification of director's duties can be seen in the s.171-178 of the Companies Act 2006[139] (CA 06). This list ensures directors consider a number of issues when governing or acting on behalf of a company. However, it is worth noting that it is not an exhaustive list.

Fraudulent and wrongful trading can be said to be two major attempts to curb the abuse of limited liability by permitting the court to look beyond the corporate veil. They were introduced to address potential abuse of corporate legal personality. These provisions can be seen as an

[134] Company Directors Disqualification Act 1986
[135] IA 1986, s.212
[136] ibid s.213
[137] ibid s.214
[138] Companies Act 2006 s.250
[139] ibid s.171-178

important exception to the separate legal personality rule.[140] Fraudulent and wrongful trading circumvents this rule and operates to the effect that a director, who sees insolvency coming and does nothing to arrest it, should lose the benefit of the corporate form (i.e. separate legal personality) and be made personally liable for the company's debts.

While wrongful trading has been discussed in the earlier chapter of this thesis,[141] the following section proceeds with the funding implications of the wrongful trading suit in event of insolvency.

5.8.1. The Issue of Funding

The question of who bears the cost in a wrongful trading suit was confirmed by the COA in *Re Floor Fourteen ltd; Lewis v Inland Revenue Commissioner and others.*[142] It was decided that the costs for an unsuccessful litigation are not covered by the Insolvency Rules 1986 r.4.218,(now replaced by the Insolvency (England and Wales) Rules 2016) which deals with the payment of costs of the liquidation expenses.[143] This in effect means that the risk-averse nature of liquidators leads to funding problems for wrongful trading[144] actions and will reduce the amount of actions brought under s.214. Moreover, the extent as to how s.214 is effective as a statutory tool is largely linked to the issue of funding. The uncertainty of a successful outcome could be discouraging to liquidators as they will not want to risk incurring the cost of proceedings against the director. Following the decision in the *Re Ralls Builders*,[145] it is now believed to be riskier to bring the expensive wrongful trading suit. This is because the office holders would have to show a causal link between the net deficiency of the company and the

[140] D. Oesterle, "Corporate Directors' Personal Liability in 'Insolvent Trading' in Australia, 'Reckless Trading' in New Zealand and 'Wrongful Trading' in England: A Recipe for Timid Directors, Hamstrung Controlling Shareholders and Skittish Lenders" in I. M. Ramsay (ed) *Company Directors' Liability for Insolvent Trading* (Melbourne Centre for Corporate Law and Securities Regulation, 2000); see also *Salomon v A Salomon & Co Ltd* [1897] AC 22.
[141] See discussion 2.12 in chapter 2; CAMA, s. 673
[142] [2001] 2 B.C.LC. 392; [2001] 2 All E.R 499
[143] Insolvency Rules 1986 r.4.218.
[144] V, Finch and D. Milman 'Corporate Insolvency Law: perspectives and principles' (3nd Edition, Cambridge: Cambridge University Press 2018)
[145] Re Ralls Builders Lrd (in Liquidation) [2016] EWHC 1812.

acts of the company. This then means that the lenders are putting their expenses at a considerable risk. This case makes it more difficult to establish wrongful trading to the extent that it is worthwhile to bring an action; nevertheless, it is not impossible to establish wrongful trading, and the availability of a legal remedy can be viewed as a corporate governance mechanism. Arguably, the risk of defending legal action could potentially serve as a check on SMEs to ensure that they instil good corporate governance practices. However, s.118 of SBEEA inserts s.246ZD in the IA 1986 to empower office holders the ability to assign causes of action (or the proceeds). This is commendable because office holders need not to go to court and spend the company's money which may not yield any assets for the general body of creditors. Hopefully, this increases the propensity for litigation in these areas where the office holder is without resources to fund a claim. Even more interesting, s.119 inserts s.176ZB into IA 1986 to provide that the proceeds of a liquidator's, administrator's or assignee's claim are not to form part of the net property of the company and so are not available to floating change holders. This effectively means that any form of security will not catch the proceeds of the assigned action.

Further, the BIS also acknowledged this issue of funding within the current regime as it states that, office holders infrequently use their power to seek financial redress from directors, largely because funds are not available to the insolvency practitioner to bring court actions and cases are only taken forward on a conditional fee arrangement basis.[146] However, Hicks found out that the availability of the conditional fee arrangement did not result to a material increase in the number of claims brought.[147] Moreover, it could be argued that the difficulties in

[146] Department for Business Innovation & Skills, 'Transparency & Trust: Enhancing The Transparency of UK Company Ownership and Increasing Trust in UK Business' (April 2014) Government Response

[147] A. Hicks, *Disqualification of Directors: No Hiding Place for the Unfit?* (Chartered Association of Certified Accountants, Certified Accountants Educational Trust, Research Report No.59, London 1998) 95

establishing a wrongful trading claim could potentially be discouraging to solicitor firms to enter into conditional fee arrangements in this area.[148]

Additionally, there is no doctrine of adequacy of capital [149] and the case of *Re Purpoint*[150] lends proof to this. Vinelott J opined that the company in question was so undercapitalised from inception to the extent that it might have been insolvent from the moment of commencement of business.[151] Also, as earlier discussed in chapter 2, the absence of a minimum capital requirement for small companies in the UK coupled with the issue of access to finance SMEs encounter further complicates things. This problem has been potentially obviated with the introduction of minimum capital requirement in Nigeria, although the extent to which the minimum capital requirement assist creditors remains in doubt. The implication of this could possibly mean that wrongful trading liability would have been present throughout the life span of the company and presumably, would have covered the whole of the shortfall between assets and debts.[152] Presently, there is no appetite in the parliament to legislate on the adequacy of capital. Hopefully, these issues will trigger some reform.

