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EFFECT OF 2004 BANKING REFORMS ON LOAN FINANCING OF SMALL AND MEDIUM SCALE INDUSTRIES IN NIGERIA

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Abstract: *The paper assesses effect of 2004 banking reforms on loan financing of the SMEs in Nigeria. A sample size of 500 was randomly chosen and Chi square test provided analysis on the survey data, and Cronbach's alpha, Split-half test and Guttman's lambda provided the analysis for testing the reliability. The paper concludes that there is no significant effect of 2004 banking reform on loan financing of SME in Nigeria. This signifies that there are some constraints which restricted access to loans from the banks for SMEs in Nigeria. The paper recommends that Central Bank of Nigeria, CBN, and Nigerian government should provide general procedures for accessing the loans so as to remove unnecessary constraints from banks*

Keywords: Loan Financing, Bank Reforms, Nigeria, SME

INTRODUCTION

From the period of industrial revolution (1750-1850) to date, small and medium scale enterprises (SMEs), all over the world, have served and remain as engine of growth and catalysts for socio-economic development in developed as well as developing countries. In many developed countries more than 90% of all enterprises are within the SMEs sub-sector, while 80% of the total industrial labour force in Japan, 50% in Germany and 46% in USA is absorbed in the sub-sector (Nwachukwu, 2012). In the African, Caribbean and Pacific countries (ACP), Fadahusi(1992) reported that SMEs also represent 90% of the enterprises.

The importance of the SME sub-sector in Nigerian economy cannot be overemphasized. SMEs play significant role in creating employment opportunities, producing import substituting machinery, mitigating rural-urban drift, producing specialized items in small quantities to meet diverse needs, mobilization of local resources as well as stimulation of technological development and innovation (Ogunleye, 2000). For instance in the area of employment generation SMEs provide 70% of the of the industrial employment and 60% of the Agricultural sector employment (Lawal and Ijaya, 2010).

Despite the significant role SMEs play in the Nigerian economy, the potentials of the sub-sector have not been fully exploited. In spite of the SMEs employment of the 70% of the Industrial labour force, the sub-sector produces only 10-15 percent of the industrial output, with a capacity utilization of slightly over 30 percent, which is a reflection of low productivity (Lawal and Ijaya, 2010). The major reason for the low performance of the SMes is the poor access to credit (Cookey, 2001, Ihembe, 2000, Ojaide, 1999 and Levy, 1993). Credit is important for the take-off and efficient performance of any enterprise, be it small or large because it requires provision of funds for its capitalization, working capital as well as creation of new investments (Nnanna, 2001). Essien(2001) also argued that adequate credit delivery to SMEs is what is required to enable the country's industrial sector meet the contemporary challenges of globalization, economic restructuring, and poverty alleviation.

In view of the limited finance (due to poor access to credit) and in recognition of the numerous advantages of the SMEs, the Federal Government has over the years, devised various measures to improve the financial standing of the SMEs (Ogunleye, 2000). These measures include direct granting of credits through government owned banks like Nigerian Industrial Development Bank and formulation of policies through the Central Bank of Nigeria(C.B.N) to make access to credit easier for the SMEs (Ango, 2011). These policies are implemented through commercial banks and this implies that reforms in the banking sector will automatically have an impact on financing of SMEs. The objective of the paper is to assess the effect of 2004 banking reform on loan financing of the SMEs in Nigeria.

LITRATURE REVIEW

Definition, Characteristics and Forms of SMEs

There is no single universally accepted definition of SMEs. The definitions change over a period of time and depend, largely on a country's level of development(Aruwa, 2009). Varying definitions among or within countries may arise mainly from differences in levels of industrial development, economic development and technology (Sule, 1986).

Prior to 1992, different institutions and agencies in Nigeria adopted different definitions of SMEs. The institutions comprise the Central Bank of Nigeria(C.B.N), Federal Ministry of Finance, National Association of Small and Medium Enterprises, Centre for Industrial Research and development, National Economic Reconstruction Fund, Nigeria Bank for Commerce and Industry(now Bank of Industry) and National Council on Industry(Aruwa, 2004). In 1992, the National Council on Industry (NCI) streamlined the definition of SMEs to bring in uniformity and provided for its review after every four years (Aruwa, 2009). The main factors used in defining or determining whether or not an enterprise is an SME are capital and number of employees (Onwumere, 2000).

