The economic benefits of a public sector nano, Micro, Small and Medium Enterprise (nNMSME) grading agency: Evidence from Nigeria.

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As Africa stands on the brink of an economic revolution, we propose a vital ingredient to accelerate African economic activity by mitigating capital access and external validation gaps hindering local businesses: a public sector grading system. This system has the potential to fuel increased investments and drive growth. At its core, a public sector grading system involves government-driven assessments of enterprises within the economy. This system could bolster credibility for businesses, particularly those in the nano, micro, small, and medium enterprises (nMSMEs) sector that often lack capital access and operate in obscurity. A public sector grading system can bridge information gaps between businesses, investors, and other stakeholders, fostering an environment ripe for economic expansion. Contrary to credit ratings, which assess default probability, a grading system is a due diligence service that focuses on assessing the credibility and relative performance of nMSMEs.

Several markets have demonstrated success of public sector gradings. India, for instance, conducted independent studies that revealed improved access to finance, reduced borrowing costs, enhanced technological advancements, and heightened firm productivity due to nMSME grading. Credit Rating Analytics, Inc. further validated these results in a study conducted for the World Bank Group. Europe has also seen success with public sector grading of SMEs, with France housing the world's largest public sector credit rating agency (which is also the world’s largest SME credit rating agency, public or private); which has led to low SME loan rejection rates, favorable interest rates, and low collateral requirements for SME funding. Thus, public sector grading systems can ameliorate funding challenges and the information asymmetry associated with SMEs, thereby enhancing economic activity within this crucial sector.

Using Nigeria, Africa's largest economy, we highlight the immense potential of a public sector grading system. Nigeria hosts over 40 million nMSMEs, including the world's largest number of female-owned nMSMEs. This sector could significantly boost Nigeria's standing within emerging markets. Nigeria is well-suited to pioneer the world's largest public sector grading agency, a challenging yet achievable task, as envisioned by the Small and Medium Enterprise Development Agency of Nigeria (SMEDAN). SMEDAN is the premier SME development organization in Nigeria which reports directly to the Federal Ministry of Industry, Trade, and Investment.

Considering the economic benefits of establishing a public sector SME grading agency in Nigeria provides context for pursuing such a project. We employ a mathematical model that predicts the nMSMEs' GDP contribution following a hypothetical grading system implementation. The findings suggest the proposed agency could add $28.9 billion to Nigeria's GDP within the initial five years. This includes $14.29 billion from improved credit access, $3.65 billion from market and export opportunities, and $11.1 billion from infrastructure enhancements. These findings underscore the potential of public sector grading to address capital access and external validation gaps hindering nMSMEs.

Furthermore, a robust nMSME grading agency is important in the backdrop of the African Continental Free Trade Area (AfCFTA). Effective due diligence within the free-trade area requires comprehensive databases of export-ready firms. Thus, Nigeria's success in implementing the proposed nMSME grading agency would create a pioneering platform for inter-Africa trade, offering a substantial advantage. From a socio-economic perspective, female-owned nMSMEs stand to benefit significantly. Nigeria's abundant female entrepreneurs can leverage a value proposition tailored to their needs. Entrepreneurship empowers women, youth, and underrepresented groups to participate in the economy. However, these businesses face constraints due to structural dynamics affecting the SME space. A potential public sector grading agency could alleviate these issues, propelling economic development and positioning Nigerian businesses advantageously in both the African Continental Free Trade Area and global trade. Establishing an organization of this magnitude would not only showcase the capability of Africa's largest economy but also set an example for emerging markets prioritizing SME development. By fostering an environment conducive to growth and investment, a public sector grading system could play a pivotal role in proliferating Africa's economic transformation, with every business, big, small, or female-owned, realizing its full potential.

In conclusion, we firmly believe a public sector grading system has the potential to be a valuable tool for accelerating economic activity in Africa by addressing capital access and external validation gaps. However, its success would depend on careful planning, transparency, regulatory support, and collaboration among all relevant stakeholders.