DEBUGGING AND SANITIZING THE NIGERIAN FINANCIAL SYSTEM

*Professor M. O. Kayode and Dr. Ayodele F. Odusola**

Abstract

Using a concentric circle analysis, the paper provides a framework for examining the centrality of the borrower / user or manager of funds in the stability of the financial system. If identified as bugs, those who defaults on loan contracts and are cancerous to the system. They must therefore, be debugged. In order to drive the sanitation of the financial system, the paper advocated among others, the rejuvenation of the value system, involvement of banks in project ideas and packaging, institutionalisation and implementation of bankruptcy law as will as application of incentives and sanctions.

I. INTRODUCTION

A well functioning financial system provides additional impetus to economic development while a poorly functioning one injects additional frictions to the development process. Over the past two decades, discussion and concern over fragility of the financial system has assumed greater currency among policy analysts and policy makers. Between 1980 and 2000, over 100 countries experienced systemic financial turbulence. One of the manifestations of this problem is the preponderance of large

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amounts of substandard and non-performing loans; issues that have suggested that credit quality has declined very drastically. This consequently leads to increased variability of earnings and reduced profitability, which have been threatening the entire financial and payment systems. As such, the binding spirit of the financial system -value and confidence has been weakened. The development has shifted the structure of activities in the financial system through potential decline in the traditional intermediary services of banks and expansion in the activities of securities firms. The effects of financial system fragility transcend the financial system. Apart from restricting such traditional roles of the financial system (particularly the banking institutions) as portfolio management, payment, risk sharing, project idea assessment and project monitoring, they also hinder the efficiency of producing goods and services thereby reducing the wealth and income of the society.

Financial instability can result from macroeconomic and microeconomic causes. From the macroeconomics end, such factors as real exchange rate appreciation, lending booms, low reserves, decline in growth of economic activities and balance of payment conditions, to mention a few, are often alluded to as being responsible for financial vulnerability of many countries (Kaminsky and Reinhart, 1997; Odusola 2001). Substantial efforts have been made in articulating these issues in the literature. The microeconomic causes, on the other hand, have been linked to mismanagement, inadequate supervisory and regulatory capacity and information asymmetry with particular emphasis on moral hazard (Mishkin, 1997; de Juan 1991 and Ebhodaghe 1994). This implies that at the micro level, the stability of the Nigerian financial system, as obtained in other developing countries, rests squarely on three main groups of actors: the regulatory institutions, the financial intermediaries and the borrowers. The microeconomic underpinning thus examines the stakeholder analysis of financial crises. Crises resolution strategies have been focused more on both the financial intermediaries and the regulatory institutions. The third leg of the tripod - the borrowers has received less attention and in deed, underemphasized.

In any case, without prejudice to other factors, it is hypothesized that lack of sound project ideas and viability contributed significantly to financial instability in Nigeria. The preponderance of lack of willingness to repay borrowed loans, a newly evolving behaviour in Nigeria, is also a clog in the wheel of financial stability in the country. While the former reflects a management problem (in terms of ability and orientation), the latter mimics the rascality of man in a society characterized by decaying value system. Ensuring financial stability, therefore, presupposes putting appropriate incentives and sanctions in place to deal with rascality of man and to reposition management. This notwithstanding, stability will remain elusive if the value system is not addressed frontally.

This paper, therefore, uses a stakeholder analysis by focusing largely on the segment that has received less attention in the literature the borrowers. Here, a borrower that borrows without repaying or even repaying less than he/she borrowed is treated as a 'bug'. Hence, such 'bugs' are seen as virus to the financial system, which must be 'debugged' or 'disinfected'. Its main objective is to demonstrate that more sanctions and incentives (support) can be used to sanitize the Nigerian financial system. To address this objective, the paper has been structured into four parts. Following this introduction is part II that examines the framework for stable and sustainable financial system. The contending issues in the Nigerian financial system are considered in part III. Sanctions and incentive system that can facilitate effective debugging and sanitization of the system is addressed in part IV while part V concludes the paper.

II FRAMEWORK FOR A STABLE FINANCIAL SYSTEM

Financial stability is very central to effective functioning of a market economy; it provides the basis for rational decision making about the allocation of real resources through time. Its absence can create damaging effects on the economy through misallocation of resources and unwillingness to enter into inter-temporal contracts.

The concept of financial stability refers to smooth functioning of the institutions and markets that make up the financial system: safe, efficient and reliable financial system. It is about the ability of the financial system to withstand adverse events. The system is considered unstable when many financial institutions suffered from insolvency or illiquidity shocks that impaired the public confidence. Pischke (1991) and Soyibo and Odusola (2002) conceptualize soundness/stability as the ability of financial institutions to create value and build confidence in the process of risk management using the framework of financial triangle (Figure 1). This rests on the banks ability to harmonize two contrasting terminologies of finance - risk and confidence to create value. When risk is sufficiently offset by confidence, transactions occur and value is created. As shown in figure 1, the financial triangle demonstrates that increased risks will reduce value unless this is offset by increased confidence. Thus, declines in confidence reduce value unless risk-taking declines proportionately. Value raises the incentives to innovate. The urge for innovation raises the urge to take desperate risks while increased risks affect confidence. Hence, when value of the financial system declines continuously through inability of the operators to harmonize risk-taking with confidence building, then the health of the system is considered unsound or unstable.