For convenience and easy comprehension, this paper will adopt the Bank of Industy's definition and categorization of SMEs in Nigeria as presented by Osa-Afiana in Ango (2011). The Bank categorized SMEs in to Micro/cottage, small scale and medium scale.

- Micro/Cottage enterprises; these are enterprises with capital of not more than 1.5million Naira (orUS$11,278) including working capital but excluding cost of land and/or labour size of not more than 10 workers
- Small scale enterprises; these are enterprises with capital investment in excess of 1.5million Naira but not more than 50million Naira (US$375,939) including working capital but excluding cost of land and/or labour size of not more than 11-100 workers

- Medium scale enterprises; these are enterprises with investment worth over 50million Naira but not more than 200million Naira(US$1,503,758) including working capital but excluding cost of land and/or labour size of not more than 100-300 workers

In addition to their definition, SMEs can equally be described and identified by means of their characteristics. Onwumere in Nwachukwu(2012) identified 21 characteristics of SMEs in Nigeria as follows;

- Labour intensive production processes
- Concentration of management on the key man
- Limited access to long term funds
- High cost of funds as a result of high interest rates and bank charges
- High mortality rate especially within their first two years
- Over-dependence on imported raw materials and spare parts
- Poor inter and intra-sectional linkages-they hardly enjoy economies of scale benefits
- Poor managerial skills due to their inability to pay for skilled labour
- Poor product quality output
- Absence of research and development
- Little or no training and development for their staff
- Poor documentation of policy, strategy, financials, plans and information systems
- Low entrepreneurial skills, inadequate educational or technical background
- Lack of adequate financial record keeping
- Poor capital structure, i.e low capitalization
- Poor management of financial resources and inability to distinguish between personal and business finance
- High production costs to inadequate infrastructure and wastages
- Use of rather outdated and inefficient technology especially as it relates to processing, preservation and storage
- Lack of access to international market
- Lack of succession
- Poor access to vital information.

SMEs in Nigeria can be found in all areas of business. According to Ogundele (2007) SMEs operate in the following areas:

- Servicing; the SMEs in this category provide services like photocopying, catering, transportation etc
- Retailing; these are SMEs that involved in buying goods and services from wholesalers for onward selling to consumers
- Wholesaling; these are SMEs that involved in buying goods and services in bulk from producers for onward sale or distribution to retailers
- Manufacturing; this category of SMEs are involved in production of goods and services which are distributed by agents or wholesalers and retailers

- Agriculture; these are SMEs that are engage in production and/or distribution of all kinds of agricultural products or services

Financing of SMEs in Nigeria

SMEs in Nigeria have not made the desired impact on the economy (Nwachukwu, 2012). This may not be unconnected to the numerous challenges facing the SMEs, among which is finace. Olorunshola(2001) rightly observed that the major gap in Nigeria's industrial development process is lack of long and in some cases short term finance for the SMEs.

SMEs usually raise their finance through informal and formal sources. The informal sources comprise owners' savings/retained earnings, contributions/borrowing from friends, relations etc(Ango, 2011). In most cases finance generated from informal sources fall short of the required capital for the SMEs(Okungwu and Saleh, 2004). To raise the balance of the required finance, entrepreneurs look up to the formal sources, which comprise banks, other financial institutions, cooperative societies and government loans agencies (Ango, 2011). There are a lot of challenges for SMEs in raising finance even through the formal sources, especially as it affects banks and other financial instutions(Lawal and Ijaiye, 2010). Most of the banks are not willing to advance loans to the SMEs mainly due to the absence of the so called collateral security. SMEs are in dire need of the loans for improvement in local technology, transfer of foreign technology, domestic capital formation, provision of more employment opportunities, as well as, earn more foreign exchange than oil export earns for the country (Oboh, 2002)

Considering the significant role SMEs play in the Economic development of the Nation and the challenges they face in raising finance, the Federal Government has over the years continued to play pioneering and active roles in raising finance for the SMEs (Ayozie and Farayola, 2005). Ogunleye(2000), Tijani-Alawe in Ayozie and Farayola (2005) and Ango (2011) enumerated the roles as follows;