In terms of the defence available to directors in a wrongful trading suit, both CAMA and the IA 1986 provides that, no liability would arise if the court is satisfied that the director took every step with a view to minimising the potential loss to the company's creditors as (assuming him to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation) he ought to have taken.[153]

In *Brooks v Armstrong*[154] the court looks at the defence of every reasonable step. Therefore, the courts looked at the steps they could have taken after 2007 and found out there were a

[148] D. Milman, 'Wrongful Trading Actions: Smoke Without Fire?" (1995) 8 Palmer's in Company 1-2
[149] A. Reisberg, A H. Donovan. B.G Pettet, J. P Lowry, *Company Law* (5th edn, Longman Law Series 2018); Although Public companies must have a nominal capital at or above the minimum of £50,000, see s. 763 of Companies Act 2006
[150] [1991] BCC 121
[151] ibid
[152] ibid (n 184)
[153] IA 1986 s.214(3); CAMA 2020 s.673 (3)
[154] [2016] EWHC 2289, [2016] All ER 117

number of difficulties and ordered the directors to contribute to the company's assets. Furthermore, in *Re Continental Assurance Co of London Plc*[155] The directors were not liable for wrongful trading because on the facts, they took active steps to closely monitor the financial position of the company. However, the absence of warning from directors will not relieve the directors from s.214 as in *Re Brian D Pierson (Contractors).*[156]

This thesis suggests that whilst SME owners are still trading when in distress in the hope of achieving a turnaround, directors could possibly start streamlining their business and more importantly try to get a new line of a revised innovation in terms of their credit agreement; this could possibly be a defence, vis-à-vis taking steps to reduce loss to creditors. However, in practice, where there has been misbehaviour by the directors in the run up to insolvency, it is much more likely, that directors will be brought under s.10 of the CDDA.

5.9. *Suspension of Wrongful Trading by the Corporate Insolvency and Governance Act 2020*

The Act provides for a temporary suspension of the existing wrongful trading legislation.[157] The suspension period is to run from 1 March 2020 to 30 June 2020 or, if later, one month after the Act is enacted (which period may be extended further).[158] This Act came into force through the Corporate Insolvency and Governance Act 2020 (Coronavirus) (Suspension of Liability for Wrongful Trading and Extension of the Relevant Period) Regulations 2020. The Regulations seek to extend the effective date from 26 November 2020 to 30 April 2021, which was further extended to 30 June 2021. Directors should however remain vigilant and consider their responsibilities so that they would not be liable for misfeasance.[159]

For any wrongful trading proceedings brought within the period, the court will assume that the directors are not responsible for aggravating the financial position of the company or its

[155] [2007] 2 B.C.L.C. 287
[156] [1999] B.C.C. 26
[157] CIG Act 2020, s.10 (1)
[158] ibid s.10 (2). The suspension of wrongful trading liability applied until 30 June 2021.
[159] Insolvency Act 1986, s. 212; ibid *West Mercia Safetywear*

creditors. However, such decline in the financial position must be due to the Covid-19 crisis in the relevant period for the assumption to apply. As such, creditors are restrained from bringing wrongful trading suits against directors.

The aim of the temporary suspension by the Act, therefore, is to absolve directors of companies that are impacted by the Covid-19 crisis of such personal liability. In effect, the temporary suspension of wrongful trading liability gives room for directors of distressed SMEs who have been affected by the Covid-19 pandemic to continue trading without fear of being held personally liable should insolvency occur. Indeed, during the pandemic, directors of distressed SMEs will find it difficult to decide whether to take advantage of the unused portion under the revolving credit facilities with the prospect of staying cash flow solvent. It could therefore be argued that by evaluating and making such decisions without fear of liability, the directors of the SMEs have the space to focus on reasonably rescuing the company with all the resources at disposal.

Nevertheless, the directors must still adhere to the directors' duties regime and are liable for fraudulent trading, transactions defrauding creditors, and misfeasance. Accordingly, Van Zwieten has argued in this line by placing a doubt on the meaningful impact of the suspension of the wrongful trading on the scope of director's personal liability under English Law.[160] It has been pointed out that with the temporary suspension of wrongful trading, actions cannot be brought against directors under the wrongful trading provision under S.214 but could be brought under the rule in *West Mercia Safetywear v Dodd* [161] and pursuant to s.172(3) of the CA 06 and s.212 of the IA 1986; although, if the wrongful trading is not due to a COVID-19 decline, the status quo on wrongful trading would apply. This brings to the fore the question whether the temporary suspension can be indeed effective. However, it could be argued that

[160] K. V. Zwieten, 'The Wrong Target? COVID -19 and the Wrongful Trading Rule' (Oxford Business Law Blog, 17 April 2020) <www.law.ox.ac.uk/business-law-blog/blog/2020/03/wrong-target-covid-19-and-wrongful-trading-rule> accessed 14 July 2020

[161] [1988] BCLC 250.

the economic circumstances surrounding the introduction of this suspension exposes SMEs to a higher risk of wrongful trading suits than other director's liability regimes. Thus, while S.214 compensatory order benefits the general body of unsecured creditors, an action brought under the rules in *West Mercia* – brought in the company's name – benefits the secured creditors who have taken security over the company's assets. Further, since wrongful trading provision has been suspended, it implies that an action under *West Mercia* is available for secured creditors. As such, the interests of the unsecured creditors might be inadequately protected. This therefore makes it important for SME directors to comply with existing laws and ensure observance of duties owed to the general body of creditors when considering a restructuring plan.

5.10. An evaluation of the new business rescue provisions under CAMA

It is commendable that the Nigerian corporate insolvency regime has been updated. Thus, with the introduction of administration and its automatic moratorium on the enforcement of security or the repossession of goods and premises, creditors will not be able to continue the common practice of appointing multiple receiver managers.[162]

However, it is appropriate to examine some of the problems that may arise with the introduction of the business rescue culture in the Nigerian insolvency space with a particular focus on SMEs. First, it is arguable that since the insolvency provisions in CAMA are substantially similar to that of the UK, as it is with any business rescue process, SMEs may experience the agency problem. The principal-agent relationship gives rise to moral hazard problem where the agent (the Insolvency Practitioner) may act contrary to the interests of the principal (the company).[163] For example, the decisions of the Ips (excluding administrative receivers and certain liquidators) who act as officers of the court may not be in the best interests

[162] C. Adiele, 'Developing a Corporate Insolvency Framework for Nigeria.' (2020) 9 Master of Laws Research Papers Repository 88, 94 <https://ir.lib.uwo.ca/llmp/9> accessed 10 January 2021.
[163] M. M. Pretorius, 'The Debtor-Friendly Fallacy in Business Rescue: Agency Theory Moderation and Quasi Relationships (2016) 19(4) SAJEMS NS 479, 483

of SMEs as the IPs are not in the significant direct financial risk in the event of liquidation and the courts often accept their commercial decisions.