The building block of financial stability - moderate risks, confidence and value creation only holds when the credit cycle is complete. It is completed when the borrower repays his debt to the lender in terms of the original contract. For this to hold, borrower's ability to pay must not be in doubt. However, in society dominated by poor value system, willingness to repay borrowed funds is always very low. Even when he is willing to pay, the sufficient condition for doing so is having sound project idea and strong managerial capability.

When willingness to pay is very low, or lack of sound project idea or there is weak managerial capacity or a combination of two or more of the factors, credit disbursement tends to be self-destructive as arrears mount and bad debt losses take their toll. In effect, individual borrowers have incentives to destroy financial institutions through non-repayment of loans, rather than to preserve them as intermediaries to which savings can be entrusted and from which future loans are likely to be available if certain rule of conducts are followed. This thus destroys the fabrics of financial stability.

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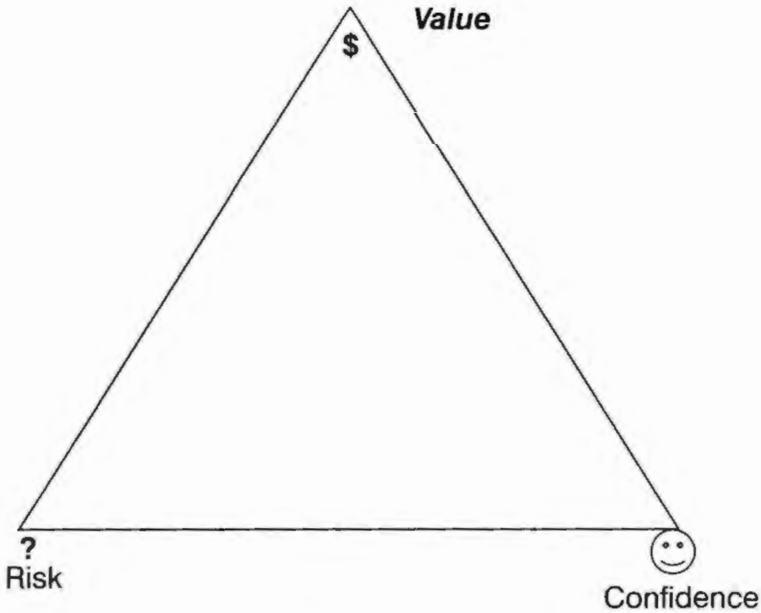
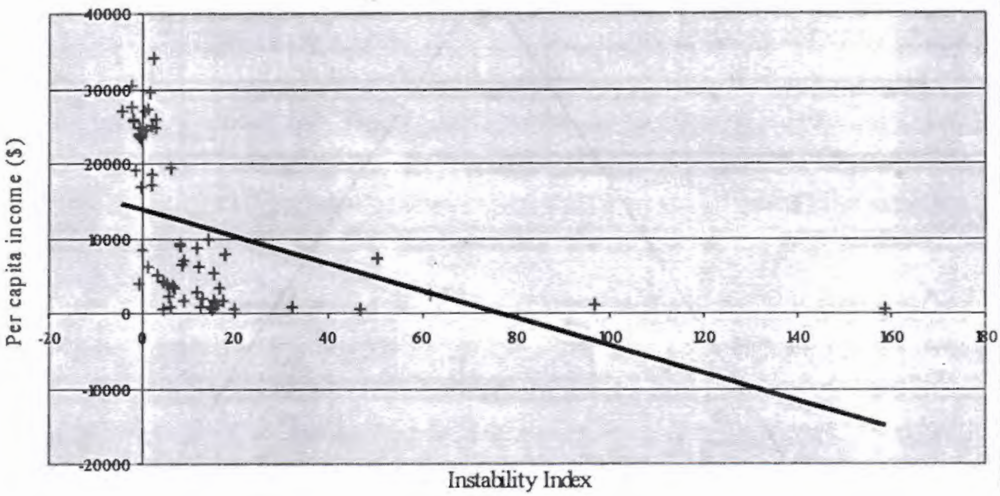
Figure 1:
The Financial Triangle



Evidence from Figure 2 confirms this relationship. The least five countries at the extreme horizontal axis (in ascending order) are Angola, Congo Democratic Republic, Zimbabwe, Brazil and Malawi. On the other hand, the best seven countries, as indicated in vertical axis (in ascending order) are USA, Switzerland, Norway, Japan, Belgium, Denmark and Canada. This is a clear confirmation of the theoretical proposition of inverse relationship between financial instability and economic growth. By implication, a stable financial system is congenial to economic growth and development.

