Financing the Real Sector for Sustainable Economic Growth in Nigeria: Performance, Challenges and Prospects

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I. Introduction

The role of finance in economic growth has received attention from economists and policy makers in recent time. In the literature, two opposing views however, have been expressed on the role of finance in promoting economic growth. In the writings of the pioneers of development economics, the role of finance was conspicuously dismissed, it was argued that finance does not cause growth but merely responds to changing demand from the real sector. These economists include, Meier and Seers (1984), Lucas (1988), Robinson (1952) and Miller (1988). At the other end, some economists believe that finance indeed causes growth. According to these economists, the understanding of growth will be severely limited without acknowledging the role of finance (Bagehot, 1873; Schumpeter, 1912; Gurley and Shaw, 1955; Goldsmith, 1969; and McKinnon, 1973).

Most importantly, finance performs certain roles in the process of economic growth. These include: mobilising savings (for which the outlets would otherwise be much more limited); allocating capital (notably to finance productive investment); monitoring managers (so that the funds allocated will be spent as envisaged); transforming risk (reducing it through aggregation and enabling it to be carried by those who are more willing to bear it). While a great attention has focused on mobilising savings and allocating capital, the other functions of monitoring managers and transformation of risks have been found to be more crucial in that it is through these functions that the financial sector has usually been referred to as the brain of the economy (Gerard and Patrick, 2001).

The monitoring function is deemed to be very crucial in that the modern system of business organisation that is based on separation of ownership and control was made possible by this monitoring role, which is termed delegated monitor

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(Diamond, 1984). As monitors, they do not only collect information and make loans to firms, but they also track activities of firms and exert corporate control. In this process, they enforce covenants on existing contracts; withdraw financing or even may not renew when firms err financing. This ensures that managers of firms pursue actions that are in the long-term interest of the firms.

Moreover, the financial system can mitigate risks in the process of economic activities. When a firm is provided with access to liquid capital, this could induce the entrepreneurs to taking on highly risky projects with higher returns. More so, when an investor is sure of opting out of an investment without diminishing the value of his investment at any time, this could encourage him to provide finance for projects.

Three broad areas have been identified where finance can contribute to economic growth. (i) Finance can contribute to long-term average economic growth; (ii) it can contribute to the reduction in poverty; and (iii) it can help in the stabilisation of economic activities and income. In all of these roles, incontrovertible evidence provides positive support for the role of formal financial institutions (Gerard and Patrick 2001). Evidence in support of finance on economic growth was provided by Levine, Loayza and Beck 2000). They tried to verify whether finance causes growth and vice versa. Their result did not only support the finance-growth nexus, but also established a positive correlation between financial development and long-run economic growth. Also, the growth effect of financial development was linked to the poverty reduction effect in the economy. Finally, financial development was found to reduce aggregate volatility. Easterly et al (2001) documented that doubling of private credit from 20.0 per cent of GDP to 40.0 per cent was predicted to reduce standard deviation of growth from 4.0 to 3.0 per cent.

In many developing countries, especially Nigeria, a great deal of effort has been concentrated on boosting finance for economic activities. There has been sweeping financial reforms to ensure continuous access to credits by the private sector, however, the Nigerian economy continues to be driven by factor accumulation which has led to unsustainable growth. In this paper, an attempt is made to examine how finance contributes to growth and try to uncover those challenges that have bedevilled the role of finance in the process of economic growth in Nigeria.

Following the introduction, the remaining part of this paper is divided into six sections. Section 2 provides clarification of the basic concept, while Section 3 reviews the theoretical linkages between finance and economic growth. Section 4 provides a brief review of the performance of the financial sector of the Nigerian economy, while Section 5 presents an overview of the performance of the real sector. Section 6 discusses some of the challenges and prospects of financing the real sector in Nigeria while Section 7 concludes.

II. Conceptual Framework

(i) Sustainable Economic Growth

The concept of growth in economics is used to mean an increase in output over time and measured by Gross Domestic Product (GDP). In the growth literature, the classical explanation of growth attributed increase in output to factor accumulation, especially capital. In that analysis, technology was assumed to be exogenous; hence, countries willing to pursue growth were advised to accumulate as much physical capital as possible. However, following the works of the neo-classical economists pioneered by Solow (1956), economic growth was modeled to be influenced by other factors apart from land, labour and capital. In their model, technology was not assumed to be exogenous; hence, countries willing to pursue growth were advised to invest in technology.

The World Development Report (1998), which focused on the role of knowledge in development, clearly highlighted the role of technology. The report compared growth performance of the Soviet Union between 1960 and 1980 that invested heavily in capital accumulation and training of their population with those of the four East Asian Tigers. It was found out that the Soviets generated far smaller increases in living standards during that period than the four East Asian countries. It was observed that these countries may have probably grown smarter than the Soviets during the review period.

The implication arising from neo-classical model of growth is that, growth that is driven by increasing factor inputs of land, labour and capital are subject to diminishing returns, and hence, to stimulate a long-run sustainable growth, there is a need to invest in technology, thereby limiting the emphasis on growth of factor inputs.

In this paper, therefore, sustainable growth is viewed in terms of generating growth that is not subject to diminishing returns in the medium to long-term. In the context of Nigeria, this growth would imply a production system that is based on application of science and technology leading to exports of manufactured goods and diversification of the economy away from oil, which is the chief source of revenue earnings to manufacturing and processing of commodities both for domestic consumption and exports.

(ii) Real Sector

The Nigerian economy has been classified into four major groups for statistical reporting. This classification includes; Production, General Commerce, Services and others. The production sector includes agriculture, manufacturing, mining and quarrying, real estate and construction. The general services include bills discounted, domestic trade and external trade. The services sector comprises, public utilities, transport and communications, while the fourth group classified as others comprises credit and financial institutions, governments, and miscellaneous, which include personal and professional services.

In this paper, the real sector is viewed as the productive sector of the economy comprising agriculture, manufacturing, mining and quarrying, and real estate and construction. However, the discussion will majorly be directed at the agricultural and the manufacturing sectors being the most crucial for sustainable economic growth and development in Nigeria.

III. Theoretical Review on Finance and Growth

This section is based on the work of Levine (2004). The role of a good financial system was classified under five functions in the process of stimulating resource allocation, innovation and growth. These functions include: provision of information ex-ante about investments and allocation of capital; monitoring investments and exerting corporate governance after provision of finance; facilitating trading, diversification and management of risk; mobilization and pooling of savings; and easing the exchange of goods and services.

III.1 Provision of Information and Allocation of Capital

The financial system promotes sustainable growth by providing information on firms, managers and market conditions thereby facilitating resource allocation. It was argued that financial resources (savings) will not flow from individual savers to areas in the economy in which they are mostly needed due to lack of reliable information and hence the enormous cost required for processing information about individual investors which is beyond the capability of individual savers. As a matter of fact, while many models assumed that capital will flow toward the most profitable firms in the economy, this presupposes that investors have good information about firms, managers and market conditions (Bagehot, 1873, p.53). The need to provide information about firms, managers and market to reduce information costs and improve resource allocation has led to the emergence of financial intermediaries, which specializes in the costly process of researching investment possibilities for others. In Boyd and Prescott (1986), financial intermediaries function like banks, in that they accept deposits from the public and also make loans to same. Also, another form of financial intermediary simply specializes in producing information on firms and sells the information to savers without having to mobilise savings and making the savings available to investors (Allen, 1990; Bhattacharya and Pfeiderer, 1985; Ramakrishnan and Thakor, 1984).