Another potential problem is the costs of the insolvency process. The costs of a normal business rescue process typically include the fees and expenses (such as costs of realisations) of the IP. The costs have priority over the claims of all the secured and unsecured creditor that are to be paid even if the rescue attempt fails and the company ends up in liquidation.[164] This thesis, therefore, suggests that any regulation that will be set out for the costs of remunerating IPs should be designed with SMEs in mind i.e. remuneration should be based not only on experience and merit but on the size of corporate entity. Particularly, there should be a maximum cost limit for the small businesses rescue. Indeed, it will be contrary to the statutory purpose of business rescue if the insolvency costs are out of reach for small companies. Also, this thesis suggests that the relevant rescue professionals should be SME experts or be joined by an SME expert. Thus, it is essential that such business rescue professionals have special skills and experience that are suitable for SMEs. Notwithstanding this, from a governance perspective, rescue occasions a relationship between the IP and company, whereby the IP plays a crucial role in the governance of the distressed SME to ensure that it is able to meet its obligations.

Furthermore, Nigeria's corporate insolvency framework is arguably rigid – the Companies and Allied Matters Act was just recently revised after 30 years.[165] On this premise, this thesis argues that the insolvency regime should be regularly updated, and updates to insolvency legal framework should be incorporated in any new corporate regulation. With the moratorium, creditors have sufficient time and freedom to vote on the implementation of CVA. For these reasons, this thesis recommends that Nigerian law should adopt a moratorium during CVAs –

[164] ibid
[165] The former law was enacted in 1990.

although with regard to local circumstances – especially for small companies, as it reduces costs and potentially prevents them from facing a liquidation order.

Also, Adiele has warned that the duality of the role of administration may give rise to pre-packaged administrations as creditors may prefer to appoint an administrator to fulfil the second objective of selling the assets to maximize their returns instead of the first objective of rescue.[166] Moreover, with the emphasis on business rescue, there is a high chance that phoenix syndrome might arise among Nigerian small companies. There are reasons why SME owners in Nigeria may opt for trading as phoenix companies. It may happen that the cost of a formal insolvency proceeding like administration or CVA is out of the reach for SMEs. Also, because of a lack of awareness of the new rescue provisions, the management of many SMEs may not be aware of the possibilities of a formal insolvency process as well as fear the harm it may bring to their business reputation. For these reasons, SMEs may decide to set up another company and transfer the assets of the former company, to be free from pressures of the former company's creditors. This thesis, therefore, recommends that there should be regulatory frameworks in place to sanction such acts. It remains yet to be seen whether options such as pre-packs and light touch administration will be adopted by Nigerian SMEs.

Another point of concern is the nature of the Nigerian legal system.[167] The courts are important in the approval of certain actions and in the appointments of nominees or administrators. In some instances, they may be called upon to settle disputes relating to, for example, unfair prejudice under an approved CVA or any procedural irregularity in any of the proceedings. Commercial considerations dictate that these actions need to be done swiftly. However, the Act does not provide a timeline for the courts to reach certain decisions concerning the business rescue procedures. Thus, it has been argued the slow nature of judicial system means that the

[166] Adiele (n 162).
[167] ibid 94

business rescue procedures might not be concluded speedily which will in turn have the effect of reducing the assets of the debtor.[168]

5.11. Rescue finance pre and post-insolvency: where to go?

Undeniably, access to finance could determine the success of any corporate rescue plan. If insolvency occurs, particularly in SMEs, viable and honest insolvent businesses should be given an opportunity enact a rescue plan. Arguably, without rescue finance, such a business would fail, and its assets would be sold at piecemeal with the company being forced into liquidation.[169]

A major issue that distressed companies face is cash flow. If financing is important pre-insolvency, it is equally important in insolvency proceedings. In a report of the review group set up by agreement between the Chancellor of the Exchequer and the Secretary of State for Trade, it was stated that financing is critical to the rescue of businesses in the UK and that rescue funding is quite important for distressed companies.[170] It is what drives the rescue process as it particularly ensures that the debtor company meets his daily monetary needs and continue daily operation. This position is also supported by the UNICTRAL model law guide on insolvency law which maintains that additional funding is a crucial part of rescuing an insolvent company while undergoing the insolvency process.[171] Indeed, rescue funding plays a significant role in reducing the likelihood of a liquidation. Therefore, rescue finance is very important when discussing the sustainable existence of small businesses. However, extending

[168] ibid 95
[169] Department for TI Consultative Documents, 'Company Voluntary Arrangements and Administration Orders' (1993) & 'Revised Proposals for a New Company Voluntary Arrangement Procedure' (1995).
[170] Department of Trade and Industry & HM Treasury, 'A Review of Company Rescue and Business Mechanisms' (May 2000) No 133.
[171] UNCITRAL Legislative Guide on Insolvency Law (2005) <www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf> accessed 14 July 2020

capital/credit to a business in insolvency is a risky endeavour. As such, it is important that there are legal provisions that encourage lenders to advance funds for rescue. This leads to a comparison of the super-priority provisions in UK, America and Canada.

The American provision for rescue funding is statutorily provided for in the Bankruptcy code.[172] It is called super-priority financing or debtor-in-possession financing and it is available for any firm that files for Chapter 11 rescue procedures. The Bankruptcy code provides for a means of determining the priority issues and the hierarchies to ensure that super-priority payments are available to lenders in order to advance rescue finance. On the other hand, the Canadian position recognises two approaches to business funding. Originally, judges could with the exercise of their 'inherent and equitable jurisdiction' approve super-priority financing request by debtor companies.[173] The British Columbia Court of Appeal in *Re United Used Auto's Truck Parts.*[174] affirmed the decision of the provincial Supreme Court's that it had the jurisdiction to grant priority financing. Later, it was replaced by super-priority interim financing.[175]

However, in the UK, one could suggest that creditor interest is highly favoured in comparison to other jurisdictions. Moreover, it has been opined that the UK does not offer enough protection and opportunities for distressed and insolvent companies to live again.[176] Although, through the IA 1986, there are provisions for priority financing within the purview of the administration expenses.[177] However, it has been noted that the possibility as a result of the statutory provisions has not fully been explored because of the rise of pre-packs as pre-packs usually come with their funding arrangements by prospective buyers.[178] There are no express