Figure 2: Financial Instability and Economic Development



III. CONTENDING ISSUES IN THE NIGERIAN FINANCIAL SYSTEM

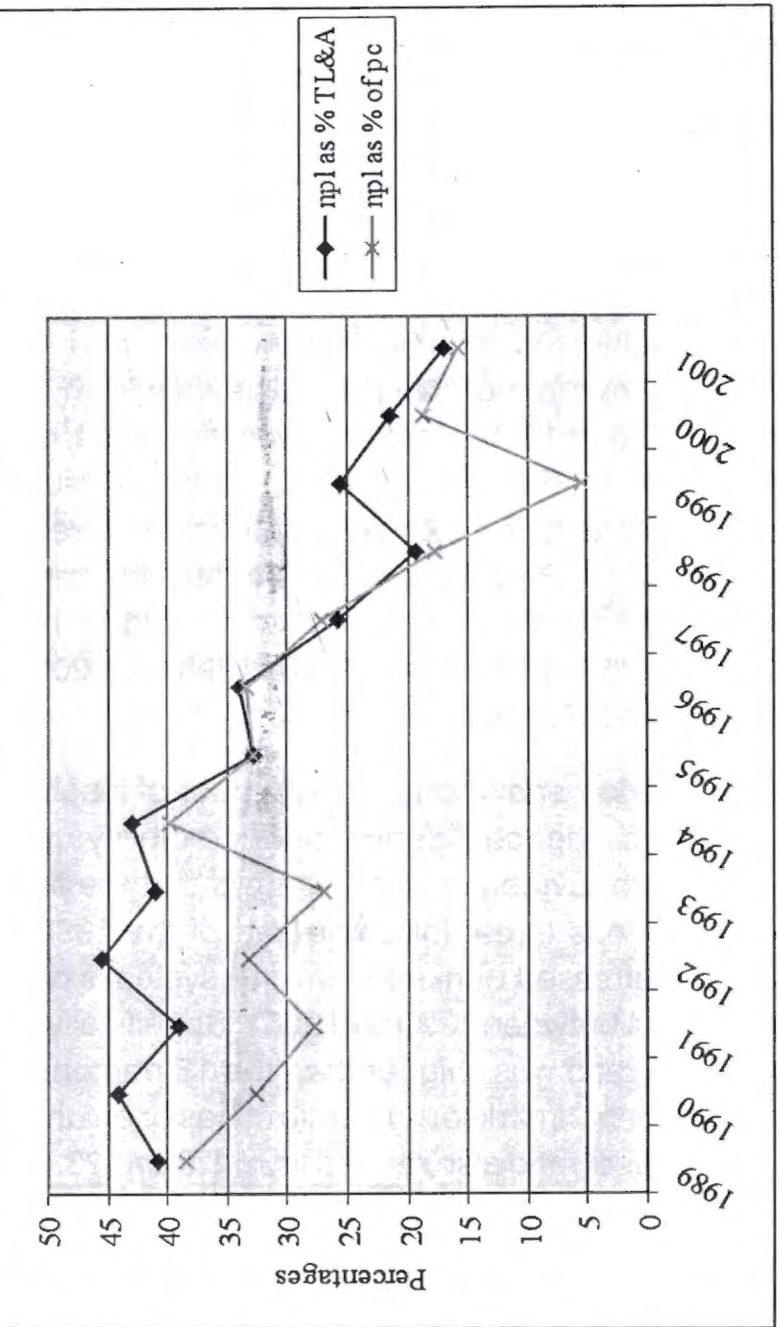
Since the introduction of Structural Adjustment Programme (SAP) in 1986, the landscape of the Nigerian financial system has changed very remarkably. Liberalization and deregulation of the financial system constituted a critical part of the programme. The constituent parts of the financial system expanded with the number of banks, for instance, increasing from 41 in 1986 to 120 in 1994. This represents a growth rate of 192.7 percent. The number of banks declined, however, to 115 in 1997. The branch networking also increased from 740 in 1980 to 2330 in 1997. A host of other deposit taking institutions also came on board. Notable among them are the grass root banking institutions such as the People's

Bank and Community Banks. Such non-bank financial institutions as finance houses, unit trusts, and discount houses also flourished. The number of operators in the capital market also increased phenomenally. The astronomical increase of financial institutions overwhelmed the supervisory capacity of the regulatory authorities.

These rapidly expanding banking and non-banking financial institutions collapsed at the astronomical rate at which they emerged. The number of banks in crisis rose from 7 in 1989 to 24, and 60 in 1992 and 1995, respectively. At this point, one out of every two banks was adjudged to be in crisis. Resulting from the unrelenting efforts of the monetary authorities to redress the issue and the Central Bank's strong commitment to the implementation of resolution options, the number of crisis-ridden banks declined consistently to 50, 15 and 9 in 1996, 1998 and 2001 respectively (Alashi, 2002 and Odusola, 2001).

