

An Overview of Current Banking Sector Reforms and the Real Sector of the Nigerian Economy

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I. Introduction

An economy is usually compartmentalized into four distinct but related sectors. These are the real, external, fiscal or government and financial sectors. Real sector activities include agriculture, industry, building and construction, and services. The sector is strategic for a variety of reasons. First, it produces and distributes tangible goods and services required to satisfy aggregate demand in the economy. Its performance is, therefore, a gauge or an indirect measure of the standard of living of the people. Second, the performance of the sector can be used to measure the effectiveness of macroeconomic policies. Government policies can only be adjudged successful if they impact positively on the production and distribution of goods and services which raise the welfare of the citizenry. Third, a vibrant real sector, particularly the agricultural and manufacturing activities, create more linkages in the economy than any other sector and, thus, reduces the pressures on the external sector. Fourth, the relevance of the real sector is also manifested in its capacity building role as well as in its high employment and income generating potentials.

Economic reforms generally refer to the process of getting policy incentives right and/or restructuring key implementation institutions. As part of economic reforms, financial sector reforms focus mainly on restructuring financial sector institutions and markets through various policy measures. As a component of the financial sector, the reforms in the banking sector seeks to get the incentives right for the sector to take the lead role in enhancing the intermediation role of the banks and enable them contribute to economic growth.

As articulated by Omoruyi (1991), CBN (2004) and Balogun (2007), banking sector reforms in Nigeria have been embarked upon to achieve the following objectives, among others: market liberalization in order to promote efficiency in resource allocation, expansion of the savings mobilization base, promotion of investment and growth through market-based interest rates. Other objectives are: improvement of the regulatory and surveillance framework, fostering healthy competition in the provision of services and laying the basis for inflation control and economic growth.

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Five distinct phases of banking sector reforms are easily discernible in Nigeria. The first occurred during 1986 to 1993, when the banking industry was deregulated in order to allow for substantial private sector participation. Hitherto, the landscape was dominated by banks which emerged from the indigenization programme of the 1970s, which left the Federal and state governments with majority stakes. The second was the re-regulation era of 1993-1998, following the deep financial distress. The third phase was initiated in 1999 with the return of liberalization and the adoption of the universal banking model. The fourth phase commenced in 2004 with banking sector consolidation as a major component and was meant to correct the structural and operational weaknesses that constrained the banks from efficiently playing the catalytic role of financial intermediation. Following from the exercise, the aggregate capital of the consolidated banks rose by 439.4 per cent between 2003-2009, while deposit level rose by 241.8 per cent. However, this was not reflected in the flow of credit to the real economy, as the growth rate of credit fell during this period, while actual credit did not reflect the proportionate contribution of the sector to the GDP.

The current and fifth phase, was triggered by the need to address the combined effects of the global financial and economic crises, as well banks' huge exposures to oil/gas and margin loans, which were largely non-performing; corporate mis-governance and outright corruption, among operators in the system. This round of reform, therefore, seeks to substantially improve the banking infrastructure, strengthen the regulatory and supervisory framework, and address the issue of impaired capital and provision of structured finance through various initiatives, so as to provide cheap credit to the real sector, and financial accommodation for small and medium-scale enterprises (SMEs).

It is against this background that this paper seeks to examine the developments in the banking industry and the real sector of the Nigerian economy since the fourth phase of the reforms which began in 2004. Specifically, the paper will review the reform programmes and how they have impacted on the flow of credit to the real sector. With the realization that the sector is facing challenges well beyond the realm of finance, other constraints would be identified and, thereafter, policy interventions recommended with a view to making the banking sector reforms more effective.

The rest of the paper is organized as follows. Section two provides the theoretical underpinning in the relationship between the financial industry and the real sector developments, while section three periscopes the banking sector reforms since 2004. Section four reviews developments in the real sector since 2005, and

section five identifies some of the binding constraints that would require policy intervention. Section six concludes the paper.

II. Financial Sector Developments and Economic Growth Nexus

II.1 Theoretical Underpinning

There is ample theoretical evidence reinforced by a number of empirical works, which supports a positive relationship between financial sector development and growth. Principally, the financial system functions to mobilize and channel financial resources through institutions or intermediaries from surplus economic units to deficit units.

A well-developed financial system enhances investment by identifying and funding good business opportunities, mobilizing savings, enabling trading, hedging and diversifying risk, and facilitating the exchange of goods and services. These functions result in a more efficient allocation of resources, rapid accumulation of physical and human capital, and faster technological progress, which in turn result in economic growth and, by extension, the development of the real sector. An efficient financial system is one of the foundations for building sustained economic growth and an open, vibrant economic system. In the early neoclassical growth literature, financial services were thought to play only a passive role of merely channeling household savings to investors. However, many later studies have been associated with more positive roles for the financial sector.

Schumpeter (1912) in his theoretical link between financial development and economic growth opines that the services provided by financial intermediaries are the essential drivers for innovation and growth. His argument was later formalized by McKinnon (1973) and Shaw (1973), and popularized by Fry (1988) and Pagano (1993). The McKinnon-Shaw paradigm postulates that government restrictions on the operations of the financial system, such as interest rate ceiling, direct credit programs and high reserve requirements may hinder financial deepening, and this may in turn affect the quality and quantity of investments and, hence, have a significant negative impact on economic growth. Therefore, the McKinnon-Shaw financial repression paradigm implies that a poorly functioning financial system may retard economic growth.

