Reinventing Nigeria's Auto Industry:

A Commercial, Legal & Regulatory Primer for Investors & Stakeholders

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g.fatokunbo@lelawlegal.com

n.ezenwa@lelawlegal.com

Introduction

In the 1970s, during the oil boom, Nigerian government (Federal and States) partnered with foreign investors mainly from France (Peugeot), America (Ford), Germany (Volkswagen, Mercedes), and Britain (Leyland) - to establish six local auto plants. During this period, vehicle assembly companies were a distinct part of Nigerian business landscape: Peugeot Automobile Nigeria Limited (PAN), Kaduna; Volkswagen of Nigeria Limited (VON), Lagos; Anambra Motor Manufacturing Limited (ANAMMCO), Emene, Enugu; Steyr Nigeria Limited, Bauchi; National Truck Manufacturing (NTM) Kano; and Leyland Nigeria Limited (LNL), Ibadan. Most of these auto assembly plants subsequently shut down or significantly downscaled operations. The question is - what made the auto policy work in the '70s and how can the foundational challenges be addressed to woo investors?

What Worked in the '70s?

In the '70s, we had sustainable rubber plantations for tyre production; the Ajaokuta Steel Company Limited (ASCL) which had 98% of its equipment erected and some functional completed unit, for steel development; also, government passed policies that supported the auto industry. For instance, the Federal Government (FG), vide a 1994 Gazette, mandated all FG agencies to source all their vehicles in-country, except where such automobiles are not available locally. This drove growth of Nigeria's auto industry. However, due to government's unstable policies (amongst several other factors), resulting in a harsh operating environment, auto assembly plant operations dwindled till they became ineffective resulting in massive vehicle importation.

FG Auto Industry Resuscitation Strategy

In a bid to revive the moribund auto industry, the FG launched the ten year (2013-2023) ***National Automotive Industry Policy Development Plan (NAIDP)*** in 2013, targeting US$5 billion investment in the sector. The NAIDP banned, from 1st January 2017, the importation of vehicles into Nigeria through land borders to encourage investment in local vehicle production and local content development. It is also expected to generate over 100,000 jobs and 10,000 units of vehicles annually, focusing on five key elements: infrastructure, market growth, standards, investment promotion and skills development. The FG also tasked the ***National Automotive Design and Development Council (NADDC)*** with ensuring NAIDP's full implementation. As at August 2017, a total of 52 local auto assemblers have been granted assembly status by NADDC. Companies like PAN, VON, and Innoson are already assembling Semi Knocked down (SKD) vehicles.

Unfortunately, the non-passage of the *NAIDP* Bill into law since its presentation to the Senate in 2013 has contributed to hamper the full realisation of government goals. One would presume that the NADDC would be in the vanguard of lobbying to ensure passage of the NAIDP Bill (by seeing to it being re-presented to the current National Assembly).

NAIDP's 'Incentive Package' to Manufacturing Companies

Government has tried to incentivise local production/assembly operations through tariff tools: imposition of prohibitive tariffs on imported fully built vehicles *cum* rebates for SKD vehicles used by local assemblies. The NAIDP increased import duties for fully built units (FBUs) passenger cars from 20% to 70% (35% duty + 35% levy) and 35% for commercial vehicles. Accordingly, the *NAIDP* states that tariff for local assemblers on: (a) Completely Knocked Down (CKD); (b) SKD I- and (c) SKD II will be 0%, 5% and 10% respectively.[1]

In addition, the FG states that: (a) new entrants in the industry would be given pioneer status (a tax holiday of up to five years, with three years initial grant and renewal for maximum two years); (b) duty

[1] CKD parts includes materials supplied loose for final welding and final assembly, or raw body shell and all other parts loose and not assembled; SKD I comprises cars/trucks that are unpainted with other components supplied as individual units for assembly; and SKD II are meant for cars/trucks that are fully painted with other components supplied as individual units for assembly.

free importation and Value Added Tax (VAT) exempt status for all machinery and equipment for tyre production; (c) all machinery and equipment imported for vehicle assembly will attract 0% import duty and also VAT exempt; and (d) long term loans to aid industrial projects would be provided by the FG through the Bank of Industry.

Responding to NAIDP: ManCos & Investor Legal Regulatory (Operational Roadmap) Issues

Investors and potential investors wanting to take advantage of the NAIDP would need to navigate the regulatory landscape and attend to relevant operational roadmap issues. First is that the investor needs to incorporate a Nigerian company (ManCo) to use as platform for the investment (or acquire requisite stake in existing entity) as foreigners can only "carry on business" in Nigeria through local companies (***section 54, Companies & Allied Matters Act, CAMA***). Entry into an existing ManCo will entail legal and commercial due diligence and possibly some restructuring (e.g. capital/ownership, board composition), in addition to negotiating and concluding requisite contractual documentation such as Subscription Agreement, Shareholders' Agreement (SHA) (or amendment thereof), etc. Obviously, ensuring that ManCo is in good compliance status and that the investor's interest is well protected would be critical.