Financial intermediaries facilitate economic growth by strengthening the screening of entrepreneurs seeking finance for their businesses. Assuming that many entrepreneurs are seeking finance whose availability is very limited, the onus lies on the financial intermediaries to assess the viabilities of the various investment projects presented by the entrepreneurs and decide to fund the most promising projects thereby inducing an efficient allocation of capital (Greenwood and Jovanovic, 1990). Moreover, financial intermediaries can help in boosting the rate of technological innovation by identifying entrepreneurs with the best chances of successfully initiating new goods and production processes (King and Levine, 1993: Galetovic, 1996; Blackburn and Hung, 1998; Morales, 2003; Acemoglu, Aghion, and Zilibotti 2003). The function of financial intermediary is at the core of Joseph Schumpeter's (1912, p.74) view of finance in the process of economic development: *The banker, therefore, is not a so much primarily a middleman…He authorises people in the name of society…(to innovate).*

Furthermore, the stock market can also encourage the production of information about firms in the market thereby enabling a more efficient allocation of resources. It was argued that as market becomes larger and more liquid, certain categories of individuals may be motivated to invest their resources in producing information about firms in the market for the purpose of trading the information and profiting from it (Grossman and Stiglitz, 1980; Kyle, 1984; and Holmstrom and Tirole, 1993).

III.2 Monitoring Firms and Exerting Corporate Governance

The standard agency theory defines corporate governance problem in terms of how equity and debt holders influence managers to act in the best interests of the providers of the capital (e.g., Coase, 1937; Jensen and Meckling, 1976; Fama and Jesen, 1983a,b; Myers and Majlus, 1984). The strength of the efficiency of the corporate governance system in any economy is presumed to have far reaching implications on sustainable economic growth. They posited that if the shareholders and the creditors were able to provide effective monitoring and influence the managers in taking decisions that maximize firm value, resources will be seen as been well allocated by investors and hence will encourage savers to provide more and enough resources to finance production and innovation plans of the firms. It was also assumed that the absence of an effective corporate governance system could impede resources from flowing to profitable and viable investments (Stiglitz and Weiss, 1983).

Corporate governance may, however, be ineffective in monitoring and influencing the decisions of the management towards the maximisation of the firm value. For instance, small and diffuse shareholders may be handicapped at monitoring the managers because: large information asymmetries typically exist between managers and small shareholders and managers have enormous discretion over the flow of information; they frequently lack the expertise and incentives to monitor the managers due to enormous costs involved in such process; the board of directors elected to represent the shareholders may be bought over by the managers thereby relinquishing their responsibility of protecting the minority shareholders; and the legal codes in several countries does not adequately protect the rights of small shareholders while the legal system does not enforce the legal codes on the books concerning diffuse shareholder rights. All these eventually go to weaken the capacity of the small and diffuse shareholders in providing an effective monitoring on the activities of the managers with adverse consequences on resource allocation and economic growth.

Moreover, concentrated ownership, which emerged in response to the problems confronting the small and diffuse shareholders in performing an effective monitoring function on the managers, can also constitute a great hindrance to resource allocation and economic growth. One major problem identified with concentrated ownership is the issue of conflict arising between controlling shareholder and minority shareholders (Jensen and Meckling, 1976). It is argued that controlling shareholders are usually guilty of expropriation of minority shareholders. Controlling shareholders could expropriate resources from the firm, provide jobs, perquisites and generous business deals to related parties in a manner that hurts firms and society but benefits the controlling owner. Hence, it is assumed that concentrated ownership can distort corporate decisions and national policies in ways that curtail innovation, encourage rent-seeking, and hinder economic growth.

Some literature has pointed out that certain financial arrangements could help mitigate the problems of corporate governance. First, an efficient and a well-functioning stock market is viewed as providing information about the managerial performance that is reflected in the stock price of the firms. This information enables the owners to link compensation of the managers to stock prices, which help in aligning the interest of the shareholders and the managers. (Diamond and Verrecchia, 1982; and Jensen and Murphy, 1990). Furthermore, in a well-functioning stock market, the threat of takeovers by corporate raiders forces the managers to pursue policies that are in the long-term interest of the firms thus, helping in aligning the interest of shareholders with those of managers (Scharfsten, 1988; and Stein, 1988). Finally, some authors have recognised the role of debt contracts in aligning the managerial and shareholders' interests. They argued that shareholders can get the managers committed to obligatory debt payments which limit the free cash flow available to the managers (Aghion, Dewatripont, and Rey, 1999). When a manager has access to enormous free cash flow and there are no viable alternative projects to invest in, the managers can invest in projects with negative Net Present Value (NPV) to boost their managerial utility. A debt contract hence reduces the free cash flow, managerial slack and accelerates the rate at which managers adopt new technologies.

A good financial system, through its intermediaries, can improve the functioning of the corporate governance system. First, financial intermediary can perform the role of a delegated monitor whereby the intermediary mobilises savings of many individuals and makes them available to firms. This process, thus, economises on monitoring costs and eliminates free rider problem (Diamond, 1984). Second, information costs about firms could greatly be reduced, arising from long-run close relationship between financial intermediaries and firms. Furthermore, an efficient financial system could influence growth by boosting corporate governance. The reduction in costs brought about by the intermediaries is viewed to aid effective credit rationing thereby, boosting productivity, capital accumulation and growth (Bencivenga and Smith, 1993).

Furthermore, financial intermediaries are believed to boost innovative activities by undertaking the particularly costly process of monitoring innovative activities, which improves credit allocation among competing technology producers, with positive spillovers on economic growth (De La Fuente and Marin (1996). More so, differences in quality of financial intermediation across countries of the world are viewed as having a great influence on international capital flows (Boyd and Prescott, 1986). Capital is viewed to be mobile and can move from a capital-deficit economy to a capital-abundant economy if the financial intermediary in the capital surplus economy possesses superior capability in fostering efficient corporate governance.

III.3 Risk Amelioration

The existence of information and transactions costs may give rise to financial contracts, markets and intermediaries that facilitate trading, hedging, and pooling of risks, which consequently influence resource allocation and economic growth. Three types of risks have been identified: cross sectional risk diversification, inter-temporal risk sharing and liquidity risk.

Cross sectional risk diversification can be facilitated by banks, mutual funds and security markets by providing a diversified portfolio of risky investments. High-return projects are generally riskier than low-return projects, hence, savers or investors who are generally risk averse will prefer to invest in low-return, low risk projects. Hence, financial markets that make it easier for people to diversify risk tend to induce a portfolio shift towards projects with higher expected returns (Gurley and Shaw, 1955: Patrick, 1966: Greenwood and Jovanovic, 1990; Saint-Paul 1992; Devereux and Smith, 1994; and Obstfeld, 1994). Also, a good and efficient financial system, which enables people to hold a diversified portfolio of risky projects, will foster growth. Without this, agents would avoid high-return and risky projects with the attendant repercussions on growth (Acemoglu and Zilibotti, 1997).

Financial systems also function to ameliorate risks by spreading risks, especially those arising from macroeconomic shocks across generations. This theory focuses on the advantages of intermediaries in easing inter-temporal risk smoothening (Allen and Gale, 1997). Long-lived intermediaries emerge with long-term investment projects thereby facilitating risk sharing across generations. The intermediaries are said to offer high returns in periods of economic downturn and offering low returns in periods of economic boom.

The third type of risk—liquidity—arises as a result of uncertainties associated with converting financial assets into cash or medium of exchange. For the purpose of economic growth, certain long-term projects, which require continuous capital commitment, are required in the economy. Given that investors or savers are not willing to relinquish control of their savings for such long periods of time, the financial system thus, evolves a system through which the continuous capital commitments required by long-term projects is reconciled with the objective of savers who may not be willing to part with their savings for long period of time. Beneivenga, Smith and Starr (1995) explained that high-return, long gestation production technologies require that ownership be transferred throughout the life of the production process in secondary security markets. However, a costly exchange system will make long-run production technologies less attractive, which affects production decisions. Greater liquidity is hence believed to induce a shift to longer-gestation and higher return technologies.