The phenomenal increase in number of insolvent banks has really impaired the confidence and credibility reposed in the banking system. Evidence clearly shows that the financial system was under serious threat for some part of the 1990s. The ratio of deposits of distressed banks to banking system's deposits ranged from 1.6 to 29.4 between 1990 and 2001. Specifically, between 1992 and 1996, the ratio was higher than the 15 percent prescribed by the CBN as a benchmark for systemic crises or an unstable financial system. The asset ratio also ranged from 1.5 and 23.7 percent with 4 years exhibiting an indication of financial instability. Non-performing loan, which was merely N9.4 billion in 1990 steadily, rose to N57.8 billion and N135.7 billion in 1995 and 2001, respectively. Evidence shows that poor lending and borrowing culture was a major cause of financial instability in the country. The ratio of non-performing

Figure 3: Asset Quality of the Banking System



Note: NPL stands for non-performing loans; TL&A is Total loans and advances of the banking system; and PC stands for Credit to the private sector.

loans as a ratio of banking system loans and advances ranged from 16.9 percent in 1989 to 45.5 percent in 2001 while as a ratio to private sector credit it oscillated between 5.48 and 39.91 percent (Figure 3). The non-performing loans as a ratio of total loans and advances of distressed banks were even more discouraging. The index was more than 70.0 percent in seven years with the most embarrassing figure in 1997 (81.92 %).

Several factors have been adduced to this spate of financial system delinquency in the 1990s. One school of thought believes that the role of macroeconomic factors predominates. To them the principal causes of the crises are capital flows, exchange rate instability and speculative bubbles, swings in relative prices, overbearing fiscal deficits, and downturn in economic activities, to mention a view. Since this is the focus of most studies on this area (e.g., Alashi, 2002; Soyibo and Odusola, 2003; Odusola, 2001), there no point in over-flogging the issue. Another school holds the view that micro issues hold sway and hence gives preference to factors such as mismanagement or poor corporate governance, information asymmetry, weak supervision, political pressures, and frauds, to mention a few. While this paper pitches its tent with the microeconomic school, however, it intends to view the problem using a different microscope. In any case, without prejudice to other factors both micro and macro, our focal point of analysis rests on the centrality of the borrower in the country's financial system stability. The framework of analysis hinges on lack of sound project ideas and viability, and preponderance of lack of willingness to repay borrowed loans. While the former reflects a management problem (in terms of ability and orientation of actors), the latter mimics the rascality of man in a society characterized by decaying value system and negation of past cultural virtues. In our view, most of the factors adduced to financial instability in Nigeria are mere manifestations of the factors mentioned above.

Individual borrowers are often faced with web of forces in a very complex manner. Complex and multidimensional forces influence the behaviour of a borrower. Each of these forces tends to influence the way borrowers treat their loan contracts. When the forces are examined independently, one tends to dichotomize the causes, thereby seeing the problems as either micro or macro causes or a combination of the two. For one to have a balanced view of the problem, it is better to view it from concentric circles framework where the nucleus represents the individual borrower. This nucleus is seen as a black box that explains the underpinning of the stability or otherwise of the financial system. It can also be viewed from a box containing several layers. Each layer stands for a force, with the individual borrower being the innermost part of the multi-layer box. Starting from the innermost to the outermost layers, the sequencing of the arrangement looks thus: individual borrower, firm/lender, financial sub-sector, the Nigerian economy, the Nigerian society, and the rest of the world. What type of interactions exists among these forces?

The individual borrower is the ultimate user of the funds mobilized by the financial system. His behaviour is not only influenced by the lender (who is also influenced by the activities in the financial sector) but also by the operations and the efficiency of the various actors in the financial system. An efficient financial system tends to neutralize the weakness of any sub-optimal lender. But when the system is grossly inefficient, the negative multiplier effect would be very serious. Hence inefficiency in the financial system sends a wrong signal to individual borrower about contract enforcement. This does not only increase the rascality of the borrower about non-commitment to contract enforcement but would make him to operate sub-optimally.

Other forces having direct influences on the borrower are the Nigerian macroeconomic development and the Nigerian society. Such macroeconomic variables that have significant bearing on the net worth and behaviour of the borrower are economic downturn, development in foreign exchange market, speculative attack, swings in relative prices, to mention a few.