There are many other salient issues. ***Should the investor route his/its investment through an optimal investment hub into Nigeria or should ManCo have an offshore ParentCo*** and therefore be able to (as a foreign investor) enjoy investment protection and tax benefits under Bilateral Investment Treaties (BITs) and Double Taxation Treaties (DTTs), whilst enhancing its ability to attract foreign investment into ManCo? What are the downsides of such arrangement, for example will it negatively impact ManCo for local content purposes?

What are the regulatory requirements that apply to the Project and how do investors optimize them?

This will entail reviewing relevant sectoral and general requirements and options for achieving regulatory optimality. They relate amongst others to: real estate and construction, vehicle manufacturing (industrial operations – there are both State and Federal regulators), transfer of technology/management support (if any), expatriate employment (and local certifications/professional registrations for expatriate employees), intellectual property rights (e.g. patent registration for 'original' designs, trade mark registration for vehicle brands and ManCo branding (its logo), application for incentives, foreign exchange compliance, reporting requirements (tax (FIRS/SIRS) and corporate returns (CAC), employee related compliance (insurance, pensions) etc., and implicate diverse Nigerian legislation;

What should be ManCo's governance structure?

It should enable or facilitate the attainment of its business objectives; the mechanics and instrumentality for doing business must be considered, including having a robust SHA that aligns the interests of all the parties but could 'clothe' a desired party with control. The professional adviser will leverage both his knowledge and input supplied by client (investor) to arrive at preferred arrangement and then devise ways to achieve them. ManCo's corporate principles and related materials like code of business ethics may also be referenced.

What kind of compensation arrangements should the Investor/Promoter (as an employee) have with ManCo? Will there be Founders' Shares/sweat equity; and equity ownership incentive scheme for management staff?

What should be the optimal capital structure and financing arrangements for the Project?

This would leverage input from the Business Plan - for example, *the estimated capital outlay till commencement of operations and the items they would be spent on*. The investor can then be advised on the best ways to optimize capital (timing/structuring debt and equity financing rounds). Should there be more debt than equity? Can we use long term foreign loans to enjoy withholding (WHT) exemptions on interest whilst enjoying tax deductibility on loan repayments instead of investing pure equity? If discussions on commercial terms are already ongoing with prospective investors/on commitments; how does the adviser weigh in and also shape or influence future negotiations for win-win outcomes?

How about transaction implementation support?

This will typically be required and could be in respect of the whole spectrum of ManCo's specific transactions, (most of which have been identified above), to ensure that such arrangements are optimized to achieve ManCo's business objectives and its rights are protected *vis a vis* its contractual (and other) counterparties. These include investors/lenders, suppliers/service providers, consultants, employees, distributors, etc. In this regard, advisers can provide draft template contracts for ManCo's use, as well as provide contract review and negotiation support to ManCo on an ongoing basis. Usually, transaction implementation support will always leverage structuring expertise, and can also cover regulatory work.

Registration with NIPC/Application for Tax Incentives: this would be done as part of startup compliance requirements. Counsel's role include preparing, reviewing, submitting and following up on the necessary applications until the requisite tax reliefs are granted. This will entail advising the Company of the documentation and procedural requirements in the context of applicable regulatory framework.

As external counsel and/or Company Secretaries, the lawyer or firm can help implement ManCo's preferred regulatory compliance model. Essentially as *steward of ManCo's compliance function* to ensure optimal compliance status. Also, ManCo would be notified of competitive landscape issues, industry developments (including on sectoral policy) as they occur or are anticipated; and where necessary advise on response strategies.

Regulatory Liaison & Representation: These will include but not be limited to review of presentations/documentation for regulatory submissions, review/articulation of business case, making input to resolution of regulatory issues, etc. Examples include registration of service agreements (consultancy, management, technical agreements) involving foreign service providers with ***National Office of Technology Acquisition & Promotion*** **(NOTAP)** and intellectual property rights protection with the ***Nigerian Registry of Trademarks, Patent, Design and Copyright.***

Sundry Support Services & Litigation: Other (legal regulatory) sundry tasks not specifically mentioned above, but necessary to support ManCo's operations will also come under counsel's support coverage.[2] Of note is representing ManCo in civil/commercial litigation and arbitration, albeit with focus on efficient, favourable, non-contentious outcomes.

The auto industry's peculiarity which requires intercompany arrangements from the various value chains (designs and development, manufacturing and marketing, sales and after sale services) would necessitate compliance with transfer pricing policy to avoid conflict of interest. Such can be avoided by ensuring that fees on related intercompany services are competitive. Also, proper documentation and invoicing such as the cost sharing arrangement, management and technical support agreements would be required to ensure compliance.