[172] 11 U.S.C., s 364.
[173] J. Sarra, 'Debtor in Possession Financing: The Jurisdiction of Canadian Courts to Grant Super-priority Financing in CCAA Applications' (2000) 23 Dalhousie L.J 337.
[174] [2000] 5 W.W.R. 178 (B.C.C.A.)
[175] Companies' Creditors Arrangement Act, R.S.C., 1985, c. C-36, s.11.2
[176] L Hiestand & C Pilkington, 'Time for (some) Chapter 11' (2008) International Financial La Review 40.
[177] A. Aruoriwo, 'Financing Corporate Rescues, Where Does the UK Stand?' 2014 1(2) IALS Student Law Review 10, 14
[178] ibid

provisions similar to the chapter 11 super-priority financing style that could possibly encourage new and pre-existing lenders to extend credit to an already distressed company. As a result, there have been various consultations on options for reform by the government, with the most recent being in 2016. In the consultation about rescue finance, the government again looked at Chapter 11 for guidance and this formed the basis of the recommendations to introduce super-priority financing. The Insolvency service in its consultation on 'A Review of the Corporate Insolvency Framework: a consultation on options for reform' put forward two main proposals aimed at increasing the availability of rescue finance. Firstly, it asked:

> *'Do you think in principle that rescue finance providers should, in certain circumstances, be granted security in priority to existing charge holders, including those with the benefit of negative pledge clauses? Would this encourage business rescue?*[179]

Secondly, it asked

> *'How should charged property be valued to ensure protection for existing charge holders?*[180]

Those calling for reforms advocated that the proposed safeguards would be without problems. However, legal transplant is a difficult task. Particularly when one considers the differences between the US and the UK framework & market, it can easily be deduced that transplanting US provisions into UK Law will be a herculean task but, not an impossible one. Nevertheless, the government noted that majority of the respondents opined that such measures were not necessary, and it could potentially have serious negative consequences on lending to businesses

[179] The Insolvency Service, 'A Review of the Corporate Insolvency Framework- A consultation on options for reform' (May 2016) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/525523/A_Review_of_the_Corporate_Insolvency_Framework.pdf> accessed 14 July 2020

[180] ibid

if the measures were introduced.[181] As a result, the government withheld its plans to proceed with the rescue finance proposals.

Notably, the Corporate Governance and Insolvency Act introduces the statutory moratorium discussed earlier in the chapter. The super-priority status for payable debts arguably incentivises new lenders to provide funds to distressed SMEs. However, the Act still leaves much to be desired as there is no specific provision for a Chapter 11-style debtor-in-possession financing. This thesis suggests that distressed SMEs should learn and adopt the new norm by securing rescue finance through crowdfunding or debt assignments in the alternative finance market albeit, in the context of insolvency.

Factoring is attractive to distressed SMEs in the fact that the debt level of the company is not taken into consideration as what is needed by the factoring company is mainly the receivables/invoices of the business.[182] However, the likelihood of default on invoices is taken into account and may affect the cost or retention fund. Factoring ensures that finance is advanced to meet the immediate needs of the business. This thesis therefore argues that distressed SMEs can access rescue finance via factoring as it helps them to continue trading with the aim of avoiding insolvency.

However, this process will not be without its hurdles, majorly from the factoring or the financier's side, which have a bearing on the insolvency procedure. Akintola considers the factors and priority issues by analysing empirical data of 528 factoring agreements;[183] he noted that factors usually take a fixed charge over the purchased receivables, and a floating charge over other assets in addition to the master factoring assignment. Notably, factors use the

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[181] Department for Business, Energy & Industrial Strategy, 'Insolvency and Corporate Governance- Government Response' (26th August 2018 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/736163/ICG_-_Government_response_doc_-_24_Aug_clean_version__with_Minister_s_photo_and_signature__AC.pdf> accessed 14 July 2020

[182] L. G. Vasilescu, 'Factoring- financing alternatives for SMEs' (2010) Faculty of Business Administration, University of Craiova, Romania 15; see chapter 4 for a full discussion of factoring

[183] K. Akintola, 'What is left of the floating charge? An empirical outlook' (2015) Butterworths Journal of International Banking and Financial Law 404 – 406

floating charge to appoint an administrator. Arguably, this type of funding affords insolvent SMEs the opportunity to raise capital in order to be rehabilitated without taking on new liabilities, exposing themselves to the liability of wrongful trading or disqualification and disrupting the waterfall. However, it is suggested that directors should not in a bid to create active cash flow embark on unreasonable endeavours that may put the business rescue in jeopardy. For instance, in the case of *Official Receiver v. Doshi*,[184] where the company depending on invoice factoring to create an active cash flow issued false invoice orders to the factoring company. The director was held personally liable to contribute to the company's asset under the wrongful trading provision.

5.12. Conclusion

The foregoing discussion illuminates the robust UK insolvency regime, relative to that of Nigeria. Parliament was decisive in its reaction to the deemed inadequacies of the Insolvency Act 1986 by introducing the Enterprise Act 2002, which made sweeping changes to the nature of the floating charge. Parliament also introduced the Small Business Enterprise and Employment Act 2015 and Corporate Insolvency and Governance Act 2020 which made important changes to rescue procedures. Commendably, part of this approach has been replicated in Nigeria with the recent revision of the Companies and Allied Matters Act 2020. Furthermore, it is clear that the extant UK legislations and the new CAMA, are more business rescue oriented and provide a wider range of business rescue options for ailing SMEs. Nigeria must now hope that the recently enacted CAMA (which encourages the initiation of business rescue proceedings as a means of forestalling insolvent liquidation) will be eagerly utilised by businesses.[185] Furthermore, in keeping pace with the more SME-friendly UK business climate, Nigeria has recently enacted the Secured Transactions in Movable Assets Act 2017 (STMA)

[184] [2001] 2 B.C.L.C. 235 (Ch D)
[185] The Insolvency (England and Wales) Rules 2016 are also worthy of note in this respect.

to aid SMEs in accessing secured credit using movable properties; this should improve the survival prospects of SMEs.

The lesson for Nigeria is to engage in continuous dialogue with stakeholders on improvements to existing regimes, to keep up with the ever-changing distressed markets.

6. Conclusion

6.1. Introduction

The crux of this thesis evaluates selected governance issues faced by SMEs as well as prospects for reform. It also discussed the existing corporate governance frameworks in Nigeria and the UK, with a view to proposing an ideal framework for SMEs governance in Nigeria. The course of enquiry was necessitated by the fact that research into corporate governance has been heavily focused on large public companies. Furthermore, SME companies were the focal point of discussion because they constitute the bulk of business concerns in most jurisdictions – including Nigeria. To this extent, the thesis sought to fill the gap in existing literature by further contributing to corporate governance research but focusing on the often-neglected context of SMEs.

