Banking Sector Reforms and the Industrial Sector: The Bank of Industry Experience

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I. Introduction

Banking industry has witnessed a number of reforms at different times in response to financial crisis or as a catalyst for economic development. In Nigeria, these reforms dated back to the colonial era. Major reforms are presented below. The Banking Ordinance of 1952 was triggered by the mass failure of about 24 banks in the pre-independence era. The situation led to the introduction of the first legislation to regulate banking operations in Nigeria; the Indigenization Act of 1977 encouraged private Nigerian entrepreneurs to enter into joint ventures with foreign banks to establish banks. The downside of the indigenization policy, however, was its unintended consequence of making the Federal Government the largest single shareholder in leading banks; and the deregulation policy of 1986, among others, liberalized the issuance of banking license, leading to a proliferation of undercapitalized banks with poor risk management and poor corporate governance practices. The Banking sector reform was a response to weak capitalization which culminated into the banks' minimum capital requirement being increased to ₦500 million. Twenty-six banks were liquidated on account of distress.

By January 2001, the banking sector was fully deregulated with the introduction of the era of one-stop-shop and the adoption of universal banking system. Thus, the inevitable need for greater capital led to the increase in banks' minimum capitalization to ₦2 billion.

A fragmented "rent-seeking" banking industry "earning income by capturing economic rent through manipulation/exploitation of the economic and political environment, rather than by earning profits through economic transactions and the production of value-addition wealth" had to be addressed. Consequently, banking consolidation with a directive to banks to increase their minimum capital base from ₦2 billion to ₦25 billion within 18 months was introduced in 2004. Thus, banks were mandated to raise funds aggressively and commence the process of mergers and acquisitions, if unable to meet the stipulated minimum capital base.

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At the end of the consolidation exercise, the number of banks dropped from 89 to 25 and, eventually to 24 following a merger of two of the consolidated banks. As a result of the flaw in the implementation, inadequate supervision and the global financial crisis which occurred simultaneously at that period, the sudden increase in capital requirement led to a very fractured banking industry which tended towards systemic failure, hence, the need for further reforms. Following this brief introduction is section two which analysizes the reforms and the real sector while section three highlights the mandate and functions of the Bank of Industry. The concluding remark is covered in section four.

II. Reforms and The Real Sector

Given the critical nature of the real sector to the growth of the Nigerian economy, the CBN had in the past used policy measures to compel banks to devote attention to the real sector especially Small and Medium Enterprises (SMEs).

II.1 Past Reforms

- The sectoral credit allocation and interest rate cap of the 1970s and early 1980s

- The CBN introduction of SME I and II financing schemes

- The Small and Medium Industry Enterprises Equity Investment Scheme (SMIEEIS) and the Rediscounting and Refinancing Facility initiated in 2002.

Despite the above measures which were meant to galvanize banks to lend to the real sector, including the bank consolidation exercise of 2005 that raised hopes that high level of liquidity in banks would engender lending to the real sector, banks' lending to manufacturers remained diminutive.

A careful review of the effects of the banking sector consolidation reforms on the real sector and macro-economy revealed the following unintended but related consequences:

- Distortions in the macro-economy caused by large and sudden capital inflows.

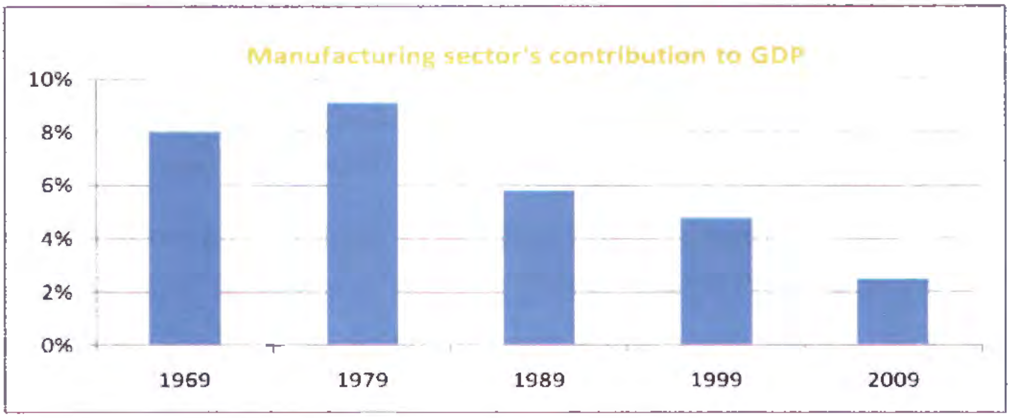
- Worsening conditions in the business environment, in particular the real sector, occasioned by :

- Crowding-out of the real sector in financial allocation as capital was deployed to purchase bank shares.