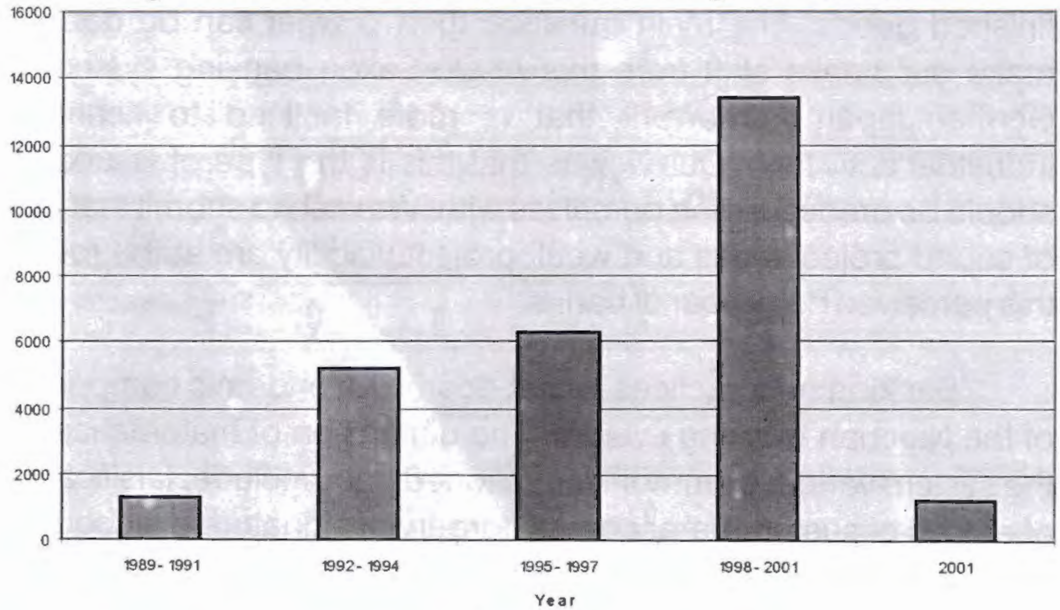
The Nigerian society, on the other hand, has significant bearing on the individuals within: "factors in Nigeria" or "the Nigerian factors" Examples of this is the pervading role of corruption, the shift away from productive capitalism to prostate capitalism when emphasis is on resources flowing from the public to individuals/firms as against the opposite that led to national cake sharing syndrome as in contrast with cake building. Another component of the Nigerian society is the negation of the country's cultural virtues. In the past, all parts of the country was blessed with the culture of bequeath and inheritance. Every elderly person aspired to leave inheritable property to his siblings and debt. Hence everybody tried to pay off his debt in his lifetime so that others would not despise his siblings when he died. Nowadays, people derive joy in being indebted. In fact, the more indebted you are the more important you are in the society. In most cases, loans became bad even before it is disbursed because he is borrowing with the intention of not repaying the loan. While the financial system is in itself influenced by the Nigerian economy and society, the rest of the world also influences its behaviour. An example of this is the Basle indicators of measuring financial soundness and the international accounting standards by the International Monetary Fund.

All these forces, particularly the inefficiency of the financial system, instability in the macroeconomy, and the "Nigerian factors" impose serious constraints on the individual borrower that make him develop some thick skin about rascality of man and in some cases losing the focus of being prudent in managing his enterprise. Because of the forces surrounding him he might decide not to repay the loans borrowed from the financial system thereby making the non-performing loans to be pyramiding. Any slightest panicky behaviour sends the affected banks into a serious crisis. One is not, therefore, surprised that the non-performing loans of the four biggest banks in Nigeria (First Bank, Union Bank, UBA and Afribank) was as high as N20.68 and N24.64 billion in 1996 and 1997 (Odusola, 2001). Because the society has forced him to lose sight of market discipline, he continues to live in false affluence. While doing this, he loses the opportunity of acquiring additional loans for expansion and when funds are not flowing in expectedly, he would be forced to dip into his enterprise capital that may eventually culminated into the enterprise demise. The borrower has eventually turned himself to a 'bug' whose business might die like that of a bug because of his rascally and parasitic behaviour. To clean the financial system of the mess, it is imperative to debug. As earlier mentioned, this is the black box of the financial instability in the country. Thus, most other factors are mere manifestations of the borrower's rascality or his deficient managerial skills. The following are some of these manifestations but wrongly seen as independent factors.

A thorough examination of the banking business in Nigeria between 1892 and 1959, when the Central Bank of Nigeria was established clearly showed that banks primarily aimed at financing trade activities of foreign companies that dominated the business scene in the country. This attribute of Anglo-Saxon banking system has become a predominant inheritance from the colonial masters that has permeated the fabrics of the current banking operations in the country. The maturity structure of bank loans and advances reveal the preponderance of short-term loans that are suitable for traders than industrial production. Between 1990 and 1997 for instance, loans given out for short-term activities ranged from 71.99 to 82.00 percent, with an average of 79.6 over the period. This is an indication that the bulk of private sector credit is delivered to tertiary sector operators; especially traders who distributed imported goods. When this is examined in conjunction with credit to the public sector, one can easily conclude that the Nigerian financial system services government (whose activities in recent times has been predominated by recurrent operations) and importers of finished goods. The main question then is what can be done to make our banks shift from this Anglo-Saxon banking system to German-Japan framework that is more inclined to financing industrial activities? Our view is that this is the type of issues we should be preoccupying ourselves with. We wish to submit that lack of sound project ideas and weak project viability are at the root of this perceived behaviour of banks.