The central theme/research question was: **'To what extent are the frameworks on companies in Nigeria capable of addressing the selected governance issues typical to SMEs in contradistinction to the companies' legislation in the UK?'**

This was used to propel the fact that corporate governance as it operates in Nigeria is fraught with challenges; and that the existing corporate governance frameworks in Nigeria fail to adequately cater for SMEs. The comparative reference to the UK was made to demonstrate the existence of a comparable legal system with a nuanced approach to SME corporate governance. In particular, the UK served as a lens through which to view the apparent failings of Nigerian law; and a source from which to derive potential reforms. Reference to the UK also served as the fulcrum for the doctrinal method taken in the thesis.

The thesis unfolded with an exposition of Nigeria's corporate economic background and its influence on the corporate ownership of SMEs. It traced the transition from colonialism and foreign ownership in corporate entities, to deregulation from foreign control, government

ownership and subsequently privatisation. This context was essential in illustrating how Nigeria's economy and business climate gradually developed over time. The enquiry was also necessary to adequately understand the business environment in which SMEs currently operate. Essentially, it was noted that Nigeria's economy and business climate (as they exist today) are a function of a complex history. It was also noted that SMEs emerged due to the privatisation drive of the government. The findings of this thesis (per chapter) are highlighted in turn.

6.2. Why are SMEs important and what makes them vulnerable?

Chapter 2 of this thesis observes that the term SME has no universally recognised definition. Thus, countries have, over the years, adopted different methods of defining the term, the most prominent of which are the quantitative and the qualitative approaches.[1] The quantitative approach, however, appears to be the preferred option as it establishes a dividing line between small and medium-sized enterprises. The two countries within the discourse of this thesis (the UK and Nigeria) both adopt the quantitative approach by using turnover and number of employees in determining entities that qualify as SMEs.

The thesis recognises the important roles that SMEs play in the development of a country. SMEs are described as the drivers of an economy as they account for the bulk of global business activity, reduce unemployment, lessen poverty, provide a breeding ground for domestic entrepreneurial capabilities, contribute to a country's GDP and ultimately ensure sustainable development. In Nigeria, 96% of businesses are SMEs;[2] they are responsible for 50% of the country's total employment[3] and contribute 47.8% to the country's GDP.[4] Similarly, in the UK,

[1] See discussion at 2.2 above.
[2] P. Agu Igwe et al, 'Factors Affecting Investment Climate, SMEs Productivity and Entrepreneurship in Nigeria' (2018) 7 European Journal of Sustainable Development 182, 183 (based on extensive studies carried out by the International Finance Corporation)
[3] ibid
[4] D. Olowookere, '37m MSMEs Contribute 47.8% to Nigeria's GDP-SMEDAN' (Business Post, 20 May 2018) available at: https://businesspost.ng/2018/05/20/37m-msmes-contribute-47-8-to-nigerias-gdp-smedan/ accessed 22 December, 2018.

99.9% of businesses are SMEs,[5] and they account for 60% employment in the private sector[6] and contribute 51% to the UK's GDP.[7] Small-private companies are the point of focus in the thesis. This is because they are representative of majority of SME businesses. Furthermore, much of the discussion around corporate governance has been focused on public companies. Thus, the thesis examines corporate governance as it applies to small-private companies. However, where appropriate, reference is made to other SME business vehicles.

This thesis acknowledges the policy efforts made by the UK and the Nigerian governments in promoting SME growth. In specific terms, the UK government incorporated the "Think Small First" approach in its White Paper which formed the basis of the Companies Act 2006 in encouraging the use of SMEs.[8] The UK government also introduced the National Loan Guarantee Scheme in 2012 with a view to facilitating SMEs' easy access to facilities.[9] The Nigerian government established financial institutions like NBCI, NERFUND and NACRDB to offer microcredit to SMEs. Agencies like SMEDAN and others were also established to provide technical and financial support to SMEs. As part of its Business Incentive Strategy, the Nigerian government reduced the cost of registering business names,[10] which is another commonly used business by SMEs in Nigeria.

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[5] House of Commons Library, *Business Statistics* (Briefing Paper 06152, 2018) page 5.; Department for Business Industrial and Energy Strategy, 'Business Population Estimates for The UK and The Regions 2020' October 2020 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/923565/2020_Business_Population_Estimates_for_the_UK_and_regions_Statistical_Release.pdf> accessed 16 November 2020

[6] Market Inspector, 'Essential Facts You Should Know About SMEs in the UK' (Market Inspector, 21 May 2017) available at: https://www.market-inspector.co.uk/blog/2017/05/facts-about-small-medium-businesses-in-the-uk accessed 25 September 2018.

[7] C. Wang, E. A. Walker and J. Redmond, 'Explaining the Lack of Strategic Planning in SMEs: The Importance of Owner Motivation' (2011) 12(1) International Journal of Organisational Behaviour 1, 5.

[8] Department of Trade and Industry, *Company Law Reform* (White Paper, Cm 6456, 2005).

[9] UK Debt Management Office, 'National Loan Guarantee Scheme' available at: <https://www.dmo.gov.uk/responsibilities/guarantee-schemes/national-loan-guarantee-scheme/> accessed 7 December 2018

[10] Corporate Affairs Commission, 'Reduction of Cost of Business Names Registration by 50%' (Corporate Affairs Commission, 2 October, 2018) available at: http://new.cac.gov.ng/home/reduction-cost-business-names-registration-50/ accessed 3 January, 2019; See discussion at 2.4 in chapter 2.

Next, the thesis discusses the broad challenges faced by SMEs. It groups the challenges faced by SMEs in Nigeria into administrative, operating, strategic and exogenous challenges.[11] In view of its scope, the thesis focuses on the exogenous challenges, which include bribery and corruption and lack of access to finance. Indeed, the lack of access to capital is another major challenge for SMEs. The global economic downturn owing to the COVID-19 pandemic and the Nigerian economic recession have contributed to the undercapitalisation of Nigerian SMEs. This has led to a reduction in accessing external finance from financial institutions. Furthermore, the pervasiveness of corruption has given Nigeria a bad reputation in the comity of nations leading to reduced attractiveness of the country as a destination for investment.

The thesis briefly discusses the internal challenges associated with SMEs. Agency cost associated with the conflict between the management and the shareholders is considered a major internal challenge facing SMEs despite the fusion of ownership and management.[12] In addition, owing to poor infrastructure, there is usually an information gap between the shareholders and managers; thus, the opportunities for fraud and other nefarious activities are rife. In setting the tone for the robust discussion on the link between SMEs and corporate governance, the thesis discusses the poor corporate governance structures embedded in Nigerian companies. The thesis posits that corporate governance compliance in Nigeria is at its rudimentary stage as most corporate failures are attributed to poor management.