The endogenous growth literature also supports this argument that financial development has a positive impact on the steady-state growth (Bencivenga and Smith, 1991; Bencivenga, et al., 1995; and Greenwood and Jovanovic, 1990, among others). Well-functioning financial systems are able to mobilize household

savings, allocate resources efficiently, diversify risks, induce liquidity, reduce information and transaction costs and provide an alternative to raising funds through individual savings and retained earnings. These functions suggest that financial development has a positive impact on growth. McKinnon (1973) and Shaw (1973) are the most influential works that underpin this hypothesis and suggest that better functioning financial systems lead to more robust economic growth. McKinnon (1973) considered an outside money model in which all firms are confined to self-finance. Hence, physical capital has a lumpy nature where firms must accumulate sufficient savings in the form of monetary assets to finance the investment projects. In this sense, money and capital are viewed as complementary assets where money serves as the channel for capital formation 'complementarity hypothesis'.

The 'debt-intermediation' view proposed by Shaw (1973) is based on an inside money model. He argues that high interest rates are essential in attracting more savings. With more supply of credit, financial intermediaries promote investment and raise output growth through borrowing and lending. Also, King and Levine (1993a) find that higher levels of financial development are associated with faster economic growth and conclude that finance seems to lead growth. Neusser and Kugler (1998) and Choe and Moosa (1999) reach the same conclusion.

More specifically, the roles of stock markets and banks have been extensively discussed in both theoretical and empirical studies (See Levine (2003) for a survey of the literature). The key findings of studies are that countries with well-developed financial institutions tend to grow faster; particularly the size of the banking system and the liquidity of the stock markets tend to have strong positive impact on economic growth.

II.2 Empirical Literature

A substantial body of empirical work on finance and growth assesses the impact of the operations of the financial system on economic growth, whether the impact is economically large, and whether certain components of the financial system, e.g. banks and stock markets, play a particularly important role in fostering growth at certain stages of economic development.

Patrick (1966), in his work postulates a bi-directional relationship between financial development and economic growth. Ever since, a large empirical literature has emerged to test this hypothesis (see Levine, 1997 for survey). Two trends in this respect have emerged in the literature. The first tests the relationship between economic growth and financial development, adopting a single

measure of financial development and testing the hypothesis on a number of countries using either cross-section or panel data techniques (Erdal, et. al, 2007 for survey). The second trend examined the hypothesis for a particular country using time series data/technique, as done by Murinde and Eng (1994) for Singapore; Lyons and Murinde (1994) for Ghana; Odedokun (1998) for Nigeria; Agung and Ford (1998) for Indonesia; Wood (1993) for Barbados, and James and Warwick (2005) for Malaysia.

Other works by King and Levine (1993a, 1993b); Demetriades and Hussein (1996) and DemirgüçKunt and Maksimovic (1998), structured on the works of Bagehot (1873), Schumpeter (1912), Gurley and Shaw (1955), Goldsmith (1969), and McKinnon (1973), employed different econometric methodologies and data sets to assess the role of the financial sector in stimulating economic growth.

The mounting empirical research, using different statistical methods and data have produced remarkable results. First, the results have shown that countries with well-developed financial systems tend to grow faster, especially those with (i) large, privately owned banks that channel credit to the private sector, and (ii) liquid stock exchanges. The level of banking development and stock market liquidity exert positive influence on economic growth. Second, well-functioning financial systems ease external financing constraints that obstruct firms and industrial expansion. Thus, access to external capital is one channel through which financial development matters for growth because it allows financially-constrained firms to expand. The endogenous growth literature supports the fact that financial development positively affects economic growth in the steady state (Greenwood and Jovanovic (1990); Bencivenga and Smith (1991); Roubini and Sala-I-Martin (1992); Pagano (1993); King and Levine (1993b); Berthelemy and Varoudakis (1996); and Greenwood and Smith (1997)).

Over the last two decades, the literature has shown a growing body of new empirical approaches to treating the causality pattern based on time series techniques Gupta (1984); Jung (1986); Murinde and Eng (1994); Demetriades and Hussein (1996); Arestis and Demetriades (1997); and Kul and Khan (1999). In these studies, the focus is on the long-run relationship between financial sector development and real sector growth, using frameworks of bivariate and multivariate vector auto-regressive (VAR) models for different country samples. The outcome was that the causality pattern varies across countries according to the success of financial liberalization policies implemented in each country and the level of development of the financial sector.

The Nigerian economy has from the mid-1980s been moving towards increased liberalization, greater openness to world trade and higher degree of financial integration. This policy stance and other reform measures, particularly the banking sector consolidation exercise of 2004/05 have led to enormous build-up of capital from both domestic and cross-border sources. Nigeria is, therefore, a veritable case for investigating the link between finance and growth for at least two reasons. First, there has been considerable increase in the activities of the financial markets prior to the recent global financial crisis, particularly with regard to private sector credit and stock market capitalization. Credit to the private sector, stock market capitalization and the all-share value index were all on the upswing up until the onset of the crisis. Second, Nigeria has an interesting history of financial sector reforms. However, this proposal is not an agenda for this paper, given that this is only an overview of developments in the two sectors – financial and real.