Banking malpractices have become an endemic component of the Nigerian banking system. The dimension of malpractices in the system varied. Commonly mentioned ones include: falsification of entries of customers' accounts, forgery of signature of accounts, deliberate distortions of loans records, forged cheques and letters of credits, suppression of cash, foreign exchange frauds, unauthorized printing of banks stationery or carving of banks rubber stamps, counterfeiting, wrong issuing of cheque books, to mention a few. Many banks have been liquidated because of these acts. Amount involved in these crimes has been on the increase over the years. It rose consistently from N105.0 million in 1989 to N3.399 billion in 1994. Arising from liquidation and acquisition of many banks and regulatory commitment to impose sanctions on perpetrators, it declined between 1995 and 1996. From 1997, however, perhaps as result of weak commitment to imposition of sanctions and week regulatory capacity, it resumed its rising trend and by 2001 the amount lost to frauds and forgeries had reached N11.243 billion. See figure 2 for more details. Because of this development, a total of 6,228 staff were terminated, retired or dismissed between 1989 and 2001 with the least recorded in 2001(152) and highest in 1994 (737).

Figure 4: Amount Lost to Fraud & Forgeries in Banks



Loan contract enforcement has been a desideratum of the Nigerian credit system. Because of inadequate legal framework and cumbersome loan recovery processes, it is very difficult for lending banks to foreclose collaterals (Alashi, 2002). Obtaining judgment when a loan defaulter is sued is often lengthy and complex, thereby increasing the cost of doing banking business in Nigeria. Many Nigerian borrowers now capitalize on this weakness by developing the habit of not willing to repay when the ability to pay is very high. Some people have really turned themselves to 'professional' borrowers whose primary objective is not to repay whatever they borrow. Some of them see the loans as part of their share of 'national cake', particularly those given through directives on priority sectors as agriculture and small-scale industries. Others connived with bank staff by capitalizing on existing loopholes with no intention of paying borrowed funds. In some cases, loans were granted without (adequate) collateral securities and proper documentations.

The levity with which the law handles dishonoured cheques has been disappointing. Although a two years imprisonment is prescribed for any individual offender, prescribing N5,000.00 for corporate body is ridiculous. The law creates incentives for unethical behaviour because the opportunity cost of being caught is quite low. Much has not been heard about individual punishment either. In spite of this, the law makes it nearly impossible to catch anybody. As indicated in subsection 3 of Section 1 of the Dishonoured Cheques (Offences) Act:[1]

> *A person shall not be guilty of an offence under this section if he proves to the satisfaction of the court that when he*

1. Dishonoured Cheques (Offences) Act, CAP 102 of the Federal Law of Nigeria:4643.

> *issued the cheque he had reasonable grounds for believing, and did believe in fact, that it would be honoured if presented for payment within the period specified in subsection (1) of this section.*

This type of law tends to promote illicit behaviour because the sanctions are too open and may be very difficult to implement.

Another disheartening culture of borrowing and lending culture that has weakened banks health is insider abuse, another scenario that mimics the bug syndrome. In contravention of banking regulations, loans are issued to banks' staff without collaterals and even above what the law prescribed. An appraisal of liquidated banks shows that insider loans contributed significantly to the conditions of distressed banks in Nigeria. Evidence from Alashi (2002) reveals that the ratio of insider loans to total loans of twelve distressed ranged from 50 percent (Kapital Merchant Bank) to 99.9 percent (Nigeria Merchant Bank) while contribution of insider loans to total non-performing loans ranges from 52.0 and 104 percent respectively.

Evidence from the foregoing shows that the borrower is very central to the stability or otherwise of the financial system. Apart from serving as the black box of the complex web of factors influencing financial crisis, it is also likened to be the bug that is destroying the fabrics of the financial system. How can we debug the system? This is the focus of the next section.

IV. TOWARDS DEBUGGING AND SANITIZING THE SYSTEM

The predicament of the Nigerian financial system is a collective responsibility of all the stakeholders: the regulatory authorities, the bankers and the borrowers. The emphasis here is on the need to create incentives and sanctions within the financial system with a view to bringing sanity to the financial system.

Systemic financial fragility entails relatively significant costs for the stakeholders in the financial system, in particular, the public sector. The costs to the public sector range from non-payment of company and staff income taxes, contributions to social security, laying off of staff and bail-out funds, among others. In line with the market-based approach, any option that promotes incentives for reckless behaviour is discouraged. To this end, cost and loss-sharing arrangements is a necessity for any result-oriented strategy. Three stakeholders are examined here: borrowers, banks stakeholders and government. The regulatory authorities have responsibility for ensuring good conduct and performance, that is, a sanitized and stable financial system. Thus, appropriate invocation of relevant laws such as Banks and Other Financial Institutions' Decree (BOFID), 1991; Failed Banks (Recovery of Debts) and Financial Malpractices in Banks (FBFMB) (with Amendments); and Company and Allied Matters Decree (CAMAD) as they affect perfection, enforcement and realization of collateral securities of borrowers. Should defaulting enterprises be allowed to die naturally? Loan delinquency can be treated as a pathological disease whose treatment depends on its intensity; it ranges between minor to acute or malignant diseases. While some (minor ones) can be cured through the use of drugs, or clinical operations or a combination of both, malignant ones remain resistant to all forms of treatment.