Based on studies independently conducted by the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) and National Bureau of Statistics (NBS), the thesis acknowledges that majority of Nigerian SMEs are not incorporated.[13] Despite the situation, SMEs are still regulated by Companies and Allied Matters Act CAMA (2020), although

[11] See discussion at 2.5 in Chapter 2
[12] See discussion at 2.6 in Chapter 2
[13] National Bureau of Statistics, 'SMEDAN and National Bureau of Statistics Collaborative Survey: Selected Findings (2013)' (June 2013) available at: <www.nigerianstat.gov.ng/download/290> accessed 9 December, 2018.

CAMA itself adopts a less stringent regime for SMEs. For example, the thesis notes that the filing of annual returns for SMEs registered as private companies is less stringent compared to the conditions prescribed for large entities. For SMEs registered as partnerships and business names, there is no requirement for filing annual returns. However, section 773(1) of CAMA requires that every "limited liability partnership shall file an annual return with the Commission within 60 days of closure of its financial year in the form and manner and accompanied by such fee as may be prescribed."[14] Without prejudice to the liberal regulatory regime adopted for SMEs, the thesis recognises that while it would be impracticable to mandate unincorporated SMEs to file annual returns, the importance of filing annual returns cannot be overemphasised as it encourages accountability.

As part of its regulation of SMEs registered as private companies, this thesis highlights the provision of CAMA which mandates all private limited liability companies to have a start-up capital of ₦100,000. This does not however apply to unincorporated SMEs. It has been argued that the failure to prescribe a minimum capital requirement for unincorporated SMEs may be detrimental to the creditors of such SMEs.[15] Due to the fact that minimum capital is equity finance and unincorporated businesses do not have equities, it may be worthwhile to prescribe a proprietor fund, business deposit or insurance as an equivalent for unincorporated SMEs, to protect creditors. On the flip side, as argued by some authors, placing a minimum capital requirement (or the equivalent for unincorporated SMEs) might be onerous and discourage the emergence of more SMEs.

As a prelude to the more detailed discussion in chapter 5, chapter 2 of the thesis suggests that the volatility of SMEs, as well as their exemption from the regulatory scrutiny applicable to larger companies, significantly raises their risk of insolvency and wrongful trading.[16] Having

[14] CAMA 2020, s. 773(1)
[15] See discussion 2.11.2 in Chapter 2
[16] See discussion 2.12 in Chapter 2

illustrated the importance of SMEs in building an economy vis-à-vis the challenges facing SMEs generally, it is recommended that all measures applicable to larger companies in forestalling corporate failure(s) be implemented for all types of SMEs. Specifically, the existing corporate governance regimes should be amended with a view to extending the scope (as far as practicable) of relevant provisions of CAMA to all types of SMEs – specifically, provisions relating to effective leadership through a competent board or leadership team and improved financial governance through annual audits and/or audit committees. This would go a long way in restoring both investors' and creditors' confidence in SMEs as a veritable tool for sustainable development. In the alternative, specific legislations could be targeted at the SME sector. Furthermore, the Nigerian government's fight against corruption appears selective and poorly implemented, as only members of the current opposition party have been indicted in recent time. The thesis therefore recommends an unselective fight against corruption in boosting the country's wider investment climate.

6.3. What are the external and internal corporate governance issues that face SMEs in Nigeria and what benefits, if any, does corporate governance hold within the context of SMEs?

The thesis recognises the importance of corporate governance in ensuring the efficient performance of SMEs in both the UK and Nigeria. As a preliminary point, Chapter 3 of the thesis undertook a historical overview of the emergence of corporate governance (as a concept) and expounded on its meaning.[17] Corporate governance came to the fore in the 1980s when several businesses collapsed due to managerial inefficiency, resulting in various takeovers. The instant global concern necessitated the establishment of the Cadbury Committee which published its report; one that became the foundational basis of the first code of corporate

[17] See discussion 3.3 in Chapter 3

governance in the UK. In adopting a working definition of corporate governance, the thesis considered the concept from different perspectives viz: the operational, relationship, stakeholders, financial and societal perspectives which are all interconnected in directing the affairs of a company. It also considered the distinction between the internal and external dimensions of corporate governance.

Further, it examined the agency theory as the basis for the bulk of corporate governance research and shed more light on the applicability of the agency theory to SME governance.[18] As a corollary, the thesis also recognised the major challenge associated with the agency theory which is the recurrent conflict between the shareholders and the managers. This inevitably gives rise to agency cost and same appears to be a setback seldomly attributed to SMEs. Hence, the use of SMEs has been touted as a panacea to agency cost.

The Nigerian Code of Corporate Governance (NCCG) 2018 and the OECD Principles applicable in Nigeria and the UK respectively iterate the significance of the Board in ensuring the success of a company. Unlike the NCCG 2018 which also applies to SMEs registered as private companies, both the Companies Act 2006 and the UK Regulations are silent on the appointment of Non-Executive Directors (NEDs) for private companies. Independent Non-Executive Directors (INEDs) are appointed in public companies in Nigeria to provide independent opinion on the Board. However, like NEDs, the Companies Act and UK Regulations do not require SMEs to appoint INEDs. The thesis therefore posits that the exclusion of NEDs and INEDs from the governance structure of UK SMEs is in recognition of the simple nature of the governance structure of SMEs and is intended to make the operation of SMEs less cumbersome and costly.

In addition, the thesis considered the question of whether corporate governance should be applicable to SMEs, particularly in the light of the fusion of ownership and management in

[18] See discussion 3.5 in Chapter 3

SMEs. This is in light of the fact that the UK Corporate Governance Code[19] only applies to public companies despite the immense contribution of SMEs to the GDP. Further, the OECD Principles although applicable to all companies in the UK, have non-binding effect. In fact, certain corporate governance principles applicable world-wide (including the holding of AGMs and the appointment of NEDs and INEDs) are currently inapplicable to SMEs in the UK. Consequently, arguments have been made in some quarters that the concept of corporate governance should not apply to SMEs since: (a) they are non-reliant on public-shareholder funds; and (b) there is a lower likelihood of agency cost associated with the conflict between the shareholders and managers since both ownership and control of SMEs are fused. However, the thesis identifies the basis for the global concern (over the applicability of corporate governance to SMEs) as the desire to enhance the smooth operation of SMEs. Many SMEs have become insolvent due to poor corporate governance controls. It is suggested, therefore, that corporate governance controls, vis-à-vis oversight mechanisms such as annual audits/audit committees, would ensure that SMEs are properly governed and guarantee their continued sustainability.