Furthermore, the ability of the financial system to provide funds to ease adjustment costs of financing long-run growth-enhancing projects would lead to sustained economic growth. Aghion *et al,* (2004) provided a model in which firms can either invest in short-term, low return investments or in more risky, growth-enhancing research and development. They also assume that there is an adjustment costs involved in financing innovative projects, especially in periods of macroeconomic shocks. It is believed that under-developed financial systems that are less able to provide firms with funds to ease these adjustments will hinder innovation. Also, macroeconomic volatility exerts negative impact on innovation and growth in underdeveloped financial system because firms' willingness to undertake research and development depends on their ability to borrow in the future to meet adjustment costs, which is influenced negatively by the likelihood of experiencing a recession and positively by the level of financial development.

III.4 Pooling of Savings

The processes of mobilising savings involve overcoming two important costs: transaction costs associated with collecting information from various individuals; and information costs bothering on the integrity of the financial institution collecting the funds. In an attempt to mitigate the effect of these costs, two major financial arrangements are usually put in place. These include multiple bilateral contract between productive units raising capital and agents with surplus resources as well as financial intermediaries that pool the resources from several savers and invest the savings in several companies (Sirri and Tufano 1995). Pooling of savings is said to help economic growth and development in the following ways: increasing the level of savings in the economy; exploiting economies of scale; overcoming investment indivisibilities; improvement in resource allocation; and boosting technological innovation.

Without access to multiple investors, many production processes would operate at a sub-optimal scale of production (Sirri and Tufano, 1995). Furthermore, there are several investment projects whose capital requirements are beyond the capabilities of single individuals (Bagehot, 1873). More so, financial intermediaries create financial instruments in small denominations, which enable households to hold diversified portfolio of assets (Sirri and Tufano, 1995). Acemoglu and Zilibotti (1997) showed that with large, indivisible projects, financial arrangements that mobilise savings from diverse individuals and invest in a diversified portfolio of risky projects facilitate a reallocation of investment toward higher return activities with positive ramifications on economic growth.

III.5 Easing Exchange

Financial arrangements that lower transaction costs can promote specialisation, technological innovation and growth. Greenwood and Smith (1996) explained that more specialisation in the economy gave rise to more transactions that would lead to increase in costs, financial innovation which lowers the costs of transactions and eventually promote productivity gains.

IV. Overview of the Nigeria Financial System

The Nigeria financial system consists of the regulatory agencies such as the Central Bank of Nigeria (CBN) and Nigerian Deposit Insurance Corporation (NDIC) for the banking sector, while the Security and Exchange Commission (SEC) and the Nigerian Stock Exchange (NSE) oversee the capital market.

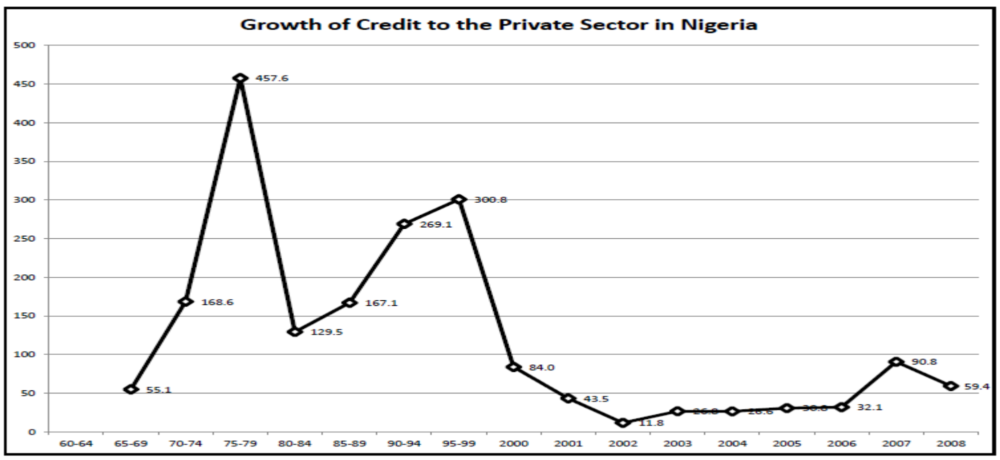
IV.1 The Banking System

The banking system consists of institutions that deal in short-to-medium-term loans and advances, which includes the commercial banks and the specialised development banks. The Nigeria banking industry, all through the 1970s and better part of 1980s was dominated mainly by three big banks — the First bank, the Union Bank and the United Bank for Africa (UBA). This situation persisted until the liberalisation of the financial system in 1986, which opened up the sector for more participants. After deregulation, the number of banks increased to over 100, however, most of these banks were characterised by weak capitalisation and management. In July 2004, government came up with a new plan to strengthen the banking industry. The capital base was increased to ₦25 billion and banks were encouraged to consolidate their assets through mergers and acquisitions. The aftermath of this exercise left the Nigerian economy with 25 banks, compared with 89 banks in 2003. The assets of Nigeria's deposit money banks represent about 90.0 per cent of the total assets of Nigerian financial system and also accounted for about 70.0 per cent of the total credit extended to the private sector (King, 2003).

Apart from deposit money banks, there were some other institutions that function as non-bank financial intermediaries in the banking industry. These included finance companies, mortgage finance institutions and development financial institutions. The finance companies have shown very little signs of growth in Nigeria and have not achieved any significant impact on the economy. The development finance institutions (DFIs) have been the major channel for government's financing of the real sector in Nigeria. These institutions include: the Nigeria Agricultural, Cooperative and Rural Development Bank (NACRDB) now Bank of Agriculture; the Nigerian Industrial Development Bank (NIDB), the Nigerian Bank for Commerce and Industry (NBCI) now merged to become the Bank of Industry (BOI), are part of the DFIs. The development banks did not really have a good history of development in Nigeria. They are characterised by weak management, excessive operating costs, politicised lending and enormous loan losses (King, 2003). As at the end of the 1990s, more banks had become technically insolvent because their asset-base had totally or partially been eroded.

The financing of the real sector in Nigeria by the banking system can be much appreciated by examining the growth trend of banking system credit to the private sector. This is presented in Figure 1. The values were presented as averages from 1960 to 1999, and presented as actual growth from 2000 to 2008.

Figure 1: Growth of Credit to the Private Sector in Nigeria (Per cent).