III. Recent Banking Sector Reforms in Nigeria

III.1 Bank Consolidation 2004-2009

There has been a wave of restructuring and consolidation of the banking sector around the globe, particularly in the developed and the emerging market economies. This has been driven mainly by globalization, structural and technological changes, as well as the integration of financial markets. Banking sector consolidation has become prominent in most of the emerging markets, as financial institutions strive to become more competitive and resilient to shocks. It is also promoted by the desire to reposition corporate operations to cope with the challenges of an increasingly globalized banking system. It was based on the above premise that banking sector consolidation, through mergers and acquisitions, was embarked upon in Nigeria from 2004.

The Bank consolidation was focused on further liberalization of banking business; ensuring competition and safety of the system; and proactively positioning the industry to perform the role of intermediation and playing a catalytic role in economic development. The reform was designed to ensure a diversified, strong and reliable banking sector which will ensure the safety of depositors' money, play active developmental roles in the Nigerian economy, and be competent and competitive players in the African, regional and global financial system.

Following the banking sector consolidation, notable achievements were recorded in the financial sector among which was the emergence of 25 well-capitalized banks from the former 89 banks. The banks raised ₦406.4 billion from the capital market. In addition, the process attracted foreign capital inflow of

US\$652 million and £162,000 pound sterling. The liquidity engendered by the inflow of funds into the banks induced interest rate to fall significantly, while an unprecedented 30.8 per cent increase was recorded in lending to the real sector in 2005.

With a higher single obligor limit, Nigerian banks now had a greater potential to finance large value transactions. More banks now have access to credit from foreign banks, while the capital market deepened and consciousness about it increased significantly among the populace. The market became active and total market capitalization increased markedly. Ownership structure has been positively affected such that the problems of insider abuse and corporate governance have been reduced. Depositor confidence has improved due to "safety in bigness" perception by depositors. With virtually all banks now publicly quoted, there is wider regulatory oversight. With the inclusion of the Securities and Exchange Commission and the Nigerian Stock Exchange in the regulatory team, resources have been committed to the regulation of few and more stable banks in an efficient and effective manner. The banks have begun to enjoy economies of scale and, consequently, are passing on the benefit in the form of reduced cost of banking transactions. In general, the reform efforts had engendered stable macroeconomic environment evidenced by low inflation and relative stable exchange rates.

However, not long after, the global financial and economic crises came in 2007, leading to the collapse of many financial institutions across the globe. The financial crisis reduced the gains made in the Nigerian financial services sector from the banking sector consolidation exercise. The experience in the industry however, followed global trends. Following from the impact of the global financial crises, a section of the banking industry was badly affected as some banks were in grave condition and faced liquidity problems, owing to their significant exposure to the capital market in the form of margin trading loans, which stood at about ₦900.0 billion as at end-December 2008. The amount represented about 12.0 per cent of the aggregate credit of the industry or 31.9 per cent of shareholders' funds. Furthermore, in the wake of the high oil prices, a section of the industry that was excessively exposed to the oil and gas sector was also badly affected. As at end-December 2008, banks' total exposure to the oil industry stood at over ₦754.0 billion, representing over 10.0 per cent of the industry total and over 27.0 per cent of the shareholders' funds.

The excessive exposures resulted in serious liquidity problems exhibited by some of the banks towards the end of 2008. As part of its liquidity support, the CBN

Discount Window was expanded in October 2008 to accommodate money market instrument, such as Bankers' Acceptances and Commercial Papers. As at June 2009, the banks' total commitment under the Expanded Discount Window (EDW) was over ₦2,688.84 billion, while the outstanding commitments was over ₦256.0 billion, most of which was owed by less than half of the banks in operation. When the CBN closed down the EDW and, in its place, guaranteed inter-bank placements, it was observed that the same banks were the main net-takers under the guarantee arrangement, indicating that they had deep-rooted liquidity problems. Further investigation by the CBN identified eight interdependent factors as the main origin of the crisis in the banking sector.

These include:

- Sudden capital inflows and macro-economic instability
- Poor corporate governance and character failure
- Lack of investor and consumer sophistication
- Inadequate disclosure and lack of transparency
- Critical gaps in regulatory framework and regulation
- Uneven supervision and enforcement
- Weaknesses within the CBN
- Weaknesses in the business environment

III.2 On-going Banking Sector Reform

It was against this background that the CBN moved decisively to strengthen the industry, protect depositors' and creditors' funds, safeguard the integrity of the industry and restore public confidence.

In that regard, the CBN replaced the chief executives/executives directors of the banks identified as the source of instability in the industry and injected the sum of ₦620.0 billion into the banks in an effort to prevent a systemic crisis. Arrangements were also made to recover non-performing loans from banks' debtors, while guaranteeing all foreign credits and correspondent banking commitments of the affected banks. Furthermore, the Bank proposed the establishment of the Asset Management Corporation of Nigerian (AMCON). The AMCON Bill has already been passed by the National Assembly and signed into law by the President. The AMCON as a resolution vehicle is expected to soak the toxic assets of troubled banks. Members of the Board of Directors of AMCON have also been cleared by the Senate and inaugurated.

The CBN is also collaborating with the Securities and Exchange Commission (SEC) and the Nigerian Stock Exchange (NSE) to reduce the cost of transactions particularly bond issuance so as to diversify funding sources away from banks, as well as attract more foreign portfolio investors into the sector. Efforts are also being intensified towards strengthening regulatory and supervisory framework and enhancing the monitoring of the operations of the Deposit Money Banks (DMBs) to ensure that they remain safe, sound and healthy.