Figure 5:- Possible Loan Conditions

Ability to pay		Willingness to Pay: low	Willingness to Pay: high
	high	**B** **Healthy but 'rascally'** (Sanctions required)	**C** **Healthy,** no assistance required.
	low	**A** **Malignant,** no profit able assistance can be rendered	**D** **Sick,but salvageable;** send to the clinic
		low	high

Willingness to Pay

In line with the foregoing analogy, delinquent borrowers (enterprises in particular) can be grouped into four as represented in the matrix of possible loan condition in Figure 5 below. Each group should be treated on its own merit. Borrowers in group A have low willingness to pay and low ability to pay. Assuming the problems are purely microeconomic phenomenon, the loans suffer from both adverse selection and moral hazard. The conditions cannot be helped and the focus should be on lessons to learn to avoid repeat of such situations. With borrowers in group B, the ability to pay is high but they are not willing to pay. They should be forced to pay through the invocation of the appropriate laws. Given the peculiarity of the Nigerian Society, names of this type of defaulting borrowers should be published in national dailies before the determination of the pledged collateral securities and other possible sanctions.

Borrowers in C are those requiring no assistance. This is a desirable group to be in and the focus should be on the lessons for driving projects to that group. Interestingly, projects in C do not require assistance although for different reasons. However, appropriate lessons for sanctions and incentives for managing projects could be learnt. The questions essentially are:

> What sanctions and supports/incentives to lead borrowers to category C?
> What sanctions and support/incentives to get borrowers falling into category A?

The last option is group D with low ability to pay but high willingness to pay. This is a very good case for clinical operation and such borrowers deserve some assistance, which can both be technical and financial.

The following emerges from the foregoing: the need to learn lessons from failures and successes. These lessons would derive from the value system and viability of projects. Such lessons could be from history or and from elsewhere. Traditionally, in most part of Nigeria, the willingness to repay loans was so high that most parents would rather settle loans before death instead of passing such to children. Children accept responsibility for loan repayment where parents were unable to settle before death. This contrasts with the prevalent tendency to low willingness to repay loans, in spite of the creative device by lenders in using 'personal guarantee'. The question is why the disconnect in willingness to repay loans? And what new bridges have been built to strengthen, or indeed replace the disconnect.

The inability to repay is essentially technical-rooted. There has been a lot of debate concerning the precise cause of the technical problem. Technical has been broadly defined as to include fund shortage, management, technology, ownership preference, and so on. Prior to Nigeria's independence, capital shortage was regarded as the operating or effective impediments to indigenous private investment. In a study published in 1964, Schatz maintained that "frequently the belief that capital shortage is the effective or operating impediments to indigenous private investment is mistaken, that it is an illusion created by a large false demand for capital, and that what really exists is not an immediate shortage of capital at all, but a shortage of viable projects"[2]. It is important to note that Schatz came to this conclusion after studying the loan experience of the Federal Loans Board from its establishment from 1956 to 1962. Of the 290 applications received, 229 (or 79 percent) were rejected.

An appropriate question, 40 years after Schatz conclusion is the extent to which capital shortage and /or dearth of viable projects is the impediment to industrial development. May be we should be more concern about the factors that determine viability and hinder business success, i.e., promote failure. These are other factors that should be targeted in debugging or sanitizing. The questions then would be the provision for these factors in strengthening the ability for loan repayment. To provide a comprehensive framework for project viability, it is important to differentiate between project proposal and on-going projects. For the latter, the degree of viability may put it into 'healthy' or 'sick' category. Since sickness cannot be forever, a sick project either recovers and becomes viable or dies. To ensure financial stability, facilities must be created to handle the sick projects. Consequently, we recommend project clinics.

2. Schatz, P.S. (1964); Development Bank Lending in Nigeria Ibadan: OUP for NISER, p.89.

Our view is that project clinics must be established and run as private sector initiatives, with support from government only in terms of concessions. The clinics would have resource persons with diverse skills required to ensure the parents' recovery for most, if not all of the projects, efficient and effective management would be adequate prescription. The ownership need not be exclusive of banks since such clinics would be expected, in any case, buy non-performing projects.

As a corollary to the foregoing analysis, and as mentioned earlier, projects that are sick, but salvageable need technical and financial assistance. The technical aspect should emphasize capacity building in the area of project cycle management with particular stress on project ideas as they relate to project proposal and on-going projects. Even when project proposals have been adjudged adequate, viable and feasible, the potential entrepreneurs should be exposed to the challenges of running profitable enterprises. The recently established Technology Incubation Centre and industrial nurseries may be of good assistance in this respect. If necessary, they could be given the opportunity to benefit from the facilities of the existing 105 industrial estates across the country. While banks should assist in rescheduling loan agreement and articulation of result-oriented project ideas, exposure to managerial skills and creation of other incentive structures should be the role of the Federal Ministry of Industry.

There is need, more than ever, for banks to be more involved in project idea development and packaging. Their involvement will enable investors with good investment to design bankable projects. The new initiative of the Small and Medium Enterprises Insurance

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and Equity Scheme (SMEIES) will promote equity participation and will disabuse the present sole proprietorship syndrome in the country. This will encourage advancement of credits to industrial projects on long-term basis. Given the current urge for market-oriented instruments, the management of SMEIES should be the mandate of private sector operators. The involvement of banks should not provide any basis for traditional responsibility abdication.