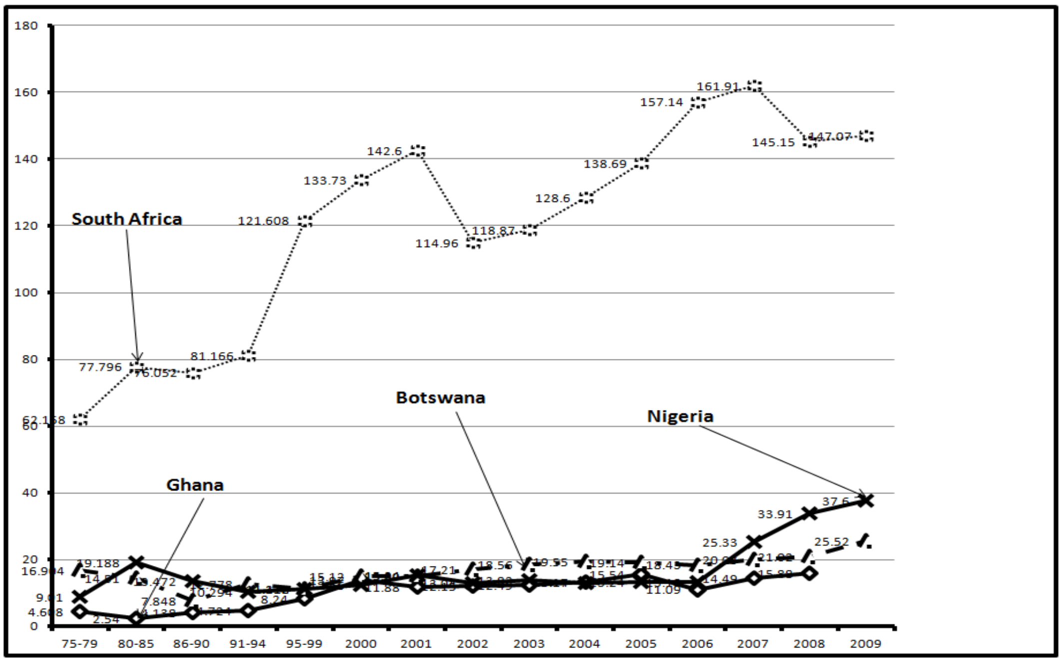
Source: CBN Statistical Bulletin 50 years Special Anniversary Edition.

From Figure 1, it can be gleaned that credit to the private sector grew very significantly between 1965 and 1979 before falling significantly in the late 70's and early 80's. However, credit to the sector eased from 1984 to 1999. Incidentally, the period of a fall in growth coincided with the period of civil rule, while the period of credit growth corresponded with the period of military intervention. The period of credit growth to the private sector reached the peak from 1995 to 1999. Nonetheless, from 1999 to date when government returned to civil rule, credit to the private sector growth has been very sluggish except in 2007. This indicated a downward trend in the growth of credit to private sector making it less attractive for bank financing.

Financial Deepening in Selected African Countries

The trend of percentage of finance to the real GDP in Nigeria and some selected African countries is presented in Figure 2. The figure shows that Nigeria's financial deepening never exceeded 20 per cent of the GDP until around 2006 when it began to experience an increasing trend.

Figure 2: Financial Deepening of Selected African Countries (Per cent)



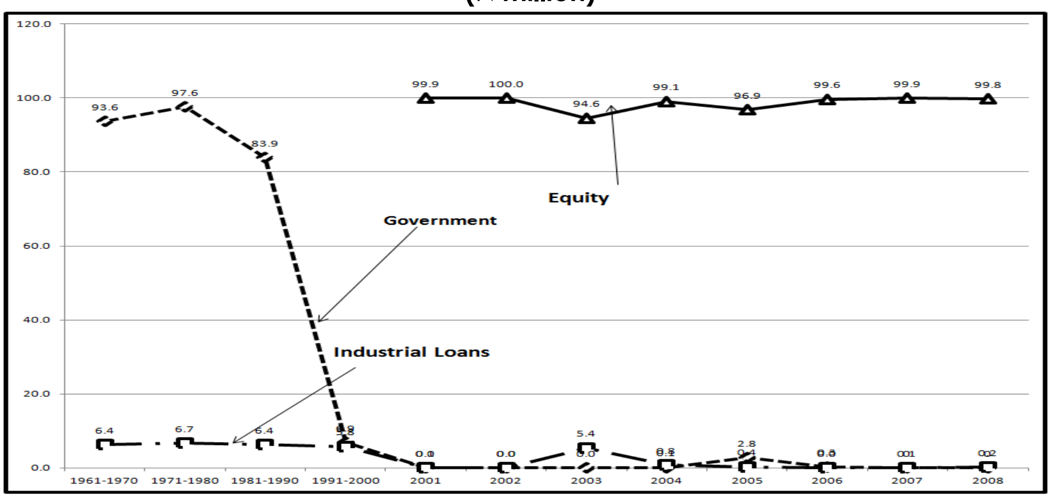
Source: CBN Statistical Bulletin 50 years Special Anniversary Edition and World Bank Staff estimates from the Comtrade database maintained by the United Nations Statistics Division.

When compared the performance of Nigeria with other countries in the continent, Botswana was found to perform better until 2006 when Nigeria experienced some level of growth. However, Botswana's performance has been on the increasing trend although not up to 20.0 per cent till the middle of 2006 and 2009. The highest growth recorded for Botswana was 25.52 per cent. Ghana's performance has also been increasing steadily although not at the same pace with Nigeria. The story became different when Nigeria's performance was compared with that of South Africa. The impression emanating from the figure shows that it will take a longer time for Nigeria to reach the starting point of South Africa in 1970-1975, which is put at 62.1 per cent. South Africa has continually witnessed an increasing growth in financial deepening, which in 2007 reached a performance level of 161.91 per cent of GDP before moderating to 145.5 per cent in 2008. Indeed, Nigeria will need to learn a great lesson from South Africa to boost its financing of economic activities.

IV.2 The Nigerian Capital Market

The capital market comprises the Securities and Exchange Commission (SEC) and the Nigerian Stock Exchange (NSE). It is a market for long-term funds whose performance could have a bearing on the performance of the real sector of the economy. Figure 3 provides a picture of the transactions in the market between 1961 and 2008.

Figure 3: Transactions in the Nigerian Stock Exchange between 1960-2008 (₦'million)



Source: CBN Statistical Bulletin 50 years Special Anniversary Edition.

The figure clearly shows that between 1961 and 1990, government stocks were the most actively traded in the market before nose-diving to less than 10 per cent of total stock traded in 2001. The proportion of industrial loans traded has been very insignificant all through the review period. It averaged about 6.0 per cent from 1961 to 2009, but fell significantly to zero per cent in 2001 and 2002. It recorded the highest of 5.4 per cent in 2003. The equity sector was the most actively traded shares in the market.

V. Performance Appraisal of the Real Sector of the Nigerian Economy

The structure of the Nigerian economy can be classified into four categories. These include the production sector, general commerce, services and others. The production sector, which is also referred to as the real sector, comprises agriculture, manufacturing, mining/quarrying and real estate/construction. General commerce comprises bills discounted, domestic trade, exports and imports. The services sector includes public utilities, transport and communications. The final category comprises credit and financial institutions, governments, and miscellaneous.

The appraisal is focused on the real sector performance. The performance of the real sector is very essential for the long-run growth and development of the country and efforts have been made by successive governments in Nigeria to develop the sector.