To further engender public confidence in the banking system and enhance customer protection, the CBN established the Consumer and Financial Protection Division to provide a platform through which consumers can seek redress. In the first three months of its operation, about 600 consumer complaints were received by the Division which was a manifestation of the absence of an effective consumer complaints resolution mechanism in banks. The CBN has also issued a directive to banks to establish Customer Help Desks at their head offices and branches. In addition, the CBN has commenced a comprehensive review of the Guide to Bank Charges with a view to making the charges realistic and consumer-friendly. Furthermore, the Consumer and Financial Protection Division is expected to commence a programme of consumer education and enlightenment and is also collaborating with the Consumer Protection Council on the review of the Consumer Protection Council Act No. 66 of 1992, to regulate and enforce discipline in the market.

The CBN has taken steps to integrate the banking system into the global best practices in financial reporting and disclosure through the adoption of the international Financial reporting Standards (IFRS) in the Nigerian Banking Sector by end-2010. This is expected to enhance market discipline and reduce uncertainties, which limit the risk of unwarranted contagion. The CBN is also closely collaborating with other stakeholders like the Nigerian Accounting Standard Board (NASB), Federal Ministry of Finance (FMF), NDIC, SEC, NAICOM, PENCOM, Federal Inland Revenue Service (FIRS), and the Institute of Chartered Accountant of Nigerian (ICAN), among others, towards ensuring a seamless adoption of IFRS in the Nigerian banking sector by 2012. These efforts are being pursued under the aegis of the Roadmap Committee of Stakeholders on the Adoption of IFRS in Nigeria inaugurated by the NASB and facilitated by the World Bank.

The universal banking (UB) model adopted in 2001, allowed banks to diversify into non-bank financial businesses. Following the consolidation programme, banks became awash with capital, which was deployed to multiples of financial

services. In effect, the laudable objectives of the UB Model were abused by operators, with banks operating as financial supermarkets to the detriment of core banking practices. To address the observed challenges, the CBN is reviewing the UB Model with a view to refocusing banks to their core mandate. Under the new model, banks would not be allowed to invest in non-bank subsidiaries, while banks with such investments would be required to either divest or spin-off the businesses to holding companies that will be licensed by the CBN as other financial institutions. The three classes of deposit money banks being proposed are: International banks, National banks and Regional banks.

III.3 Real Sector Financial Initiatives under the Current Banking Sector Reforms

Pursuant to the objectives outlined under the fourth pillar of the reforms and as part of its developmental function, the CBN has introduced new initiatives to enhance the flow of credit to the productive sectors of the economy.

III.3.1 ₦200 Billion Commercial Agricultural Credit Scheme (CACS)

The Scheme was established in 2009 by the CBN in collaboration with the Federal Ministry of Agriculture and Water Resources (FMA&WR). It is being funded through the issuance of FGN Bond worth ₦200 billion, by the Debt Management Office (DMO) in two tranches. The first tranche of N100 billion has been raised and passed on to participating banks for on-lending to farmers. Loans made under this scheme are at single digit interest rate subject to a maximum of 9.0 per cent while the CBN bears the interest subsidy at maturity. The scheme was initially to promote commercial agricultural enterprises but was later amended to accommodate small-scale farmers through the on-lending scheme of the state governments. All the 24 banks in the country would participate in the administration of the scheme, but only 7 banks are involved, thus far. As at end-October 2010 a total of about ₦90.36 billion has been disbursed to eleven banks including 15 state governments for financing 94 projects. Other developmental functions of the CBN that have impacted on the agricultural sector are the Agricultural Credit Guarantee Scheme and its Trust Fund Model, Interest Drawback Programme and the establishment of the Microfinance Banks.

III.3.2 ₦500 Billion Development Bond

As part of the efforts by the CBN to show the way towards enhanced financing of the real sector and infrastructure projects, and improve credit flow to the sector, a ₦500.0 billion fund was established out of which ₦300 billion is earmarked for Power/Infrastructure projects and Airlines, and ₦200.0 billion for the Refinancing/Restructuring of banks' existing loan portfolios to manufacturers/small and medium enterprises (SMEs).

III.3.3. ₦200 Billion Small and Medium-Scale Enterprises Guarantee Scheme (SMECGS)

The ₦200 billion Small and Medium-Scale Enterprises Guarantee Scheme (SMECGS) established by the CBN in 2010 aims at promoting access to credit by SMEs in Nigeria. The scheme provides guarantees on loans by banks to the sector in order to absorb the risk element that inhibit banks from lending to the real sector. The activities covered under the scheme include manufacturing and agricultural value-chain; SMEs with assets not exceeding ₦300 million and labour force of 11 to 300 staff; and processing, packaging and distribution of primary products.

The main objectives of the Scheme are to: fast-track the development of SME/manufacturing sector of the Nigerian Economy by providing guarantees; set the pace for industrialization of the Nigerian economy; and increase the access to credit by promoters of SMEs and manufacturers. The maximum amount to be guaranteed under the scheme is ₦100 million which can be in the form of working capital, term loans for refurbishment, equipment upgrade, expansion and overdraft. The guarantee covers 80 per cent of the borrowed amount and is valid up to the maturity date of the loans, with maximum tenure of 5 years.

All deposit money and development banks are eligible to participate in the scheme and the lending rate under the scheme should be the prime lending rate of the banks since the CBN is sharing the credit risk with the banks by providing guarantee.