Investment Promotion Steps

To accelerate the *NAIDP* execution, key issues that need to be addressed are:

Access to Finance: Commercial banks offer vehicle financing (typically above 20% p.a. and the requisite down payment (typically from 25% of the vehicle price). It is trite that the absence or very low volume of affordable finance solutions reduces the number of potential vehicle buyers; thus, developing a tailored vehicle purchase schemes with lower interest rates, instalment payments, leasing arrangement and a more developed credit information system to aid market development and encouraging patronage of locally assembled vehicles.

Safety and Products Standards: *NADDC* in collaboration with *Standards Organization of Nigeria (SON)* and other stakeholders, have developed 106 vehicle safety standards that would apply to the automotive industry. *NADDC* is also building automotive component test centres where automotive products can be tested to guarantee compliance with standards. The expectation is that direct entry of international vehicle brands will improve overall product quality and standards of Nigeria's auto industry.

Introduction of National Vehicle Identification System (NVIS) to Check Smuggling: In September 19 2016, the *Nigeria Customs Service (NCS), Federal Road Safety Corps (FRSC)* and the *Federal Inland Revenue Service (FIRS)* partnered to enforce payment of duties before registration of vehicles in order to promote electronic vehicle registration and documentation accessible via the internet. In spite of this collaboration, having an effective monitoring system, to cut off corrupt activities at various *NCS* offices would go a long way in curbing smuggling activities.

Manpower Development: The *Nigerian Universities Commission (NUC)* has developed a curricula for a degree in Automotive Engineering. Abubakar Tafawa Balewa University Bauchi, Elizade University, Ilara Mokin currently offer the programme. Majority of low-skilled and mid-skilled positions in the automobile industry are filled by Nigerians while efforts are on to champion Nigerianisation of high-skilled positions in the next four to six years. Beyond offering (theoretical) curricula in engineering, a well thought out strategy that would ensure that graduates from these institutes have equal play ground to practice what they have learnt can be ingrained via exchange programmes, government grants for institution auto inventions and operations etc. as practiced in China and other industrialized nations.

Auto Industry Statistics: South Africa & Egypt

According to *Business Day (30 August 2017, p.4)* the South African automobile sector contributes about 6% to her GDP, accounting for close to 12% of manufacturing exports. In 2010, a total of 271,000 vehicles were exported and has resulted in the employment of about 300,000 people while Egypt's auto industry employs 600,000 people and attracted over $5 billion investment between 2013-2017. Implementing the *NAIDP* will improve Nigeria's export earnings.

Conclusion

Whilst the *NAIDP* is a good development, it reveals some gaps. Local assemblies in Nigeria are primarily incentivized by protective measures such as import barriers and are not equipped to compete with international automotive hubs. Dr. Oseme Oigiagbe (*The Guardian, 25/09/2017, p.41*) described the NAIDP as *"a motion without movement"* because no significant achievements have been recorded since its emergence. A recent striking *BusinessDay* headline (17/08/2017) was *'Nigeria's Bogus Auto Policy Pushes Car Prices Up 200%'* chronicling reducing access/affordability of new cars, even by corporates as a result of reducing imports owing high tariffs and inability of local assemblies to meet supply gaps. A weakened Naira is also a major contributor.

In order for the *NAIDP* to make meaningful impact, the country's power and steel sectors need to be improved as these are key sectors that serve as the industry's backbone. Another good starting point would be the revival of moribund rubber plantations in the South-South region. Also, under local content development Original Equipment Manufacturers (OEMs) require that their components be supplied at competitive cost, with the required quality and delivered on time. They also require suppliers to keep pace with the rapid technological developments in the sector. Any local content strategy must therefore enable local suppliers meet these OEMs demands.

It is no longer news that countries like China, France and UK are planning to prohibit production of diesel and petrol cars starting from 2030s, thereby encouraging electric powered vehicles. Tesla, a US based car manufacturing company, already a leader in electric vehicles, has been at the forefront in effort to mass-produce self-driving cars by 2020. To meet this deadline, Tesla has started rolling out its new enhanced autopilot hardware, (*Business Insider 2017*). With the sluggish approach to implementing the *NAIDP*, would Nigeria be able to catch up with next level of development in the auto industry? This is a gnawing question that concerted efforts by all sector stakeholders will ensure that Nigeria is not left too far behind.

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[2]Projects like those undertaken by ManCo could require preparation of a ***compliance matrix*** highlighting all the regulatory issues associated with ManCo's vehicle manufacturing business. This will consider:(a) sectoral laws and regulations relevant to ManCo's operations, and ***highlighting regulatory requirements with related comments on compliance implications (e.g. timelines, fines, penalties, etc)***; and (b) other generally applicable requirements to Nigerian companies like ManCo for example on employment, corporate governance, fiscal matters, statutory filings, etc.