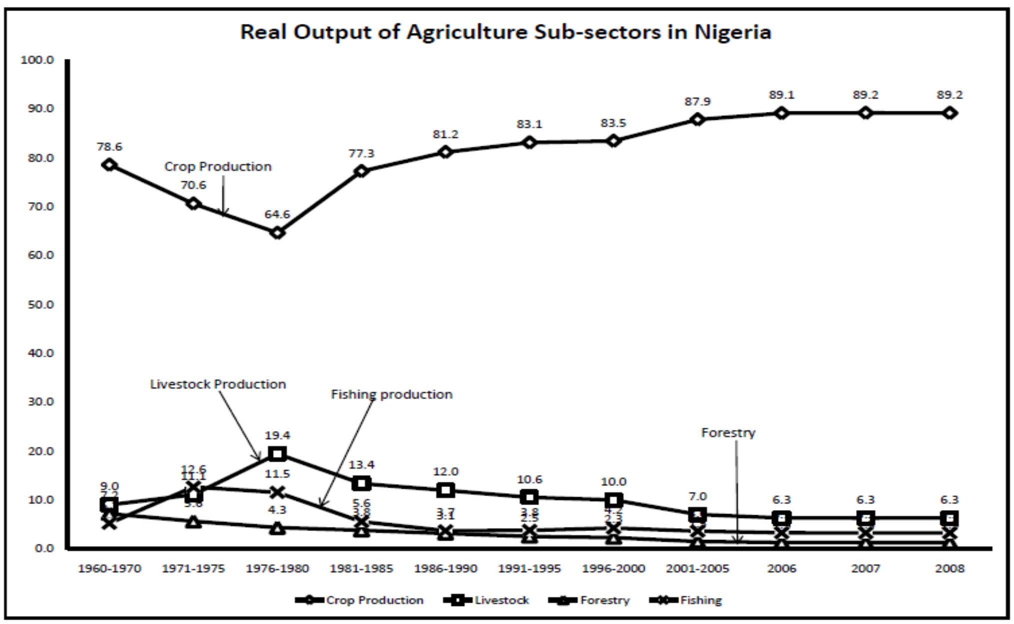
V.1 Performance of the Agricultural Sector

Nigeria is generously endowed with favourable conditions for sustainable agricultural development. First, the country is blessed with different climatic and vegetational zones, which make it suitable to the cultivation of various agricultural crops. Furthermore, the country has a large expanse of land that is suitable for both crop production and animal husbandry. It is estimated that the country possesses about 91.07 million hectares of land of which about 77.0 per cent of it is cultivable while 44.0 per cent of the cultivable land were actually under cultivation. The remaining 30.8 hectares were under arable and permanent crops. Several inland rivers and extensive ocean coast also exist for profitable fishing activities both for local consumption and exports.

The production system comprises small scale farmers (cultivating 0.1-5.99 ha), medium scale farmers (cultivating 6-9.99 ha) and large scale farmers (cultivating more than 10 ha and above). It is estimated that the small scale farmers account for 81.0 per cent of producers, while they produce about 95.0 per cent of agricultural output in Nigeria (Shaib et al, 1997). The production system is expected to be dominated by the small scale farmers for the next 25 years. The average age of the farmers are high and increasing which implies that young and dynamic entrepreneurs are not attracted to agriculture.

The agricultural sector is divided into four sub-categories. These include; crop production, animal rearing, fishing and forestry. Under the crop production category, crops cultivated include roots and tubers, cereals, tree crops (oil palm and cocoa), fiber and fruit crops. In terms of cultivation, cereals predominate as 20,000 ha of land were cultivated followed by the roots and tubers crop with about 8,000 ha and 4,000 for tree crops. Fruit crops and fibre were cultivated on 2,000 ha and 1,000 ha, respectively. The major crops cultivated include sorghum, millet, cowpea, maize cassava, rice and cocoyam. Analysis of sub-sectoral real outputs showed that the crop production sub-sector was the most significant. This is shown in the Figure 4.

Figure 4: Output growth of Agriculture Sub-sectors of Nigeria (Per cent)



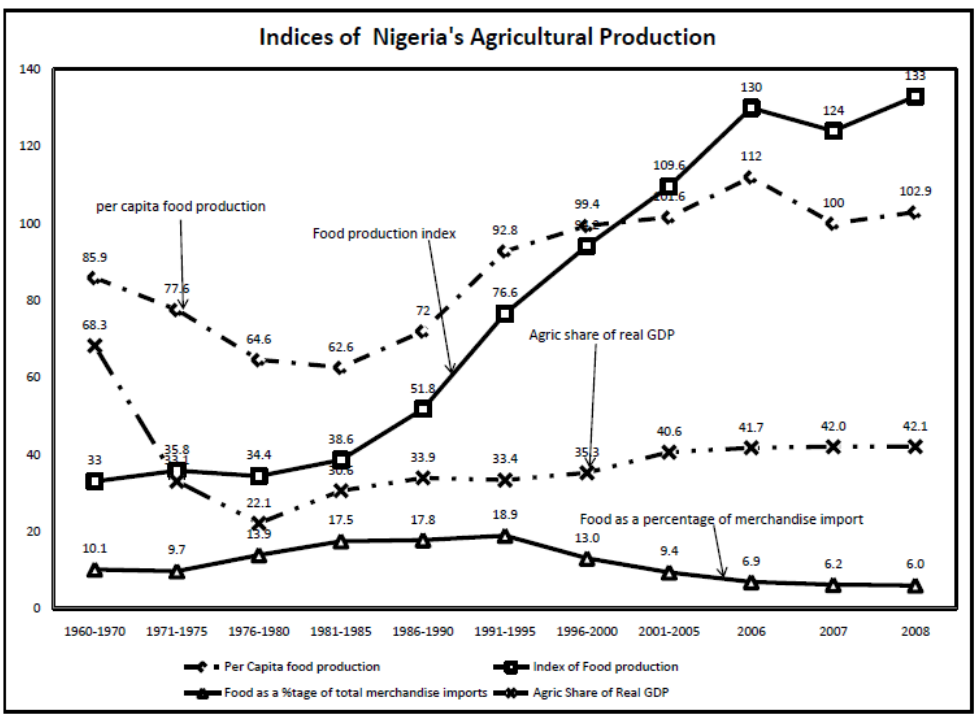
Source: CBN Statistical Bulletin 50 years Special Anniversary Edition.

The figure presents the trend performance of the sub-categories in the agricultural sector from 1960 to 2008. The crop production sector shows that average real output fell from 78.6 per cent from 1960 to 1970 to its minimum of 64.6 per cent from 1976 to1980. However, average real output has since steadily been on the increase to 77.3 per cent from 1981to1985 until 2008 when it rose to

89.2 per cent, which is higher than the average recorded from 1960 to 1970. Following the crop production category was the livestock production sector. Average real output rose from 9.0 per cent from 1960 to 1970 to its highest of 19.4 per cent from 1976 to 1980, and it has declined consistently thereafter, until 2006 to 2008 when it stagnated at 6.3 per cent. The fishing and forestry sector contributed less than 10.0 per cent all through the review period, except for fishing that contributed an average of 11.5 per cent between 1976 and 1980.

An appraisal of the performance of agricultural sector is further presented in Figure 5. Four indices of performance were adopted in appraising the sector. These include: agric share of the real GDP; Index of food production; per capita food production; and food import as a percentage of total merchandise import.

Figure 5: Indices of Agricultural Production



Source: CBN Statistical Bulletin 50 years Special Anniversary Edition

Figure 5 showed that agricultural sector played a very prominent and significant role in the economic growth of Nigeria from 1960 to 1970, as the sector contributed an average of 68.3 per cent of the real GDP. However, this contribution declined to an average of 22.1 per cent from 1976 to 1980 before picking up gradually until 2008. The contribution of agriculture to GDP is still buoyant considering the role played by crude oil in Nigeria since the 1970s. Considering the structure of agricultural production dominated by small scale cash-crops producing rural dwellers, the agricultural sector is still grossly unproductive and unsustainable.