III.3.4 Nigerian Incentive-based Risk Sharing System for Agricultural Lending (NIRSAL)

Despite the plethora of financing schemes, the issue of adequate, affordable and timely access to credit by Nigerian farmers remains a major challenge. For example, between 2006 and 2009, the agricultural sector attracted on average 2.1 per cent of the total credit to the economy in contrast to its average contribution of 42.2 per cent to the GDP over the same period. The low credit to the sector by the banking industry could be attributed to a number of reasons, notable among which are the high risk inherent in the sector and the perception of the sector as non-strategic to their business models. Hence, as long as these concerns linger, the issue of financing agriculture in Nigeria would require more than just providing funds to the sector. It is against this background that a new financing framework, the Nigerian Incentive-based Risk Sharing System for Agricultural Lending (NIRSAL) is being introduced.

This model of financing agriculture is different in many ways from the current financing models which have not yielded the desired impact of making adequate credit available to the sector. NIRSAL is a demand-driven credit facility rather than the current supply-driven funding. It would adopt a value-chain approach to lending as banks would be free to choose which part of the value chain they would be interested in lending to. It would build the capacity of the banks to engage and deliver loan; reduce counterpart risks facing banks through innovative crop insurance products; reward performance in agricultural lending; and would be managed with performance-based incentives.

NIRSAL would be tailored along the already developed model of the Impact Investing Fund for African Agriculture (IIFAA) based on Nigerian's financial and agricultural development requirements. It would pool together the current resources in CBN's agricultural financing schemes and other investors' funds and transfer these into the five components of the programme but managed outside of the CBN. In other words, existing agricultural support frameworks like CACS, ACGS, ACSS and NAIC, etc, would be assessed, modified and integrated into five components.

The scheme aims at reversing the trend of low credit to the agricultural sector by encouraging more banks to lend to the sector through an incentive based system. The programme would ensure that hitherto unproductive public capital will translate to more productive output by using it to create incentives for banks to be more involved in agricultural lending, increase market absorptive capacity, reduce lending risk as well as help banks to understand the sector better. Furthermore, it would help banks build capacity to develop sustainable term financing and affordable loan products to promote commercially oriented agriculture for small holder farmers and businesses. It will also develop efficient financial delivery system that would serve the need of medium and large scale farmers. The programme set out to stimulate a new form of strategic partnership and alliance between banks to increase lending, reduce the transaction cost and establish a sustainable financial delivery platform into rural areas.

Specifically, the objectives of the programme include:

- Stimulate innovations in agricultural lending
- Encourage banks that are lending to the sector
- Eliminate state dependency by banks for deploying loanable funds to agriculture
- Leverage DMBs balance sheet for lending into Agriculture; and

- Ensure risk-sharing approach that will build a business approach where banks share in the risk of lending to the sector

In achieving these objectives, there would be five integrating components to ensure increased bank credit to the agricultural sector, ensure systemic change and reward performance based on evidence using market-driven incentives. These five pillars would work together in an integrative way to change the way banks lend to agricultural sector. The five major components of this programme are: Risk Sharing Facility (RSF), Insurance Components (IC), Technical Assistance Facility (TAF), Bank Incentive Mechanism (BIM) and Agricultural Bank Rating System (ABRS). These components are further explained below:

The Risk Sharing Facility (RSF) is a risk-tool box that would serve as a framework for negotiation between the programme and the participating banks. It would be used to deploy different risk sharing instruments to reduce the risk of lending to the agricultural sector. This would comprise first loss and share loss arrangements, the volume of lending, the part of value-chain that the bank would be willing to lend to, the term of lending and the type of bank as well as experience and capacity for agricultural lending.

The Insurance Component (IC) would identify existing insurable risks and solution coverage, assist in developing such solutions and link such products to the loan provided by the banks to the beneficiaries.

The Technical Assistance Facility (TAF) would be used to assist banks that have demonstrated interest and commitment to lending to small-holding agriculture. It would help to build capacity of the banks to lend and develop delivery platform in support of agricultural lending. It would also assist in building capacity of small-holder farmers and help them in managing markets and financial activities.

The Bank Incentive Mechanism (BIM) would motivate banks to lend to the agricultural sector. The BIM would define appropriate incentive mechanism to encourage banks to lend to the sector without creating moral hazard. This would be done through lower guarantee fees for use of services under the scheme.

The Agriculture Bank Rating System (ABRS) would rate banks according to their level of engagement in agricultural development. The rating would be based on banks performance in lending to the agricultural sector and the impact of the lending on food security, rural development and income. Banks with higher rating would be given more incentive through BIM to encourage more lending to the

sector. Provisional estimates for funding the various components are currently put as follows: RSF (US\$300 million – with a goal of leveraging up to US\$3 billion), TAF (US\$90 million), BIM (US\$100 million) and ABRS (US\$10 million). The CBN as a founding and strategic investor would play a crucial role in creating long term systemic change in agriculture financing.

The blueprint for the current reforms is built around four pillars namely; enhancing the quality of banks, establishing financial stability, enabling healthy financial sector evolution and ensuring that the financial sector contributes to the real economy. Each of these pillars is discussed in detail as follows.