- The lure of the stock market, leading to the allocation of significant part of the capital sucked in by banks during consolidation to margin loans and proprietary equity trading.

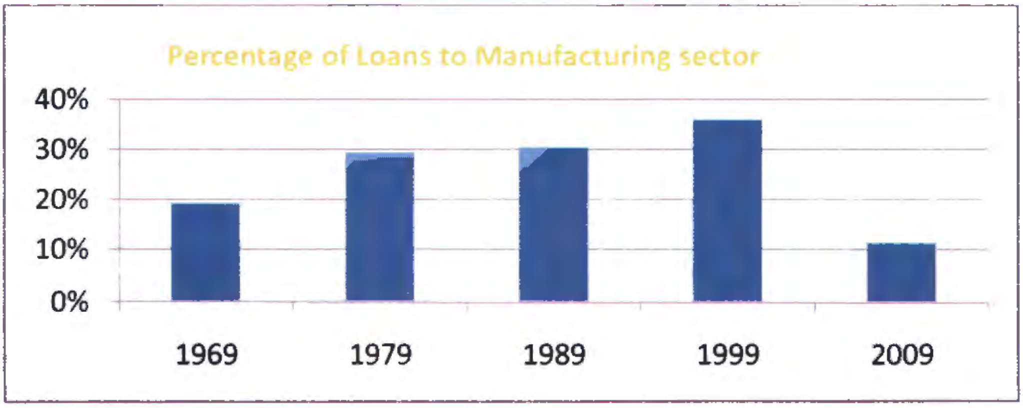
Thus, while the stock market "bubbled", the real sector witnessed significant downturn in activity. Manufacturing output was particularly hard hit, estimated to have fallen to its lowest levels since 1969 in terms of contribution to GDP as well as share of credit allocation to the sector as depicted in the charts below:

Figure 1: Manufacturing Sector's Contribution to GDP



Source: Central Bank of Nigeria Statistical Bulletin, December 2009

Figure 2: Percentage of Loans to Manufacturing Sector



Source: Central Bank of Nigeria Statistical Bulletin, December 2009

II.2 Current Banking Reforms

From the foregoing, there was need for urgent measures to be taken to contain the crisis and this informed the actions taken in the current banking reforms. The objective of the current banking reform is broadly two-fold:

- stabilize and enhance the quality of the banking sector; and
- promote long-term sustainable growth of the banking sector and the economy as a whole.

Both elements as indicated have significant impact on the overall growth of the manufacturing sector and the reasons are that:

i. financial sector soundness facilitates macroeconomic stabilization and creates the conditions for the resumption of growth.

ii. the tendency towards a systemic banking crisis prior to the reforms made major government intervention imperative. Intervention is justified by negative externalities associated with widespread bank failures, such as disruptions to credit flows and reduction in the granting of loans.

iii. Progress in banking reforms was critical for improving domestic and foreign confidence in the economy.

Given that lack of credit is just one of the many setbacks facing the manufacturing sector, critics of the banking reforms argue that weak domestic demand, the high cost of doing business in Nigeria arising from the poor state of infrastructure require intervention beyond establishing a sound financial system and that the reforms short-circuited lines of credit to Nigerian banks with adverse consequences for the economy.

A major question was whether the economic program should focus exclusively on macroeconomic policies, leaving the banking reforms for a later time, or should the banking reforms have been made at a slower pace? The following holds true and is consistent with lessons learnt and good practices from international experience:

i. The large amount of non-performing loans in the system had resulted in an excessively cautious lending environment. The delay in the banking reforms would have caused even greater credit hold back and further postponed the restoration of normal credit flows.

ii. Allowing insolvent banks to continue operating without restructuring the sector would have promoted market distortions.

iii. The banking reform was important in facilitating the rollover of maturing foreign lines of credit and new private investment crucial to ensuring the necessary financing of the economy; flows may have stopped if domestic banks and businesses were perceived to remain financially shaky and inadequately supervised.

iv. Keeping insolvent banks in business for much longer would have cost the system much higher than the ₦620 billion liquidity injection by the CBN and further complicated monetary management.