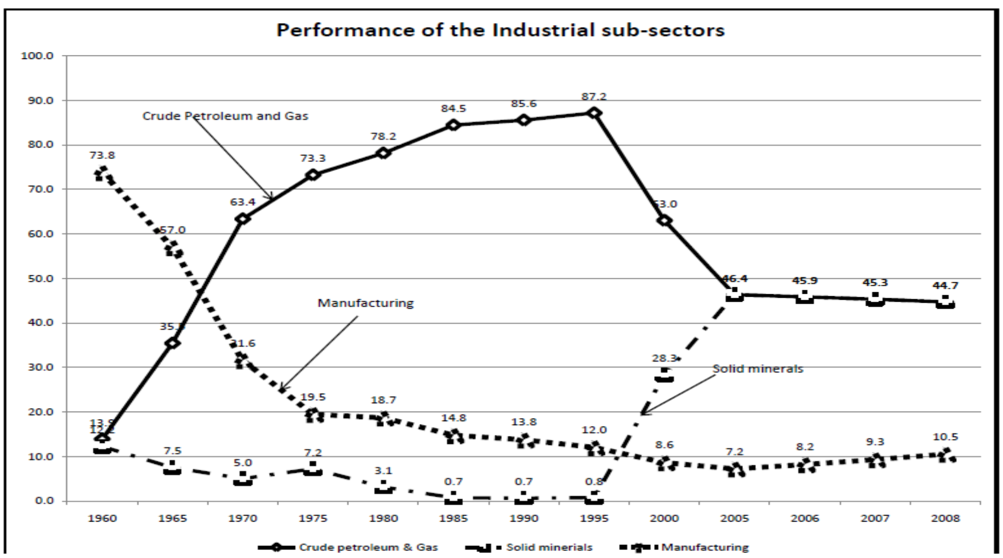
The food production index assumed an upward trend throughout the review period. It rose from an average of 33 points for the period 1960 to 1970, to 51.8 points from 1986 to 1990 and further to 130 and 133 points in 2006 and 2008, respectively. The rise in index of food production was attributed to increase in the area of land cultivated and number of people engaged in the production process. A sustainable and productive agricultural sector will require extensive application of science and technology with limited proportion of people engaged in the sector. The weakness of this increase in food production index could, however, be seen in the per capita food index, which consistently declined from an average of 85.9 points from 1960 to 1970 to an average of 62.6 points from 1981 to 1985. The index, thereafter, took an upward movement, but its rate of growth has been very sluggish and could not compare with the rate of food production. The per capita food production index eventually assumed a decline in 2006. The implication of this is that the rate of food production is definitely not at pace with the rate of population growth.

Nigeria has continually spent a huge sum of her foreign exchange earnings on importing food to meet the domestic short falls over the years. From 1960 to 1970, the country spent an average of 10.1 per cent of import on food importation, while it fell to 9.7 per cent from 1971 to 1975. The rate increased thereafter, until it reached an average of 18.9 per cent from 1991 to 1995, when it began to decline steadily to 6.0 per cent in 2008.

V.2 Performance of the Industrial Sector

The industrial sector is categorised by the National Bureau of Statistics (NBS) into three sectors. These categories include crude petroleum and natural gas, solid minerals and manufacturing. Nigeria is blessed with abundant crude oil and natural gas. Official estimates put Nigeria's crude oil reserves at 34 billion barrels and it is expected to increase to about 40 billion barrels. Also, Nigeria is blessed with natural gas, which is estimated to be about 159 trillion cubic feet, which ranks it as one of the ten largest gas endowed countries in the world. Apart from crude oil and natural gas, Nigeria is blessed with several solid minerals, among which are limestone, tin, columbite, kaolin, gold and silver, coal, led, zinc, gypsum, clay, shale, marble, graphite, iron-ore, stone, among others. Most of these minerals are not yet fully tapped due to the dominance of crude oil in the Nigerian economy. These resources provide Nigeria with ample opportunities of becoming an industrial giant not only in Africa, but also in the world. Figure 6 presents a picture of the activities in the industrial sector of the Nigerian economy.

Figure 6: Performance of Industrial sub-sectors of Nigerian economy

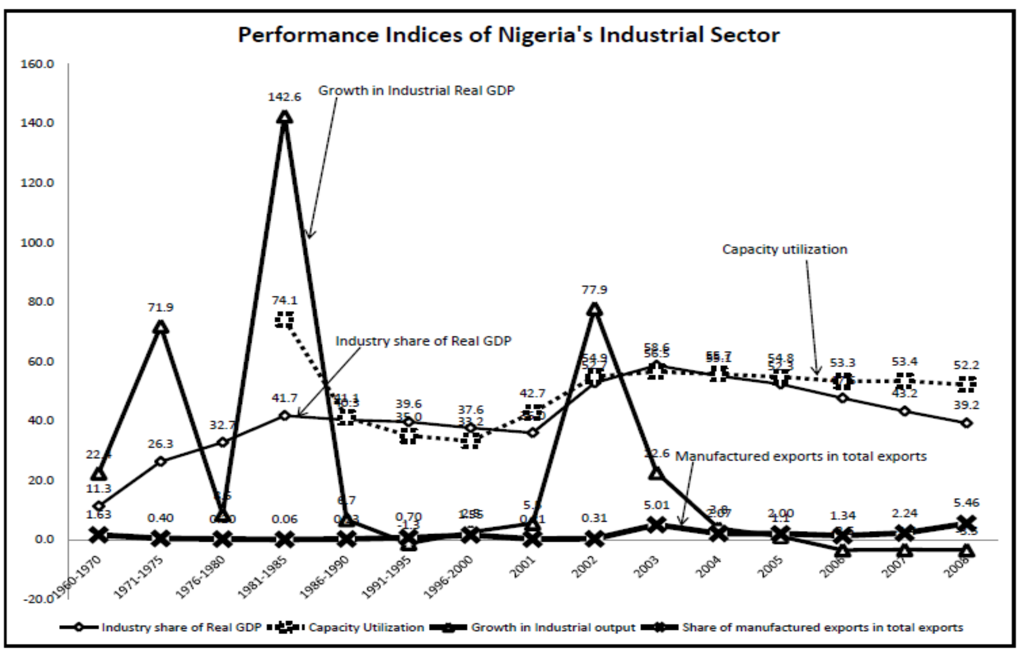


Source: The CBN Statistical Bulletin 50 years Special Anniversary Edition.

From the figure presented, it is very clear that there has been an inverse relationship between the growth of the crude oil and gas on one hand, and the growth of the manufacturing on the other. It is disheartening to observe that in 1960, the manufacturing sector which contributed about 73.8 per cent of the industrial real GDP was only able to contribute 7.2 and 10.5 per cents in 2005 and 2008, respectively. It is very clear that crude oil production in Nigeria led to the suppression of the manufacturing activities. The sector grew from 13.9 per cent in 1960 to 63.4 per cent in 1970 before reaching a peak of 87.2 per cent in 1995 and assumed a steady decline from then till 2005. The solid minerals sector was very much inactive until 1995 before it began to play some roles in the industrial sector. Its contribution rose from 0.8 per cent in 1995 to 28.3 per cent in 2000 and the highest of 46.4 per cent in 2005 and grew at the same rate thereafter with the crude oil production.

The manufacturing sub-sector has occupied the attention of government for several years in Nigeria and there has been a deliberate policy to stimulate the growth of the sector. For instance, the Bank of Industry was established by government to finance the industrial sector in addition to the credit guidelines issued to the deposit money banks (DMBs) to set aside certain percentage of their loans to the industrial sector, especially the small and medium scale enterprises (SMEs). The overview of the performance of the manufacturing sector is hereby explored.

Figure 7: Performance Indices of Nigeria's Industrial Sector



Source: The CBN Statistical Bulletin 50 years Special Anniversary Edition.

The indices of performance are as indicated in the graph. The growth in industrial GDP has been highly volatile. The average growth of the industrial real GDP rose from 22.4 per cent in the 1960s to an average of 71.9 per cent from 1971 to1975, it again nose-dived to an average of 8.5 per cent from 1976 to 1980. The sector experienced another sharp growth from 1981 to 1985 when the highest growth of 142.6 per cent over the previous period was recorded, while all through the 1990s to 2000, the sector almost got paralysed. Incidentally, this period coincided with political upheavals in Nigeria. The sector began to pick up again in 2000 and beyond.