Enhancing the Quality of Banks

Under this pillar, the CBN has initiated a five-part programme that would enhance the operations and the quality of banks in Nigeria. It consists of industry remedial programmes to tackle the fundamental causes of the banking sector crises, implement risk-based supervision, reform the regulatory framework, as well as enhance provision for consumer protection and internal transformation of the CBN. This initiative would go a long way in enhancing credit to the real sector of the economy. In order to address the failure of corporate governance in the industry, the CBN will also establish a specialist function centered on governance issues to ensure that governance best practices are imbibed in the industry.

Establishing Financial Stability

This pillar focuses at strengthening the Financial Stability Committee within the CBN as well as establishing a hybrid monetary policy and macro-prudential rules. It also includes the development of directional economic policy and counter-cyclical fiscal policies by the government and the further development of the capital market as alternative to bank funding. When financial stability is established, the banking sector would be the major driver of economic activities and a significant channel for capital flows into the real economy.

Enabling Healthy Financial Sector Evolution

Under this pillar, attention would be given to creating an appropriate banking industry structure, the cost structure of banks, the role of the informal economy and providing banking infrastructure such as credit bureau and registrars. The CBN would review the basic one-size-fits-all model of banking in addition to reviewing the universal banking model, which would be replaced by the specialized banking model, where three licence types would be issued. The first is the commercial banking licence issued to organizations for the purpose of regional, national or international banking. The second is the specialized banking licence for microfinance banks and mortgage banks. The third licence is for

investment banking, which extends to development banking. These developments in the near-term would make it possible to have international, national, regional, mono-line and specialized banks, with different capital requirements proportionate to the depth of their activities.

Ensuring the Financial Sector Contributes to the Real Economy

The rapid growth experienced in the financial sector in Nigeria has not impacted positively on the real economy as much as anticipated. Development finance institutions set up for specific purposes, such as agricultural finance, housing finance, trade finance, urban development, did not achieve their stated mandates. Also, credit flow from the deposit money banks to the real economy has been grossly inadequate. Thus, the need for creating financial accommodation for economic growth through initiatives such as development finance, foreign direct investment, venture capital and public-private partnerships has become very imperative.

Under this pillar, the CBN has outlined measures to ensure that the financial sector contributes meaningfully to the development of the real sector. These include:

- (i) Leverage on the role of the Bank as adviser to the government on economic matters, to ensure that the financial sector impacts on the real economy;
- (ii) Take the lead in measuring more accurately, the relationship between the real sector and financial sector, as well as the transmission mechanism;
- (iii) Evaluate continually the effectiveness of existing development finance initiatives such as agricultural credit and import-export guarantees;
- (iv) Take the lead in encouraging examination of critical issues for real sector developments;
- (v) Encourage further studies on the potential of venture capital and private-public partnership initiative for Nigeria in the real sector; and
- (vi) Cooperate with state governments to run pilot programmes in positively re-directing the financial sector's contribution to the real sector.

With the above mentioned initiatives, the current banking sector reforms of the CBN is expected to contribute significantly to the development of the real sector of the economy.

III.5 Financing Initiatives under the Current Reforms

Pursuant to the objectives outlined under the fourth pillar and as part of its developmental function, the CBN has introduced new initiatives to enhance the flow of credit to the productive sectors of the economy.

The new incentives include:

III.5.1 ₦200 Billion Restructuring/Refinancing to the Manufacturing Sector/SMEs

In a bid to unlock the credit market, the CBN provided ₦500 billion out of which ₦200 billion is for re-financing/re-structuring of banks' existing loan portfolios to the manufacturing sector and SMEs. The investment is in the form of debenture stock to be issued by the Bank of Industry (BOI). The main objective of the fund is to fast-track the development of the manufacturing sector by improving access to credit by manufacturers as well as improving the financial position of the DMBs. The category of facilities under the fund include long-term loans for acquisition of plant and machinery, refinancing of existing loans, resuscitation of ailing industries, working capital and refinancing of existing lease. The loan amount for a single obligor is the maximum of ₦1 billion in respect of re-financing/re-structuring with an interest rate of 7.0 per cent payable on quarterly basis. All the 24 banks in the country as well as Development Finance Institutions (DFIs) excluding the Bank of Industry (BOI) are to participate in the fund. Thus far, the sum of ₦130.2 billion has been disbursed from the fund with ₦117.7 as term loan while the balance of ₦12.5 billion was disbursed as working capital.

IV. Developments in the Real Sector (2005-2009)

Table 1 below shows credit by the banking sector to selected sub-sectors in the real sector. For the period 2006–2009, total credit to the economy from the banking sector rose from ₦2,535.4 billion in 2006 to ₦8,769 billion in 2009 and averaged ₦5,830.7 billion during the period. Credit to real sector activities, agriculture, solid minerals, manufacturing, real estate, public utilities and communication on the average, accounted for 41.8 per cent of total credit, while general commerce, services and government received the balance of 58.2 per cent. The share of manufacturing in total credit to the economy fell sharply, from 16.9 per cent in 2006 to 10.6 per cent in 2007, before rising to 12.6 per cent in both 2008 and 2009 (table 2). Manufacturing average share was 13.2 per cent and had the highest credit allocation. It was followed by solid minerals and communication, the shares of which averaged 11.1 and 7.7 per cent, respectively. The average for agriculture was abysmal at 2.1 per cent.