The thesis then raises the query whether corporate governance should be applicable to unincorporated SMEs (like business names and partnerships), suggesting that corporate governance (in the strict sense of the word) cannot necessarily be applied to these business vehicles. For instance, the Cadbury Report and the NCCG 2018 define corporate governance within the context of a company. Furthermore, unincorporated SMEs do not possess the organs of corporate governance such as the Board and the Members. However, certain governance safeguards might be beneficial in the context of unincorporated SMEs.

In determining whether the existing corporate frameworks in Nigeria adequately cater for SMEs, copious reference was made to the Nigerian Corporate Governance Code 2018 – the

[19] UK Corporate Governance Code 2018, see 'Application' p. 3.

most recent (and current) attempt at a unified corporate governance code applicable to SMEs in Nigeria.[20] The thesis found that the Code fails in several respects, including but not limited to its underlying philosophy ('Apply and Explain') and the attendant burden of compliance. Accordingly, the thesis proposed a new corporate governance code for SMEs, premised on six key principles and with an underlying philosophy of 'Comply or Explain'.[21]

The thesis equally identified financial reporting as a corollary to maintaining good corporate governance.[22] It was noted that in both jurisdictions, SMEs are mandated to prepare accurate accounting records as well as make periodic returns with a view to promoting accountability and circumventing insolvency. A case was made for strategic SMEs to have audit committees. The thesis further considered the impact of COVID-19 pandemic on SMEs and their corporate governance.[23] It was noted that SMEs are particularly volatile in the pandemic. However, good corporate governance practices would make an SME better placed to survive the pandemic and remain a going concern afterwards. In particular, the role of good corporate governance was highlighted in relation to providing access to government-backed interventions and schemes, as well as mitigating against losses and negative eventualities

Thus, it is recommended that the Board/management should keep shareholders adequately informed of the state of the business. The thesis also recommends that the CAC employs staff with cognate experience and expertise to boost the CAC's efficiency as an apparatus for external corporate governance control. Lastly, to ensure the efficient regulation of the internal corporate governance structure through the judiciary, the thesis recommends the appointment of specialist judges (with experience in corporate governance matters) to the Federal High Court.

[20] See discussion 3.9 in Chapter 3
[21] See discussion 3.10 in Chapter 3
[22] See discussion 3.11 in Chapter 3
[23] See discussion 3.14 in chapter 3

6.4. Why is access to finance crucial for SMEs and how does this impact on Corporate Governance?

All businesses require funding to ensure their continued existence and for rescue in case of distress. Thus, Chapter 4 of the thesis focuses on the importance of funding to SMEs and recommends that SMEs be provided with more access to funding to facilitate their contribution to national development.[24] Moreover, funding is essential for proper governance. To illustrate, a poorly funded company would be unable to invest the necessary fixed and working capital to conduct business. It would also be unable to afford to settle its financial obligations. By extension, its directors would be unable effectively manage the company or steer its affairs, especially as it relates to financial governance.

The thesis discusses the sources of financing available to SMEs and generally iterates that while larger companies rely on external sources of financing such as bank loans and asset financing, the case is not the same with SMEs. Nevertheless, the thesis explores debt and equity financing as key sources of financing.[25] Debt financing typically involves – but extends beyond – borrowing money from creditors, while equity financing involves the allotment of shares in the SME to investors. The thesis also considers the floating charge as a common security option available to SMEs, as a very high percentage of credit facilities offered by financial institutions to businesses are backed by security. Debt financing leaves ownership of the business to the owners/directors of the SME. The reverse is the case in equity financing, in that the owners will typically be required to dilute their current shareholding in the SME in exchange for finance. This thesis notes that the type of financing that SMEs opt for in their formative stage impacts their lifespan.[26] In terms of factors informing/influencing an SME's choice of financing option, the thesis suggests that debt financing should be favoured where an SME urgently requires financing. The thesis maintains this position despite the fact that SMEs have

[24] See discussion 4.2 in chapter 4
[25] See discussion 4.4 in chapter 4
[26] See discussion at 4.4.4 in chapter 4

limited access to facilities from financial institutions due to SMEs' inability to furnish the required collateral. The thesis also identifies the quantum of capital required as a key factor in determining the best form of financing to adopt. The thesis posits that where the amount is relatively low, debt financing should be the preferred option as the interest rate would also be proportionately low. However, equity financing obviates the financial burden that accompanies borrowing a substantial sum and may, subject to its limitations,[27] qualify as the better option. For instance, the thesis recommends that SMEs resort to equity financing where, in addition to financing, an SME seeks to leverage on expertise and contacts of an equity financier such as an angel investor. Lastly, the thesis argues that the type of funding which an SME resorts to ultimately depends on the willingness of the proprietors to dilute their ownership in the business. However, nothing precludes an SME from adopting a financing mix.

From a governance perspective, the thesis notes that an SME's choice of financing has a direct correlation with corporate governance. With respect to debt financing, the thesis suggests that good corporate governance practices increase the likelihood of an SME obtaining cost-effective debt financing. This is because governance indicators such as a company's gearing ratio are yardsticks to measure its creditworthiness and its likelihood of repaying the credit facility. Thus, SMEs are best placed to obtain debt financing on favourable terms when they practice good corporate governance, specifically financial governance. Further, equity financing also has a governance impact on SMEs. This is because equity investors typically require assurances as to the corporate governance structures of a company, they plan to invest in. Thus, seeking equity financing requires an SME to align its corporate governance practices with the expectations of an equity investor.

World economies are generally measured based on the ease of doing business which includes access to financing. As such, the thesis briefly discusses the wider importance of financing to

[27] Such as the restriction of private entities on public offering; the risk of dilution and the cost of equity.

a business, including (a) being a key factor of production; (b) increasing the ability to meet commercial and technological developments; (c) creation of employment; (d) increasing entrepreneurial activities amongst others. The thesis recounts the attempt made by the Nigerian government to generate financing for SMEs and considered the period commencing from 1962 to date in showing the government's acknowledgement of the importance of SMEs as major contributors to the economy.[28] The Nigerian government came up with several schemes in bridging the financial challenges faced by SMEs. However, despite the assiduous attempt made thus far by the Nigerian government, the thesis identifies factors such as corruption, greed, mismanagement as the reasons for the failure of the schemes. The thesis comparatively examines several schemes devised by the UK government to facilitate SME finance.[29] However, there appears to be an information gap regarding the existence of the schemes. The thesis therefore recommends that financial institutions be mandated to inform SMEs that approach them for loans of the existence of these alternative sources of financing.