The industrial share of the real GDP also has not been too impressive. It grew from 1.6 per cent in 1960s to 41.7 per cent for the period 1981 to 1985. As a matter of fact, the growth experienced in the manufacturing sector declined to 36.0 per cent in the period, 1996 to 2000. The trend of growth since 2001 has been downwards. The rate of capacity utilisation has also followed a similar trend with its share of real GDP. Capacity utilisation fell from 74.1 per cent from 1981 to 1985 and 33.2 per cent from 1996 to 2000. The rate has since gradually climbed to its highest of 56.5 per cent in 2003.

Available statistics showed that the Nigerian manufacturing sector is grossly uncompetitive. The dismal performance of manufacturing can be attributed to the hostile environment of operation. Manufacturing is very expensive in Nigeria due to inadequate electricity and other poor infrastructure; hence the output of the sector has not been competitive in the global market.

VI. Challenges of Financing the Real Sector in Nigeria

VI.1 Weak Property Rights Protection

One of the major challenges of financing the real sector in Nigeria lies in the weak protection of property rights. The Heritage Foundation computed data on economic freedom index and incorporates property rights protection as one of its indices. It was pointed out that the ability of the government to protect people's rights goes a long way to stimulating sustainable growth. In this regard, the independence, transparency and effectiveness of the judicial system were viewed as the key determinants of a country's prospects for growth. In fact, it was asserted that capital accumulated over long period of time will help to stimulate growth, if there was effective protection of property right (EFI, 2002).

Countries were classified into one of the five categories: Free, mostly free, moderately free, mostly un-free and repressed. Unfortunately Nigeria's record of performance among other countries of the world has been very poor. Nigeria's score has consistently put it in the group of repressed nations. The report pointed out that Nigeria's judiciary suffers from corruption, delays, insufficient funding, lack of court facilities, a lack of computerised systems for document processing, and unscheduled adjournments of court sessions due to power outages. Out of 179 countries listed in the 2011 report, Nigeria was ranked 111th position. Other African countries ranked included; Ghana 95, South Africa 74, Egypt 96, while United Kingdom was ranked 16.

The implication of the weak property right protection on financing the real sector in Nigeria is that banks usually finds it difficult to give out loans to prospective applicants due to the problem envisaged in enforcing loan repayment agreements in case of default. More so, getting acceptable property as collateral security from borrowers can be very difficult since protection is weak.

Another dimension of this problem lies in the area of intellectual property rights protection. The fragile nature of intellectual property rights protection has placed an enormous challenge on banks in financing the real sector in Nigeria. Creative works of science and technology, and also arts require heavy investments which the investor would like to recuperate if the work succeeds. However, the intellectual property rights environment in Nigeria has been very weak and hence constituting a dis-incentive to investment in creative works. A good example is the movie and the music industry in Nigeria. Some analysts believe that if the industry is well protected it could yield income in excess of what is derived from the oil industry, but the rate of piracy of works of arts, counterfeiting of products such as pharmaceuticals in Nigeria has made it difficult for serious investment in the real sector and such development could discourage banks from advancing credit to the sector.

VI.2 Poor Entrepreneurship Development

The entrepreneur is key to the growth and expansion of the capitalist economic system. According to Schumpeter (1943) entrepreneurs are the individuals who adopt inventions. They introduce new products or processes and new or improved management techniques; they open up new markets and new sources of supply.

Nigeria's entrepreneurial class has failed to emerge and this could be attributed to certain factors. First, the indigenous entrepreneurs in the Nigeria's colonial days were eventually turned to mere traders because Britain was not interested in the industrial development of Nigeria. Raw materials were produced in Nigeria and the local businessmen who were supposed to be entrepreneurs became produce buyers for the British, hence the entrepreneurial class was subdued. Secondly, in the early days of independence, in an attempt to gain economic independence, Nigerian government became entrepreneurs and was involved in almost all the economic activities. However, all the efforts made by government at building the economy became largely unsustainable when the price of oil crashed and the state-owned enterprises became a draining pipe for public funds. The advent of the neo-liberal policies propelled the Nigerian government to embark on the Structural Adjustment Programme (SAP) in 1986, thereby ceding ownership of some public enterprises to the private sector. Apart from the banking sector, which became unstable during that period, the real sector was still in the state of comatose. Another reason why Nigeria suffers from dearth of entrepreneurs is the nature of the public sector. The sector is not flexible to changes in the job market. Minimum wage legislations and the rigid wage system make entrepreneurship unattractive.

Poor entrepreneurship development has posed a great challenge in financing the real sector of the Nigerian economy. In spite of the huge funds set aside by the government at various times to finance the SMEs coupled with the huge deposits in the hands of the banks, especially in the wake of the banking consolidation exercise, good business proposals from businessmen in the real sector were, however, not forthcoming. Hence, the banks had no option than to look for outlets that would guarantee safety of their loanable funds. A good number of the banks came out with proposals for those willing to purchase new cars, which were mainly imported into the country. Another challenge faced by banks in this area is that most of the firms (SMEs) applying for loans did not have a good record keeping culture thus, making it difficult for banks in evaluating the viability of such firms as well as their repayment capacities. The cumbersome nature of assessing the viability of firms in the real sector has discouraged banks from financing the real sector, especially the SMEs in Nigeria.

VI.3 Uncompetitiveness of the Real Sector

The real sector of the Nigerian economy is largely uncompetitive, which poses a great challenge to adequate financing of the sector. The World Economic Forum (2007) provided a clue to understanding the competitiveness of a country. In its view, competitiveness was understood to mean a set of factors, policies and institutions that determine the level of productivity of a country. Hence, it observed that raising productivity is the driving force behind the rates of return on investment, which in turn determines aggregate growth rates of the economy. A competitive economy was believed to be the one that will likely grow faster in a medium to long-term perspective. Productivity growth was believed to result from greater openness and stronger links with the world economy, thereby imposing valuable discipline of international competition and attraction of capital and expertise that could enhance the prospects of growth through increased efficiency.

Nigeria's rating in the competitiveness report, among 125 countries assessed, was 101. In other words, Nigeria was 24th most inefficient country in the world. In that same report, other African countries rated included: South Africa, 45; Mauritius, 55 and Botswana, 81. Another way of viewing Nigeria's position is that, enormous resources are been wasted in the process of production in Nigeria. Indeed, most of the reports assessing financing of the real sector in Nigeria have alluded to the fact that agricultural financing has been very discouraging due to the fact that most of the operations or planting have depended on natural rainfall for harvest. More so, the agricultural farming sector has mostly been dominated by peasant farmers who cultivate mainly for subsistence purposes on small acres of land. The implication of this farming method is that the application of mechanisation, coupled with science and technology is constrained, thereby limiting the effectiveness of funds committed to boosting the growth of the sector.

Moreover, the manufacturing sector largely remains uncompetitive, owing to the cost of doing business in Nigeria. The poor state of infrastructure, such as electricity, inefficient transportation and telecommunications, has placed a limit on the extent to which modern technology can be sourced and applied in Nigeria for production processes. Hence, products from the sector are usually more expensive than imported ones. This may have consistently put off the banks from committing funds to the sector because the rate of return eventually may not be worth all the troubles of administering and monitoring the loans.