**Table 1: Credit to Selected Sectors in the Real Sector by the Banking Sector
(N' Billion)**

Credit By Sector	2006	2007	2008	2009	Average
Total Credit to the Economy	2,535.37	4,606.56	7,411.43	8,769.34	5,830.68
Agriculture	56.50	149.58	106.35	136.89	112.33
Manufacturing	427.28	487.58	932.80	1,109.86	739.38
Solid Minerals	255.01	490.71	846.94	1,083.99	669.16
Real Estate	148.49	285.82	466.80	756.06	414.29
Public Utilities	23.71	26.03	45.84	40.51	34.02
Communications	191.49	321.01	539.15	817.90	465.14
General Commerce	601.45	735.80	1,229.66	1,006.31	893.31
Finance & Insurance	116.02	432.36	714.47	995.40	564.56
General	600.23	1,516.23	2,384.53	2,529.20	1,757.55
Government	115.19	170.43	144.88	293.14	180.91

Source: Central Bank Nigeria

Table 2: Percentage Share of Credit to Selected Sectors of the Real Sector

Sectors	2006	2007	2008	2009	Average
Agriculture	2.23	3.25	1.43	1.56	2.12
Manufacturing	16.85	10.58	12.59	12.66	13.17
Solid Minerals	10.06	10.65	11.43	12.36	11.12
Real Estate	5.86	6.20	6.30	8.62	6.75
Public Utilities	0.94	0.57	0.62	0.46	0.65
Communications	7.55	6.77	7.27	9.33	7.73
General Commerce	23.72	15.97	16.59	11.48	16.94
Finance & Insurance	4.58	9.39	9.64	11.35	8.74
General	23.67	32.91	32.17	28.84	29.40
Government	4.54	3.70	1.95	3.34	3.39

A study by the CBN in 2010 on "Enhancing Bank Credit flow to the Real Sector of the Nigerian Economy" showed that 24.03 per cent of the total fund requirement of firms came from bank loans and advances.

Table 3: Company Sources of Fund

	Company Fund	Equity	Loans & Advances	Others	Total
2006	3,167.09	632.00	1,936.78	7,741.87	13,477.74
2007	3,235.50	632.00	2,745.17	13,951.35	20,564.02
2008	4,338.65	1,268.00	5,652.45	18,965.60	30,224.70
2009	6,150.42	1,318.00	2,004,967.50	2,022,230.57	4,034,666.49
	(As % of Total)	(As % of Total)	(As % of Total)	(As % of Total)	
2006	23.50	4.69	14.37	57.44	
2007	15.73	3.07	13.35	67.84	
2008	14.35	4.20	18.70	62.75	
2009	0.15	0.03	49.69	50.12	
Average	13.43	3.00	24.03	59.54	

Table 4: Criteria For Considering Loan Applications (per cent)

	Value of Collateral	Project Viability	Development Potential	Repayment Period	Managerial Capability	Character of Borrower	Risk Borrowers Sector
1	30.0	5.0	40.0	0.0	5.0	10.0	5.0
2	20.0	10.0	25.0	10.0	10.0	5.0	15.0
3	5.0	5.0	10.0	5.0	55.0	5.0	15.0
4	5.0	30.0	0.0	10.0	25.0	15.0	20.0
5	20.0	25.0	5.0	20.0	0.0	5.0	35.0
6	15.0	20.0	0.0	45.0	5.0	10.0	5.0
7	5.0	10.0	20.0	10.0	0.0	50.0	5.0

Table 5: Demand and Supply of Credit to Firms (Number)

	No of Firms that demanded loans	No of Firms that received loans	Firms that Demanded Loan as(per cent) of Total	Firms that Received Loan as (per cent) of Total
2006	4	3	21.05	15.79
2007	8	3	42.11	15.79
2008	9	5	47.37	26.32
2009	5	5	26.32	26.32
	Number of Firms Covered	19		

Further analysis shows that funding from the banks accounted for only 14.4 per cent of total funds in 2006, 13.4 per cent in 2007, 18.7 per cent in 2008 and 49.7 per cent in 2009. The result of the survey also gave indications of how real sector enterprises fared in terms of attracting bank credits. The survey showed that banks satisfied an average of only 15.8 per cent of the number of loan requests made by real sector firms in 2006 and 2007, and 26.3 in 2008 and 2009.

Furthermore, the study tried to establish the credit gap and explain why banks are reluctant to lend to the real sector in Nigeria and found that, in credit packaging, bank treasurers evaluate the safety of their funds, the liquidity of the balance sheets and the profitability of proposed ventures. Safety has more weight the smaller the asset base, while the need to ensure liquidity depends on the customer base and the frequency of transactions. Profitability compensates shareholders and guarantees going concern for the bank. Since the liberalization of the credit market in Nigeria under the Structural Adjustment Programme, the status of Preferred Sector was stripped off the real sectors and so the compulsory funding from banks dried up. Moreover, the market-determined interest rates have tended to exclude the real sectors, especially, agriculture, from the credit market. An assessment of the National Accounts of Nigeria indicates that the real sector contributes over 60.0 per cent to the gross domestic product (GDP), but attracts only about 40.0 per cent of total credit. Worse still is the case of agriculture which contributes over 40.0 per cent of the GDP (Table 6) but attracts less than 2.0 per cent of total credit. Banks were reluctant to lend for real sector activities for reasons such as poor managerial ability, ability to repay, unfavourable growth prospects in the sub-sector, inherent risk and insufficient collateral, etc.