Chapter 4 of the thesis concludes with the position that Nigerian SMEs are underperforming owing to their limited access to finance which, in turn, is due to their perceived credit risk.[30] Nevertheless, access to finance has a correlative impact on the corporate governance of SMEs; thus, its importance cannot be overstated. The thesis therefore recommends (a) establishment of a credit risk database for the purpose of determining SMEs' creditworthiness; (b) creation of awareness of alternative sources of funding; (c) establishment of credit guarantee schemes; and (d) the increased provision of financing outlets finance for SMEs.

6.5. Why is it important for distressed or insolvent SMEs to be rescued?

Chapter 5 of the thesis recognises the Insolvency Act 1986 as the primary legislation regulating the Insolvency of SMEs in the UK. It also acknowledges the modifications made by the Small

[28] See discussion 4.5 in chapter 4
[29] See discussion 4.6 in chapter 4
[30] See discussion 4.8 in chapter 4

Business, Enterprise and Employment Act 2015 and the Corporate Insolvency and Governance Act 2020 to the Insolvency Act, with a view to enhancing the business rescue-oriented approach already enshrined in the Insolvency Act. The thesis recognises that, Insolvency law in Nigeria is largely governed by the Companies and Allied Matters Act 2020 (CAMA). The thesis also examines the importance of insolvency to the company's stakeholders and the economy at large.[31]

Given that businesses offer more value as a going concern, the thesis considers the business-rescue options available to SMEs in both jurisdictions. Accordingly, the thesis discusses the administrative receivership, company voluntary arrangement and administration and their effect on the governance of distressed SMEs in both jurisdictions with focus on the status of the directors, creditors and other stakeholders.[32] In addition, this thesis examines the temporary restriction on winding-up petitions under the Corporate Insolvency and Governance Act 2020 which protects SMEs affected by the Covid-19 pandemic. Further, the statutory moratorium introduced by the Corporate Insolvency and Governance Act 2020 and the restructuring plan in Part 26A of the Companies Act 2006 were examined considering their impact on the business rescue procedures and distressed SMEs governance.[33]

Good corporate governance places SMEs on the pedestal needed to achieve the scale of business successes often associated with large companies. As a corollary to this point, the thesis analyses the fiduciary duty imposed on directors and other officers of the company or persons to refrain from holding out a distressed entity as a going concern to creditors and other stakeholders.[34]

[31] See discussion 5.4 in chapter 5
[32] See discussion 5.5 in chapter 5
[33] See discussion 5.6 and 5.7 in chapter 5
[34] See discussion 5.8 in chapter 5

Further, the thesis examines the importance of rescue finance for distressed SMEs.[35] It is recognised that the UK insolvency regime previously did not have a structured statutory framework for super-priority financing as against America and Canada. However, with the enactment of the Corporate Insolvency and Governance Act 2020, a standalone moratorium now exists in the UK. The thesis also considers the different mechanisms that are similar to a debtor-in-possession financing; it suggests that SMEs could utilise debt assignment as a means of raising rescue finance.

The UK insolvency regime exists predominantly in a single body of laws – the Insolvency Act – which applies to all types of SMEs. Conversely, the Nigerian insolvency regime can be described as "scattered" as there is no single piece of legislation specifically designated to regulate insolvency. While the insolvency provisions relating to companies, limited partnerships and limited liability partnerships are enshrined in CAMA, those relating to business names are entrenched in the Bankruptcy Act 1979. Laudably, an amendment has been made to the Nigerian insolvency laws after three decades. However, the thesis recommends that the Nigerian insolvency regime should be regularly revised and updated based on evidence from success or failure of the newly introduced rescue provisions.

On a final note, the thesis recommends that SMEs must toe the line of good corporate governance to better their chances of assessing funding and ultimately avoiding insolvency.

6.6. Concluding Thoughts

The importance of corporate governance has been the recurring point of emphasis throughout the thesis. The benefits of enshrining good corporate governance were noted to be equally applicable to SMEs. The prospect of regulating corporate governance in Nigerian SMEs was explored. Admittedly, such prospect is not without its challenges and limitations. Nevertheless, the thesis proposed the creation of a simplified corporate governance code (with six key

[35] See discussion 5.11 in chapter 5

principles) specifically applicable to SMEs. This could potentially be a step forward in ensuring an ideal corporate governance framework for SMEs in Nigeria. However, it must be acknowledged that attaining reform is not an easy task. For any proposition of reform to have meaningful impact, the wider corporate ecosystem must be aligned pre- and post-insolvency. There must be stronger enforcement of corporate governance guidelines, ease of access to finance, properly designed insolvency procedures alongside widespread education and sensitisation of SME owners and managers. This would ultimately ensure that that SME owners/managers are convinced about the benefits of enshrining good corporate governance; and in any event, the system is well equipped to ensure that SMEs comply with extant regulations and guidelines.

This thesis concludes on the note that Companies and Allied Matters Act 2020, although amended to incorporate new provisions still leaves much to be desired. Although, as earlier mentioned, new business vehicles have been introduced in the new law. The provisions have also relaxed the compliance requirement for small companies. Arguably, this will go a long way to guarantee the sustainability of businesses. However, with respect to the insolvency procedures, this thesis posits that there are concerns with the direct legal transplantation of the insolvency provisions in the United Kingdom. The reason for this assertion issue is the dearth of information on the insolvency landscape in Nigeria.[36] Nigeria lacks a dedicated governmental agency. What could possibly result from this situation is a poorly designed insolvency framework in Nigeria. It is, therefore, difficult to accurately analyse whether the new procedures will be effective in the Nigerian business climate. Nonetheless, it is recommended that the Corporate Affairs Commission should keep up with modern trends and

[36] B. Adebola, 'Conflated Arrangements: Company Voluntary Arrangements in the Proposed Nigerian Insolvency Act 2014' (2015) 3 NIBLeJ 2 1

embark on a reform of the landscape. This will ensure that the new procedures are properly measured and evaluated with respect to their applicability to SMEs.

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