II.3 CBN Intervention Fund

- The ₦500 billion intervention is part of monetary policy management to ensure adequate monetary growth and provide sufficient long-tenured liquidity in the banking system to boost real sector activity.

- Managed by the Bank of Industry, the ₦200 billion out of the ₦500 billion intervention fund is for the refinancing/restructuring of bank loans to the manufacturing sector while the balance of ₦300 billion is for power and aviation sectors and the loan attracts an interest rate of 7.0 per cent and tenor of up to 15 years.

- Applications were received from 681 companies for the refinancing component for a total of ₦250 billion, with 516 found to be eligible for about ₦200 billion.

Preliminary analysis indicates that the impact of the fund both on the real sector, the banking sector and the economy as a whole has been tremendous. This includes:

- Improved cash-flow through lowered beneficiaries' interest cost, lengthened beneficiaries' debt maturities and reduced overall debt service.

- Improved banks' loan books and reduction in loan loss expense.

- Improved liquidity in the system.

- Provided working capital to enhance SMEs / Manufacturers' operations.

- Increased employment generation

- Resuscitation of ailing industries

The intervention in the power sector now in progress is likely to have more impact in reducing the cost of doing business for manufacturers and boosting economic activity.

Specific interventions like the ₦500 billion Fund portend a bright future for the Nigerian manufacturing sector.

III. Bank of Industry (BOI)

The Bank of Industry is Nigeria's leading development finance institution (DFI) which has contributed significantly to Nigeria's economic and social development since emerging from the reconstruction of its precursor institution, the Nigerian Industrial Development Bank (NIDB).

III.1 Mandate of BOI and Major Activities

The mandate of the bank is primarily to finance and catalyze industrial development. In the last five years, the vision has been to finance growth and empower the weaker segments of the society to gain access to productive assets and opportunities for sustainable growth and development.

The effort towards equity and empowerment through lending and capacity building for sustainable inclusive development has engendered a paradigm shift since 2005 in the bank's strategic direction, orientation and mode of operation. Central to the bank's paradigm shift are:

- Structured industrialization of the country through the stimulation and development of micro, small and medium enterprises (MSMEs), which are widely recognised as the engine of economic growth, with higher developmental impact and multiplier effect per unit of investment;

- BOI's commitment of 95 per cent of its resources to MSMEs geared toward the attainment of the objectives of National Economic Empowerment and Development Strategy (NEEDS), New Partnership for Africa's Development (NEPAD) and the Millennium Development Goals (MDGs).

- Expanding the private sector and bringing to bear, the efficiencies and institutional capacity of the formal sectors operations on the large informal sector which could contribute significantly to GDP.

All of these culminated in the phenomenal growth in the volume of the bank's investments as shown in the table below:

Table 3: Value of Investment/Loans - 2005-2010

	Sept 2010	2006-2009	2001-2005	Per cent Growth (2005-2009)	Per cent Growth (2005-2010)
No of Investments	**249**	**643**	**88**		
Commitment in the No of Investments	**980**	**731**	**88**	**731 per cent**	**1013 per cent**
Value of Investments (₦bn)	**44.7**	**56.1**	**9.8**		
Cumulative Value of Investment (₦bn)	**110.6**	**65.9**	**9.8**	**572 per cent**	**1028 per cent**

Source: Bank of Industry (various issues)

Very importantly, the financial and operational performance confirms that enterprise profitability and development could be complementary. Through home grown reforms, there exists a strong, dynamic and flexible DFI responsive to the citizenry.

III.2 Emerging Initiatives in the SME Sub-Sector

Specific initiatives and self-driven developmental measures taken to ameliorate the challenges of SMEs which were discovered through our intensive and extensive work with the SMEs over the period, include:

a) **Cluster-based Industrial Development Strategy.** Advocated for and encouraged the adaptation of the cluster-based industrial development strategy through the establishment of industrial parks and other cluster formations – the parks/clusters are planned to be implemented using the public-private partnership (PPP) arrangement under BOI.

b) **Value-Chain Approach.** Deliberate measures towards the insertion of the Nigerian SMEs on the global value-chain and the encouragement of entrepreneurial capitalism to be developed by transformational rather than transactional entrepreneurs.

c) **Pro-Employment Strategy**. Pro-employment with emphasis on the re-establishment of the missing middle-class especially through the empowerment of the disadvantaged groups, e.g women and the youths. Through this, the bank created a Gender Desk, handling various loan schemes exclusively for women affairs amongst others.