Table 6: Percentage Share of Selected Sectors of the Real Sector in GDP

Sectors	2005	2006	2007	2008	2009
Agriculture	41.19	41.72	42.01	42.13	41.85
Manufacturing	3.79	3.91	4.03	4.14	4.20
Solid Minerals	0.27	0.28	0.30	0.32	0.33
Real Estate	1.52	1.59	1.67	1.75	1.82
Public Utilities	3.58	3.54	3.49	3.42	3.31
Communications	1.53	1.91	2.38	3.00	3.74

Table 7: Selected Real Sector Indicators

	2005	2006	2007	2008	2009	Average 2005-2009
Real GDP Growth Rate	6.51	6.03	6.45	5.98	6.90	6.37
Non-oil GDP Growth Rate	8.59	9.41	9.52	8.95	8.61	9.02
Agricultural Sector Growth Rate	7.07	7.40	7.19	6.27	6.21	6.83
Industrial Sector Growth Rate	1.71	-2.51	-2.23	-3.41	0.83	-1.12
Manufacturing Growth Rate	9.61	9.39	9.57	8.89	8.58	9.21
Inflation Rate (per cent) Year-on-Year	11.6	8.5	6.6	15.1	13.9	11.14
Capacity Utilization (per cent)	54.8	53.3	53.5	52.6	55.01	53.84
Crude oil Price (US\$)	55.43	66.38	74.96	101.15	62.08	72.00

Source: CBN Statistical Bulletin and Annual Report and Statement of Accounts, Various Issues

A review of some selected real sector indicators provides a picture of the performance of the real sector in the face of the banking sector reforms. Real output growth has been modest over the review period, averaging 6.37 per cent. Growth rates of the agriculture and manufacturing sectors have been relatively stable. Inflationary pressures moderated between 2005 and 2006, before assuming an upward trend for the rest of the period. Average capacity utilization in the manufacturing sector averaged 53.84 per cent for the period.

V. Challenges of Real Sector Lending

The major challenges to real sector financing from banks have been identified as unfavorable macroeconomic environment, cumbersome documentation process, inadequate long-term finance, lack of data base on borrowers and poor infrastructure.

Addressing the Challenges of Lending to the Real Sector

- (i) A stable macroeconomic environment encourages lending. Thus, the Bank should ensure minimal price and exchange rate fluctuations which are proxies for macroeconomic stability. Related to macroeconomic stability is the need for effective coordination of monetary and fiscal

policies which could be assured through regular liaison with the Debt Management Office, Budget Office and the Accountant General's Office. Frequent and focused meetings of the fiscal and monetary authorities would ensure consistency in government pronouncements and economic policy measures, and this would build confidence among industrialists who say that frequent policy reversals scare them from borrowing.

- (ii) Most business people opine that the documentation process for obtaining loans in Nigeria is too cumbersome and discourage prospective borrowers. The Bank could through the mounting of workshops on documentation requirements encourage DMBs to reduce the documentation processes for loans. The issue of borrower identification which gives rise to multiple documentation requirements could also be solved by the Bank partnering with relevant agencies to create a database for all industrialists.
- (iii) The various financing scheme established by the CBN should be monitored and evaluated on half-yearly basis to ensure their efficient and effective implementation.
- (iv) Borrower identification is also a major consideration for banks. The CBN should encourage and help equip the credit bureau which will warehouse data concerning firms and their credit portfolios. The bureau's data base should be electronic and remotely accessible to all stakeholders.
- (v) In addition to iv above, to be able to assign unique identification to all Nigerians, the Bank should partner with the agency responsible for the National Identity Cards Scheme to complete the project. It has to be emphasized that the new cards should be chip-based and consolidated in a database that all authorized persons and corporates could access as and when needed.
- (vi) The Bank should increase communication with the populace, especially as it affects the various schemes which are available for industries and small borrowers.
- (vii) Management should consider re-evaluating the funding schemes, like the ACGSF, SMEEIS, CACS, etc to ascertain the reasons why they are not effective and take steps to improve on their service delivery. In particular,

SMEIS should return to being mandatory to the banks as it performed relatively well before it was made optional.

- (viii) Government should take urgent steps to fix the infrastructural facilities in the economy to reduce the burden of providing them by the private sector, reduce their operational costs and make them competitive. An approach that could help is to raise development bonds earmarked for infrastructure in the energy and transport sectors, in particular. For electricity, the national grid could be dismantled and regional electricity boards set up to manage the transmission and distribution operations, as generation is largely privatized. This will engender competition and efficiency. A complementary approach is to encourage the promotion of the cluster system in which infrastructures are provided at designated sites for the benefit of industrialists.
- (ix) Lack of managerial expertise is echoed by both banks and firms as impediment to lending/borrowing. The government, through the Ministry of Labour and Productivity, should institute more skill acquisition programmes for entrepreneurs, to inculcate in them corporate governance and managerial skills.
- (x) With regard to collaterals, the government should fast-track its land reforms to ensure that land owners are enabled to secure Certificate of Occupancy from governments which will make the banks more confident in granting loans to the firms.

VI. Conclusion

The current priority attention being accorded the real sector is well deserved. This is because the sector has great potentials to be the engine of growth in Nigeria. In the face of rising unemployment and high poverty levels, growth generated from this sector, particularly agriculture, is pro-poor and most desired. It is capable of lifting the greatest number of people above the poverty level. While efforts are being made to address the credit bottlenecks are very commendable, there is the need for complementary reforms to provide the other critical elements. These include improving power, transportation, water, and all other ancillary issues which account for under-performance in the sector.

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