- Provision of direct financial assistance through government owned financial institutions. The institutions include the Nigerian Agricultural, Cooperative and Rural Development Bank, the Federal Mortgage Bank of Nigeria etc
- Provision of packages of subsidized or discounted loan portfolio through special schemes arranged between government and commercial banks. For instance the small and medium industries investment scheme(SMIESIS), established in 2001, requires banks to set aside 10% of their profit before tax for equity investment in SMEs.
- Provision of capital to SMEs through soft loans advanced by government owned financial institutions. Such institutions include the Nigerian Industrial development Bank (established, 1964), the Nigerian Bank for Commerce and Industry (established, 1973), Peoples Bank (established, 1986) and National Economic Reconstruction Fund (established, 1989). All the institutions were merged to form the Bank of Industry. Peoples Bank and some poverty alleviation agencies were merged to form the Nigerian Agricultural Cooperative and Rural Development Bank
- Funding of SMEs in liason with Multilateral Financial Institutions such as the World Bank, the African Development Bank, the International Finance Corporation(IFC) etc. for instance in the back 1989, the World Bank gave Nigeria a facility of $270million, out

of which a total of $267.7million was set aside for lending to SMEs through eligible participating banks

- Issuance of directives on mandatory credit to SMEs through the Central Bank of Nigeria (CBN) credit guidelines to commercial banks. For instance in 1992, the Federal Government through the CBN directed commercial banks to mandatorily allocate 20% of their total credits to SMEs. This scheme, Osa-Afiana(2004) argued, was only partially successful mainly due to the reluctance of the banks to advance loans to SMEs without collateral security and appropriate credit guarantee scheme. It went to the extent that some banks were more comfortable paying the penalty for default than comply with the directive, as such the regulation was eventually abolished in 1996. The type of credit commercial banks usually extend to SMEs include overdraft, commercial or short term loans, term or medium term loans, long term loans and bank guarantees. Other means of financing SMEs by commercial banks include trade credit, equipment leasing and hire purchase. The paper will examine the impact of banking reforms on financing of SMEs through the aforementioned sources that come from the banking sector.

Banking Reforms in Nigeria

The earliest banking reforms in Nigeria started in 1952 with the enactment of the Banking Ordinance of 1952. The major of objective of the reform/ Ordinance was to provide a framework for the regulation and supervision of banks. Subsequent efforts at strengthening the regulatory framework resulted in the enactment of numerous banking legislations such as the Central Bank Act of 1958, the Banking Act of 1969, Nigeria Deposit Insurance Corporation Act etc (Oni, 2007)

The banking reforms of the mid 1980s occasioned by the introduction of the Structural Adjustment Programme (SAP) saw the banking sector experiencing a serious policy shift from directly government regulated to market oriented system. The policy shift was mostly motivated by technological innovations, deregulation of financial services, international competition and globalization (I.M.F, 2001). Oni (2007) categorized market oriented banking reforms in to four phases. The first phase is the financial system reforms which led to deregulation of the banking industry as a whole, in addition to deregulation of credit, interest rate and foreign exchange. This resulted in rapid increase in number of commercial and merchants banks from 40 to 121 with a combined branch network of about 1,655 in 1986 to about 2,385 in 1992 (CBN, 1993). In 1993 the banking sector witnessed serious financial distress. In response to the situation, banking reforms entered the second phase from 1993-1998. In this phase the banking sector witnessed another round of banking regulations with a view to reversing the ugly trend of distress in the sector. The third phase which began in 1999 saw the return to liberalization of the financial sector. Following the reforms some of the bankrupt banks were liquidated. A total of 89 banks survived and had about 3,382 branches predominantly in the urban areas as at June 2004 (Soludo, 2007). Despite the re-structuring, the then CBN governor, Soludo (2007) asserted that the banking sector was characterized by structural and operational weaknesses and its performance can further be improved through a more pragmatic reform. This led to the fourth phase of the banking reforms. The major element of the reforms was the banking sector consolidation. The consolidation policy requested banks to recapitalize from a minimum capital base of 2billion Naira to 25billion Naira. At the end of the exercise the total of banks reduced from 89 to 25 and the number of bank branches increased from 3,382 in 2004 to 4,579 in 2007. The study will restrict itself to the impact of banking reforms in the fourth phase, ie consolidation period (2005 to 2012)

