



Assessment of the Contribution of the Recapitalization (innovation) of Nigerian Banks to the Growth of Nigerian Real Sector

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ABSTRACT

In Nigeria, access to finance has been identified as a key element for Small and Medium Scale Enterprises to succeed in their drive to build productive capacity, compete, create jobs and contribute to poverty elimination in the country. Banks in Nigeria have been recapitalized and adopt necessary infrastructures (ICT) to enhance their performance and stimulate the real sector as catalysts of development. *How* effectively have they performed this function as a pivot around which economic development revolves? Without finance SMEs cannot acquire or absorb new technologies neither can they expand to compete in global market or even strike business linkages with larger firms. Despite this, SMEs have faced difficulties in obtaining formal credit or equity from the commercial banks. A regression of bank facilities to SMEs prior and after recapitalization with GDP showed a downward trend and eventual positive downward correlation movement in the main two variables. It was found that banks need to do more to assist the SMEs for effective performance than mere recapitalization.

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Introduction

In Nigeria, finance has been recognized as an essential tool for promoting Small and Medium Enterprises (SMEs). The federal and state governments in Nigeria have recognized that for sustainable growth and development the financial empowerment of the SMEs is vital, being the repository of the predominantly poor in society. An important role for banks to play is to design ways of providing loans to informationally opaque small business -Berger, Klapper, and Udell (2001).[1] However, a number of factors may affect the banking system's ability to provide credit to small borrowers. There is evidence of bank consolidation across many countries of the world through mergers and acquisitions. These mega banks may be oriented towards transaction (lending and providing capital markets services) to large corporate clients and often less quantitative and qualitative relationship with small business. Recapitalization of banks in Nigeria is intended among others to help mobilize domestic savings, deepening and broadening intermediation, improve allocation of resources and helping to mobilize foreign savings.

Credit is the largest element of risk in the books of most banks and failures in the management of credit, risk, by some banks in some cases have weakened some individual banks and contributed, to many episodes of financial instability. An increasing amount of research on credit risk is being carried out within financial firms, central banks, regulators and universities. However, in most developing countries like Nigeria, manufacturing SMEs are operating in an environment with weak institutions for technical and financial supports -Oyeyinka, (2002).[2]. They face severe legal and regulatory constraints and little institutional, financial support is available for them for innovation. Hence, important technical affiliations, network capacity and ownership are crucial factors in the economic performance and innovative behavior of these industries in such an environment.

Research Problems/Purpose

Despite recapitalization of Nigeria banking industry and consequent declaration of large profit by the banks the real sector had not really felt their impact. This paper intends to analyze the accessibility of SMEs to bank loan and to ascertain whether recapitalization offers an effective means of solving the problem of funding small and medium scale businesses in Nigeria, thereby determine the relationship between bank recapitalization, bank loan disbursement to SME and their contribution to GDP.

The objectives are:-

- i. To determine the effectiveness of banks in their role as economy stimulator; and
- ii. Whether the recapitalization improves loan disbursement to economic engine rooms – the SME's

Hypothesis

The study will investigate and hypothesis whether increased Bank Capital base facilitate loan facilities to SME

Literature Review

Small businesses do not conform to any neat parameters because much of their activities depend on the industry in which they operate also the personalities and aspirations of those in charge of these businesses. These factors vary from manufacturers to retailers and high start-ups that are funded by venture capitalists to self-financed tradesmen and women for the purpose of making a living. -David.S and Nicholas, (2006) [3]. SMEs occupy a pride of place in virtually every country or state, they have aptly been referred to as the engine of growth and catalysts for socio-economic transformation of any country. SMEs represent a veritable vehicle for the achievement of national economic objectives of employment generation and poverty reduction at low investment cost as well as the development of entrepreneurial capabilities including indigenous technology. SMEs in Nigeria can be organized or unorganized enterprises. The organized enterprises have paid employees with

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a registered office while the unorganized enterprises are mainly made up of artisans who work in open spaces, or operate in temporary wooden workshop or structures, and mostly employ low rate or no salary paid workers. The major activity involved in this sector include; soap and detergents making, fabrics, textile and leather making, local blacksmith, tinsmith, ceramic, clothing and tailoring, timber and winning, bricks and cement, food processing, wood furniture, beverages, bakeries, electronic assembly, agro processing, chemical based products and mechanics (Sanni 2007) [4].