VI.4 Lack of Competition

The financial sector has been dominated by few big firms. It is reported that a few firms in the industry controls about 51.0 per cent of the asset-base of the banking industry. Moreover, in the capital market, active trading on stocks has been reported to be restricted to some specific sectors or firms. Under this condition, the banks can literally determine financing patterns in the economy. More so, small scale entrepreneurs will not be favoured in loans application, which can further stiffed entrepreneurship development. The problem of lack of competition has been entrenched in the Nigerian economy since independence. The large scale involvement of government in economic activities has limited the extent of competition in the country, more so, in our political affairs, most vital decisions have always been taking on the basis of federal character and quota system. The implication of this is that most of the times, excellence is sacrificed for ethnicity. Without competitive behaviour in the banking industry and the capital market, the culture of creativity and innovation, which is a feature of a capitalist economic system, will continue to elude Nigeria.

VI.5 Poor Corporate Governance System

The issue of corporate governance system has become a source of concern in the recent time. This concern arose from the various financial scandals that have rocked several large corporations in the US and other developed countries in the recent times. Thus, the efficiency of the existing corporate governance structure in protecting the rights of providers of capital has been largely called into question by policy makers and researchers. According to Shleifer and Vishny (1997), corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. Corporate governance has been shown to have links with economic development. In a report prepared by Claessens (2001), five of such links were provided. These included: increased access to external financing by firms which in turn can lead to larger investment; higher growth and greater employment; lowering the cost of capital and associated higher valuation; thereby making investment more attractive to investors and hence promoting growth; better operational performance through optimal allocation of resources and efficient management; reduced risk of financial crisis is guaranteed; and better relationship with stakeholders which helps social and labour relations.

From the channels identified above, the first two channels are very key in financing the real sector. Studies have shown that the stronger the creditors' rights are protected, the more they are willing to extend financing to firms (La Porta et al, 1997). Corporate governance system has been a challenge to suppliers of credit in Nigeria. The culture of transparency and accountability has not been well entrenched in Nigeria, owing to prolonged period of military rule, which led to evasion of official procedures in the management of the state businesses. This has resulted in inadequate finance from lenders and where funds were made available; they are usually at high cost thereby constraining the growth of the real sector in Nigeria.

Furthermore, the poor state of corporate governance in Nigeria may have sent negative signals to foreign investors. If foreign investors are able to form an opinion that resources channelled to the firms are not going to be well allocated, it discourages more funds from coming into the system and hence limits the extent of innovation a firm may contemplate embarking upon for further expansion and competitive advantage.

VI.6 The Size of the Public Sector

The size of government in Nigeria has posed serious challenges in financing the real sector. Ordinarily, an increase in government size crowds out private investment. In Nigeria, government has resulted to the banks in financing some of its activities. This places some pressure on the available funds in the economy thereby driving up the interest rates and making cost of investment to private investors, especially in the real sector to be expensive. Banks finds it more profitable and safe to lend money to government than for real investment, over time, finance has tilted in favour of government in meeting its recurrent expenditure which discourages long-term sustainable growth and economic development. Furthermore, this has further limited the extent of competition in the Nigerian banking sector. Borrowing to the government is almost riskless, hence genuine entrepreneurs seeking funds from the banks may find it difficult to access.

VI.7 Inappropriate/Inefficient Government Intervention

Nigerian government in an attempt to stimulate the growth of the real sector and achieve economic independence has consistently intervened in the financing of the real sector. Government, through the Central Bank of Nigeria, has provided loans to the agricultural and the industrial sectors, more so, credit guidelines have been used to direct credits to government's priority sectors. Government also established development banks for agriculture and industrial development.

Government strategy here involved making loans available to farmers and small scale industries at concessionary interest rates far below the market interest rates. However, some beneficiaries of these loans eventually divert the loans to other profitable businesses, since it was at a lower interest rate. Some other beneficiaries are not able to utilise the loans appropriately because of lack of credit discipline and the underlining welfare implications attached to such loans such as poverty alleviation.

In an era of liberalisation, there is the need for government to begin to review its roles in the area of intervention in the financial markets. Government must work to ensure that the markets perform its role while government also should not abdicate its roles of ensuring that necessary infrastructure is provided to drive economic growth.

VI.8 Politicisation of Policy Instruments

The politicisation of government policy programmes has also led to the inefficient financing of the real sector of the economy. Most of the times, politicians make promises to rural farmers on how to release funds to them to expand their agricultural projects in return for their votes. When elections are over, government special financing programme are implemented with political coloration. Loans are secured through party affiliations and loyalties. Hence, the loans were usually not disbursed on the basis of merit. In addition, beneficiaries of the loans believed that the loan was their own share of the national cake which need not be paid back. An appropriate policy instrument for the development of the real sector must be such that once it is formulated, it must be implemented by efficient and capable bureaucrats who are insulated from politics.

VI.9 Lack of Development of Rating Agencies

One of the challenges facing financing of the real sector in Nigeria is the lack of development of the rating agencies. These agencies provide useful information about the stock market thereby providing ratings to the performance of the stocks quoted on the exchange. The lack of development of this institution has placed a heavy limitation on information acquisition about firms in the market.

Lack of information has led to a higher level of asymmetric information, which limits the financing of the sector.

VII. Prospects of Financing the Real Sector in Nigeria

The prospect of making finance enhance sustainable growth in Nigeria rests on some three major issues, among others. These include, upgrading the financial infrastructure to a level that can guarantee effective protection of creditors' rights; stimulating competition to eliminate monopoly practices; and the adoption and intensive use of information technology infrastructure in collecting information about practices in the financial markets.

VII.1 Upgrading Financial Infrastructure

Nigeria would need to adopt the culture of transparency and accountability as obtains in the British financial legal system. Not only that the laws are upgraded and fine-tuned to strengthen creditors' rights, there must be political will on the part of the government to implement such laws. Moreover, Nigeria must begin to respect the doctrine of the rule of law in the conduct of its affairs. The democratic dispensation is a good platform to review and update the laws and make it up-to-date.

VII.2 Promotion of Competition

Nigeria would need to create environment for competition before finance can have any meaningful impact on sustainable growth. The monopoly situation in the banking industry prevents a good number of entrepreneurs from gaining access to finance. Banks in Nigeria gives loans to well established companies and government agencies, thus, denying small businesses of credits. Competition promotes innovation and creativity. It would enable the banks to creatively finance the economy if the competitive pressure is intense. The lack of competition in Nigeria emanates from its policy of quota system and federal character in the conduct of political affairs. These have crept into the economic spheres leading to monopoly behaviours which aggravates rent-seeking behaviour in the economy and limits productivity.

VII.3 Adoption of Information Technology

The risks involved in financing the real sector can greatly be reduced, if Nigeria fully adopts information communication technology in the conduct of its economic affairs. Given that most businesses, especially small scale industries do not keep records, it has become difficult to assess their creditworthiness. However, in the age of information technology, the central bank in conjunction with the state governments and the Small and Medium Enterprises Development Agency (SMEDAN), would need to commence the computerisation of all the firms operating in Nigeria. There might be the need to build standardised accounting software for the submission of all transactions on a monthly basis for monitoring and evaluation. Information generated through this process can greatly reduce information asymmetry and level of risk exposure by banks in financing the real sector.

VIII. Conclusion

This paper examined some of the challenges constraining the financial sector in stimulating sustainable growth in Nigeria. The challenges highlighted in this work includes: poor property right protection; poor corporate governance system; lack of competitiveness of the real sector; lack of competition in the economy; poor entrepreneurship development and lack of development of rating agencies in Nigeria. It observed that for a successful real sector financing in Nigeria, a culture of accountability and transparency in the conduct of our national affairs must be taken seriously. The quality of governance must also be improved, to ensure that the legal framework for economic activities is well strengthened, such that the protection of creditors' rights may not be jeopardised.

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