Banking Reforms and Financing of SMEs

The take-off and efficient performance of any enterprise, be it small, medium or large, will require finance for capitalization and working capital (Nnanna, 2001). The traditional growth theorists, in their attempt to show the importance of capital, attributed economic growth and development to capital accumulation (Duru and Kehinde, 2012). In a study covering 119 countries, Levine and Renalt (1992) discovered that there is a positive relationship between capital accumulation, investment, economic growth and development.

In developed and developing countries the banking system serves as a catalyst in allocating the economy's savings in the most productive way among competing investment outlets. Banking reforms are aimed at ensuring the soundness of the sector to mobilize domestic savings, deepen and broaden intermediation, improve allocation of resources and help mobilize foreign investments (Duru and Kehinde, 2012). Sundararajan and Balino in Duru and Kehinde (2012) identified some ways by which reforms will have impact on financial and non-financial institutions. These include:

- The relaxed freedom of entry into the financial sector and freedom to bid for funds through interest rates and new instruments, could lead to excessive risk taking
- Changes in the institutional structure of the banking system that emerge during reforms, could lead to concentration of power in banking, and interlocking ownership and lending patterns
- Excessive increases in interest rates arising from sharp increases in credit demand because of high business expectations and unsound liability structures-distress borrowing results and end result is financial crisis
- Inadequacy of instruments of monetary control or insensitivity to the need for the control of interest rates during deregulations
- Instability in the credit market during deregulation, arising from inelastic demand for credit or credit rationing
- Excessive reliance on economic rather than prudential regulations, which should focus on bank solvency and credit risk
- Mismatch of investments-deregulation of interest rates could affect financial institutions that have large exposure to long-term assets funded by short-term liabilities, which carry fixed interest rates

Apart from the informal sources of generating finance, SMEs in Nigeria depend on banks for funding. The dependence on banks makes SMEs vulnerable to all the, reforms, developments and changes in the banking system. Reform or change of any kind will make some people or institutions better off and others will be worse off. It is in this light that a study on the impact of banking reforms on financing of SMEs becomes imperative.

In Nigeria, Duru and Kehinde(2012) noted that research efforts in the area of financial sector reforms and its impact on SMEs are minimal. The few ones sighted include Duru and Kehinde (2012) on Financial Sector Reforms and the Growth of SMEs in Nigeria; Ango (2011) on the Impact of Banking Sector Reforms on Growth and Development of Entrepreneurs; Lawal and Ijaiya (2010) on SMEs Access to Commercial Banks Credit and their Contribution to GDP in Nigeria; and finally Aruwa (2009) on Assessment of Small and Medium Industries Equity Investment Scheme (SMIEIS) Implementation Guideline. The studies are unanimous in their conclusion that the negative impact of banking sector reforms on SMEs have outweigh the positive own. The reasons for this include instability in the exchange rate of the Naira, high interest rates, inflation, and ignorance of special funding schemes for SMEs by vast majority of entrepreneurs.

RESEARCH METHODLOGY

The study has a population 1500 small and medium enterprises registered 10 years ago. A sample size of 500 was randomly chosen and considered adequate because Kaiser Criterion suggested a sample size of not less than 250 for a survey study (Field, 2005). The research administered 500 copies of questionnaire and 383 copies were returned. Chi square test provided analysis on the survey data, and Cronbach's alpha, Split-half test and Guttman's lambda provided the analysis for testing the reliability.

DISCUSSION OF RESULTS

This section presented the results of analysis. The results are as follows: reliability statistics, chi-square test, and subsequently interpreted the result.