Financial systems, the world over, play fundamental roles in development and growth of the economy. Their effectiveness and efficiency in performing these roles, particularly the intermediation between the surplus and deficit units of the economy, depends largely on the level of development of the financial system. It is in order to ensure its soundness, that the financial sector appears to be the most regulated and controlled by the government and its agencies -Ogujiuba, Ohuche, Adenuga (2004)[5]. Stiglitz and Weis (1981)[6], observed that small and medium scale firms with opportunities to invest in positive net present value projects may be blocked from doing so because of adverse selection. Adverse selection problems arise when potential providers of external finance (banks) cannot readily verify whether the firms have access to quality projects. Nonetheless, the liquidity ratio of the financiers plays a major role. Through the new minimum capital requirement, the number of banks in the country has been successfully reduced, from eighty-nine to twenty-one. They are now more robust and efficient. They are, therefore, better placed now to meet the funding needs of their clients in SMEs. In the past, the financial intermediation role of the banks became heavily impaired while the macroeconomic activities seriously slowed down. It was against this background, that the Central Bank of Nigeria (CBN) announced a major reform of the Nigerian banking industry. The recapitalization of the capital base of banks constituted the first phase of the reform policy in the banking sector of the Nigerian economy. Recapitalization in Nigeria comes with amendment to the existing banking laws. In July 2004, The Governor of the CBN announced the need for banks to increase their capital base to N25 billion, and gave December 2005 as the deadline - Adegbaaju A. and Olokoyo F.(2008)[7], with a view to providing verile banking system and support for economic growth and development.

In 2001, a study identified poor access to finance as the most critical constraint on small and medium scale enterprises in Nigeria. In fact, 50 percent of the surveyed enterprises received external finance while 79 percent indicated lack of financial resources as a major constraint (see Guardian. Nov, 26, 2001) [8]. The foregoing study confirms the risk-averse behaviour of banks in funding SMEs in Nigeria. Somoye & Ilo, (2009) [9],also discussed the impact of lending on bank performance. They pointed out that the Nigerian government, through the CBN, set the lending rate for financial intermediaries at their various prevailing levels in the banking industry. To buttress their argument, they argued that the CBN set the rate to favour specific sectors in order to encourage or discourage lending to preferred sector of the economy as the case may be. i.e the environmental factors also play a vital role in banks' lending behaviour.

In recent years, banks in developed countries have launched a number of initiatives that both improve the profitability of lending to SMEs and also provide SMEs with better access to finance and to financial products that are better tailored to their

needs (Aladekomo, 2003)[10]. A number of leading banks have demonstrated that providing financial services to SMEs can be turned into a highly profitable business. Although the business environments in developing countries and developed countries differ in many respects, the problems of servicing SME customers are similar, namely high-perceived risk, problems with information asymmetry and high administrative costs. Therefore, recent innovations in developed countries to improve SMEs access to credit can provide valuable insights for developing country banks to become more SME-oriented and to increase the volume and the quality of their services to this sector. Economic growth indices in Nigeria reflect the effective production capacities of SMEs not only on how they are funded, but the practical utilization of their operational philosophy and how this is integrated towards service delivery and uplifting society. As a result, several microlending institutions were established to enhance the development of SMEs. Such micro credit institutions include the Bank of Industry (BOI), National Economic Reconstruction Fund (Nerfund), the Nigeria Agricultural and Rural Development Bank (NACRDB), the Microfinance Bank (MFB), and the Nigerian Export and Import Bank (NEXIM), and the liberalization of the banking sector. Howbeit, up till 2005 the number of banks operating in the country is about 89 with more than 50% having capital base of less than US\$10 million and about 3,300 branches. This compared to 8 banks in South Korea with about 4,500 branches or bank in South Africa with larger assets than all the 89 banks. This shows that the banking system is very marginal, relative to its potentials and in comparison with other countries. -Ogujiuba, Ohuche, Adenuga (2004)[11].SMEs, of whatever configuration, are an asset in the production of chain economy, because of their impact on issues of job creation, provision of a wide provision of goods and services, income generation and efficient sources for micro-financing.