d) **Partnership Programme.** The synchronization of the bank's funding programmes with the developmental objectives and resources of the states/local governments – This programme led to the creation of matching funds whereby state governments provide funds which are matched with BOI funds for onward-lending to projects from the partner–states.

e) **Financial Model.** Creation of financial models that will meet the requirements of the MSMEs, e.g:

- Cooperative cluster: designed to reach the relatively small operators without access to collateral property. As at date, the bank has approved over ₦1.360 billion under the window to more than 220 Associations; and

- Structured working capital financing: a "derivative" product of the bank to assist companies with growth potentials but lacking adequate working capital.

f) **Capacity Building** - Empowerment of the Nigerian entrepreneurs through exposure to international best practices and establishment of global partnership in support of the MSMEs. This entails:

  - organising Boot-Camp workshop primarily to sensitise indigenous existing and potential entrepreneurs to business opportunities, financing, as well as inculcating successful management skills in local business owners.

  - Collaborating with various multilateral development agencies in the training of local entrepreneurs.

g) Facilitating the partnership/franchising working arrangement between indigenous producers and foreign producers who are mainly Nigerians in the Diaspora.

III.3 Specialised Funds

Management of specialized funds for industrial development, including the CBN Intervention Fund, the National Automotive Development Council (NADC) Fund, the Business and Development Fund for Women (BUDFOW), the Sugar Fund, the SMEDAN Fund, the MSME Development Funds in: Anambra, Delta, Kwara, Niger, Kogi, Osun, Ondo, Edo and Ekiti States totaling about ₦3 billion as at date, the Cotton, Textile and Garment Development Scheme, and the Rice Intervention Fund .

IV Collaborative Efforts

There is an on-going collaboration between BOI, United Nations Industrial Development Organisation (UNIDO), CBN and Alliance for Green Revolution in Africa (a private agency for agricultural development and financing in Africa) among other stakeholders to develop a framework for the identification of the agricultural value-chains and provide a financing window for the agribusiness. This becomes important as aagriculture accounts for 40.0 per cent of Nigeria's GDP, 70.0 per cent jobs are agriculture-related, accounts for 85.0 per cent of non-oil export, agro-industry contribution to real sector GDP is 6.0 per cent, 90.0 per cent of the poor and engaged in agriculture, and less than 5.0 per cent of those in agriculture have access to finance

- In order to facilitate regular supply of energy as well as to reduce cost of production by MSMEs in various clusters, BOI is partnering with UNDP on renewable energy initiative, using BOI as the Implementing Agency.

- BOI is also actively involved in capacity building programmes in collaboration with UNIDO, US Department of Commerce, business partners, IDC of South Africa, USA and Thailand EXIM banks, among others, for training of entrepreneurs and officers of the bank in order to expose them to international best practices.

- In order to deepen capacity of entrepreneurs and encourage export, an AGOA Resource Centre was established in BOI head office. The centre is engaged in training entrepreneurs that are willing to export their products to the US market, duty free.

Going forward, the BOI is poised to be a key part of the team that will bring fundamental strategic change in the manufacturing sector and the macroeconomy in general, resulting in higher output and employment. Effort is being directed at diversifying, modernizing and strengthening the industrial base for international competitiveness. Some specific programs are:

- Enhancing the vitality of SMEs to drive Nigeria's manufacturing into the 21st Century
- Promoting the establishment of local resource-based manufactures to enhance primary products value-added - special funds currently running for the rehabilitation and modernization of rice milling, CTG and automotive components industries
- Creating industrial diversity and building capacity to take advantage of the emerging export opportunities
- Moving industrial production up the ladder to products with higher levels of technological sophistication.

V. Concluding Remarks

Financial and corporate sector weaknesses have played major roles in the slow pace of growth of the real sector of the Nigerian economy. These weaknesses increased the exposure of financial institutions to a variety of external threats, including declines in asset values and market contagion.

Policy responses to the banking crisis have rightly emphasized structural reforms in the financial and corporate sectors in addition to the implementation of appropriate macroeconomic policies. Current banking reform is a step in the right direction and the preliminary results are positive.

Finally, there would be need to complement banking sector reforms with the development of a vibrant educational system, modern institutions, legal structures, social and physical infrastructures as well as new skills and attitudes that will contribute to higher economic growth and development.