Reliability Statistics

Table 3 Reliability Statistics

		N
Cases	Valid	383
	Excluded	0
	Total	383
	Items	12
Cronbach's Alpha		.739
Split-half Coefficient		.719
Guttman Lambda		.709

The reliability statistics table above indicates that there are a total number of 383 cases of which 383 are valid and 0 are excluded. And also there are 12 items in each case. To assess the reliability of the factors, the researcher computes Cronbach's alpha, 0.739, which is coefficient of reliability and it suggests that the measures are acceptable.

Table 2: Statistical Test

Variable	Chi Square	*Df*	*Critical Chi*	Level of Sig.

Attribute				
F_1	**5.815**	4	9.488	**.318**
F_2	**3.089**	4	9.488	**.543**
F_3	**89.218**	4	9.488	**.000**
F_4	**4.903**	4	9.488	**.324**
F_5	**7.5**	4	9.488	**.091**
F_6	**3.153**	4	9.488	**.500**
F_7	**8.911**	4	9.488	**.210**
F_8	**5.581**	4	9.488	**.343**
F_9	**4.5**	4	9.488	**.380**
F_{10}	**6.315**	4	9.488	**.311**
F_{11}	**4.903**	4	9.488	**.386**
ssssssF_{12}	**6.387**	4	9.488	**.065**

From the chi square computed above for 12 factors, only one is significant at 1%. Therefore the research discovered that there is no significant effect of 2004 banking reform on the loan financing of small and medium scale industries in Nigeria. This means that, the reforms have not resulted in commercial banks granting more loans to SMEs as expected; instead, the banks further restricted credit to them mainly due to the presumed high risk associated with such credits. Though this factor has been the major cause of credit restriction to SMEs even before the reforms, it became more prominent with closer monitoring of banks by CBN on management of credit facilities after the reforms. The CBN attributed most part of the pre- reforms crisis in the banking industry to mismanagement of resources and loan portfolios of the banks.

CONCLUSION AND RECOMMENDATIONS

The major objective of the 2004 banking reforms was to re-structure and improve operational performance of banks in Nigeria. Achievement of this noble objective will enable the banks to be sound enough to grant credit and other facilities to all sectors of the economy, especially the SMEs that require all forms of financial support. From the findings of the study the 2004 banking reforms have not impacted positively on financing of SMEs. Instead of improvement in financing of SMEs, the reforms introduced measures that prompted banks to introduce more stringent conditions in granting loans to SMEs. The continuous crisis in the banking industry and the 2008 global melt down worsened the situation. The crises made banks to be more cautious in granting credit and other forms of facilities to clients, especially the SMEs that assumed to be vulnerable to all kinds of “shocks” (economic, political and social) due to their weak financial base.

As earlier stated in the study, SMEs globally, have served and remain as engine of growth and economic development. For SMEs to play their role in the Nigeria’s economic development, their sources funding need to improve, especially loans from banks. To achieve this, the following are recommended:

i. As special incentive to SMEs, the Central Bank of Nigeria (CBN) should set clear and measurable credit policies that will ensure increase and sustainability in allocation of credit to them.
ii. The CBN should formulate and implement policies that will guarantee stablility of interest and exchange rates. This will minimize fear of default by banks and improve the ability of SMEs to pay back loans
iii. The CBN should encourage commercial banks to offer variety of facilities apart from conventional loans. The facilities may include technical assistance, encouragement/support visits, supply of information on technology, staffing, production etc
iv. Since SMEs are finding it more difficult to obtain credit from conventional banks as they prefer to deal with scale enterprises, may be due to their strong asset base, government at Federal, State and Local levels, should encourage and support Microfinance banks and other relevant agencies, to assist SMEs in accessing soft loans.
v. To encourage local and foreign investment in SMEs, the Government should ensure a conducive business environment by means of providing security, infrastructural facilities like electricity, good roads, water supply etc
vi. The delay and difficulty in obtaining credit from banks by SMEs are sometime caused by corruption and bureaucratic bottlenecks. To remove these and similar other impediments, the Government should intensify efforts in fighting corruption and all forms of financial irregularities in the banking sector through its agencies like Economic and Financial Crimes Commission (EFCC), Independent Corrupt Practices and other related offences Commission (ICPC) etc.
vii. The SMEs operators themselves should imbibe the culture of self-discipline. This will prevent them from mismanagement of the little available credit facilities and motivate banks to grant more.

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