Despite their proactive nature, growth SMEs, have been slighted, because of inadequate access to finance, production schedules and marketing. Due to the inability of SME's to raise their own finance and access financial services from formal sources (UNCTAD, 2001),[12]. The comfort is that the governments (local, state and federal) are neither relenting nor giving up in their bid to revamp and invigorate the fortunes of SMEs as to enable them play the expected role in Nigeria's economic growth and development. This is evidenced by the government's recent establishment of, as well as the, mandate given to the Bank of Industry (BOI) and the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN), the facilitation of the Bankers' Committee's institutionalization of the Small and Medium Industries Equity Investment Scheme (SMIEIS), the federal government's drive and focus on realizing the objective of NEPAD, the government's endorsement and support of multilateral agencies and loans, and the government's backing of international development finance facilities such as the European Investment Bank (EIB) facilities and the likes. This undoubtedly is a reflection of the changes in the monetary policies of Nation. Given the crucial role SMEs play in the industrial and economic growth and development of developing countries like Nigeria, the various governments in Nigeria cannot afford to relax in their efforts towards making the SME subsector very vibrant and productive-Onugu, (2005),[13] .

SMEs Experience in Accessing Financial Resources

This category of SMEs usually look to the banking sector and other financial intermediaries for instruments to finance working capital and to provide credit for short-term liquidity

management. However, they often fail to access the financial resources in the required amounts because banks evaluate them on the basis of a checklist, as listed below:

- Audited finance statement for the last three years including management accounts;
- Project proposal highlighting strengths, weaknesses, opportunities and threats
- Financial projection
- Monitoring costs;
- Credit or default risk because of the problem of information asymmetry;
- Enforcement costs.

Unfortunately, financial and accounting records are rarely in place for most of these SMEs, and where they are available, their accuracy is usually doubtful. In instances where bank financing is provided, it is in most cases in amounts that are insufficient and at a high cost in relation to the term to maturity of loans. They also apply simple and relatively backward technology in production and, therefore, the quality of their products are usually poor. There is a general lack of professionalism within this category of SMEs in terms of strategic planning procedures, decision-making processes and business planning, and management in general - Kasekende,(2001),[14].

Banks Position in Financing SMEs

Consequently, commercial banks and investors have been reluctant to service SMEs because:- (1) SMEs are regarded by creditors and investors as high-risk borrowers due to insufficient assets and low capitalization, vulnerability to market fluctuations and high mortality rates; (2) Information asymmetry arising from SMEs' lack of accounting records, inadequate financial statements or business plans makes it difficult for creditors and investors to assess the creditworthiness of potential SME proposals and (3) High administrative/transaction costs of lending or investing small amounts do not make SME financing a profitable business.

The absence of collateral or foolproof steps for its enforcement warrants special mention since it has been an important factor, inhibiting bank from lending to SMEs particularly as banks do not just rely on their borrowers' past financial statements or projected earnings as the bases for their credit decisions. As a result, commercial banks are generally biased toward large corporate borrowers, who provide better

business plans, have credit ratings, more reliable financial information, better chances of success and higher profitability for the banks. When banks do lend to SMEs, they tend to charge them a commission for assuming risk and apply tougher screening measures, which drives up costs on all sides.

Research Methodology

For the purpose of determining the relationship between Bank loan to the SMEs and its impact on the general economic development, secondary data was sourced from CBN statistical bulletin on: (i) Total Commercial Bank Loan, (ii) Loan to SMEs; and Gross Domestic Product (at current price). These are presented in Tables I & II i.e from 2000 to 2009, and the percentage composition in the pre-recapitalization era 2000-2004 was compared to post-recapitalization era (2005-2009) percentages and ratios were used for analysis and movement trend in the two period were compared.

Finding and discussion

A study of the figures in Tables I & II i.e. pre and post recapitalization periods respectively showed that though the volume of total credit and loan disbursement to SMEs improved in the post recapitalization era as expected but that was in absolute figure, when loan to SME is compared to total credit on percentages, the trend is falling. Loan disbursement to SMEs in the pre recapitalization era is better than the post consideration era. Lowest proportion was 3.62% in pre-recapitalization in year 2000 compare to lowest proportion on post recapitalization era of 0.72% in year 2009.

There was increase in GDP in the post-recapitalization era, but given the proportion of loan disbursement to SMEs within these two periods, how much of this increase in GDP could be attributable to the contribution of SMEs. (economic growth engine)? Very small! Amazingly, the GDP itself is growing but the percentage growth is falling, more so after recapitalization, which means money is not flowing to where it is needed for real economic growth.

The results confirmed the risk-averse behaviour of banks in funding SMEs in Nigeria after the recapitalization. The analysis of the access to credit market for small and medium scale businesses in Nigeria has established two important facts:

(i) macroeconomic instability and uncertainty in the business environment has forced banks to lend short to SMEs;

Ratio of Loans to SME's by commercial Banks

Table 1. Pre-recapitalization (N'm)

Period	Commercial Banks Loans to SMEs	%tage Growth or Fall	Total Commercial Banks Loans	Commercial Banks Loans to SMEs as % tage of the Total Credit	GDP Index	% tage Growth of GDP
2000	44.54	-	508.30	8.76	4582	
2001	52.43	18	796.16	6.59	4725	3
2002	82.37	57	954.63	8.63	6912	46
2003	90.18	9	1210.03	7.45	8487	23
2004	55.00	-39	1519.24	3.62	11411	34

Source: CBN Statistical Bulletin

Table II. Post- Recapitalization (N'm)

Period	Commercial Banks Loans to SMEs	%tage Growth or Fall	Total Commercial Banks Loans	Commercial Banks Loans to SMEs as % tage of the Total Credit	GDP Index	% tage Growth of GDP
2005	50.67	-7	1899.35	2.67	14572	27
2006	25.71	-49	2524.30	1.02	18566	27
2007	41.10	60	4803.49	0.85	20657	11
2008	76.56	86	27568.41	2.7	24296	18
2009	63.30	-17	35167.20	0.72	24712	2

Source: CBN Statistical Bulletin

(ii) such overdrafts and short term loans are made available at high interest rates of over 26% and they are also relatively heavily collateralised. In a situation in which SMEs are mainly dependent on bank loans, this situation could be dangerous. The implication is that many SMEs do not have access to bank loans with grave implications for their growth and general economic development.(Odedokun,1998)[15]

Despite efforts to encourage adequate fund flow to SMEs, the result has not been enthusiastic; the margin of loan to SMEs during post consolidation era is falling, i.e the economic engine house is grinding down. The growth in GDP could be concluded to be majorly a contribution of trading and services sectors and not manufacturing or real sector (SMEs) where the bank could have concentrated after such a good recapitalization outing.

The Small and Medium Enterprises Equity Investment Scheme (SMEEIS)

The Small and Medium Enterprises Equity Investment Scheme facilitated by the CBN, was initiated by the Bankers' Committee (all the banks in Nigeria) as another means to funding small and medium scale enterprises in Nigeria. The scheme requires all banks to set aside 10 percent of their profit before tax annually for equity investment in small and medium enterprises. The scheme is to promote indigenous entrepreneurship, develop local technology, generate employment, facilitate the flow of funds from banks for the establishment of new, viable SMEs, ensure output expansion, redistribute incomes and promote industrial linkages. The Scheme involves equity participation of banks in enterprises that they have appraised to be viable. The banks partner with the entrepreneurs for social and economic development.(CBN 2004)[16]

Conclusion and Policy Recommendations

Recapitalization has in no way persuaded banks to lend more to SMEs, if anything the bank are cost and risk implication conscious hence money seems to be diverted elsewhere, perhaps where they can generate returns quickly without minding the consequence on real sector growth it therefore behoves the Small and Medium Enterprises (SMEs) to improve their management systems and adopt modern management techniques if they are to benefit from the opportunities offered by the formal sector. They need to improve their financial records and accounting systems. Proper records need to be kept and maintained. The books of accounts have to be clear and should reflect a realistic picture of their operations and financial conditions. A good system and books of accounts are not only helpful to the banks; they are also crucial in managing and monitoring business as well as guiding tax authorities.

Well-functioning and sustainable mechanisms for SME financing require institution building and a market approach. Lending institutions must improve their ability to provide financial services to SMEs through commercial mechanisms that lower costs and minimize their risk exposure. Only in this way will financial institutions find SME lending to be more profitable, and thus be encouraged to construct lending programmes targeted at SMEs.(Meyer 1998)[17]

Part of the reluctance of banks to lend to SMEs is the banks' inability to properly evaluate the position of SMEs because of the lack of reliable financial information. Banks and regulator authorities at times demand more information than what is publicly made available or required. In addition financial analysts, rating agencies or business intelligence providers can generate additional information, which is available to creditors and investors, at additional cost.

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