The newly established Bank of Industry should be re-engineered to provide policy-based loan facilities with limited subsidy if any. The training component of the bank should be invigorated to provide relevant technical assistance to small-scale enterprises. Through the initiative of the Bank of Industry, management of enterprises benefiting from its loan facilities should be exposed to the ethics of and best practices in managing successful enterprises. This notwithstanding, the implementation of its loan scheme should take clue from the experiences of the erstwhile Nigerian Bank for Commerce and Industry, Nigeria Industrial Development Bank and Nigeria Agricultural and Co-operative Bank, and experiences of countries with brilliant performance on policy-based loans. That is, learning from past failures and successes of relevant institutions within and outside Nigeria is a good prescription. An important way of learning from experience is for banks to review critically all projects that have been financed by them. We tend to believe that most projects are meant to fulfill all righteousness with limited commitment to the ideals of the project ideas. Banks should, therefore, examine the link between project proposals and performance for appropriate lessons to be learnt.

In a period of financial crisis, neglecting asset management can have detrimental consequences for all banks while exempting delinquent debtors from sanctions can have negative effects on the payment morale of other borrowers. Even when crisis-ridden banks are closed, it is equally pertinent to emphasize professionally inclined asset management in order to minimize cost and enhance payment morale as well as impose some sanctions on the rascality of man.

Evidence has shown that various institutional arrangements have been used for loans workout and asset management. Four types of arrangements are discernible: Central Asset Management Company (Czech Republic, France, Indonesia, Korea, Lithuania and Mongolia); Bank-Based Asset Management Company (Finland, Mexico and Sweden); designating existing banks as collector banks for bad assets (Albania and Hungary); and asset management integrated with bank rehabilitation (Nigeria, Mexico, Japan, Slovenia, Spain, United States). Countries like Mexico, Japan and USA used both bank-based and central asset management agency approaches for different type of problems (Dziobek, 1998). Outstanding achievements (recoveries in medium term exceed initial targets) were made by the Resolution Trust Corporation of the USA and Asset Management Company of Sweden. While specialized agencies can be useful in developing standard legal procedures for loan collection and realize economies of scale in interacting with the judicial system, with commitment and sincerity of purpose, asset management integrated with bank rehabilitation can achieve the same objective. With adequate funding, staffing, continuous skill enhancement, and effective monitoring, the Nigeria Deposit Insurance Corporation can deliver the good. The political will to impose sanctions as specified by laws without fear or favour will tame the rascality of man and send appropriate signals to enterprises that management discipline is a *sine qua non* for business survival.

An important missing gap in Nigeria's financial system reform process is the absence of bankruptcy law; an issue that played significant role in countries like Hungary[3]. Bankruptcy law plays some critical role in a market economy. First, it provides ailing firms with an orderly means of exit. Second, it shifts control rights over assets towards creditors and helps to reallocate assets to better uses through a combination of restructuring and liquidation. Third, it promotes the flow of credit in the economy by protecting creditors and serving as a final stage of debt collection. Taking control of financially distressed firm's assets before they are misused and dissipated provides an alternative way for loan recovery, either through enterprises restructuring or asset liquidation, which may be impossible in the absence of any bankruptcy law. In real sense, bankruptcy law discriminates between unviable firms and potentially viable ones that can be saved through restructuring[4]. In fact, the threat of exit spurs restructuring while the impossibility of restructuring spurs exit. While creditor-debtor workouts can be undertaken informally to avoid formal bankruptcy, firms unable to cover operating costs are clear candidates for exit unless they can seriously be restructured to regain viability. The existence of

3. Hungary adopted a though new bankruptcy law in late 1991 and took effect in January 1, 1992. Between January 1992 and December 1993, 5,156 enterprises filed up cases for reorganizations while 17,133 for liquidation (Gray, Schlorke and Szanyi, 1996).

4. It is important to note that management receivership exists. While management receivership is at the instance of the creditor, application of bankruptcy option on potentially viable firms comes at the instance of the borrower. The latter allows the borrower to still have some say through a workout solution, albeit the creditor has a predominating influence.

bankruptcy law facilitates banks and other creditors' role in funding and monitoring investment as well as exerting influence over enterprise managers thereby reducing peripheral resource allocation where credits are allocated only to known customers. In addition, the law will spur institutional building in the courts, the trustee profession, and the banks and indirectly in enterprises particularly when it is known that any 'rascality' can lead to liquidation or lost of control.

There is need to improve contract enforcement through reform of the legal system. While bankruptcy law facilitates easy exist, institutionalization of effective contract enforcement is a fundamental institution to serve the dynamic needs of small-scale enterprises. For this to be effective, commercial laws will have to be reformed and commercial courts established. In this regard, such laws and courts should facilitate the seizure of equipment and stock in case of default. This apart from encouraging taking collaterals in forms other than landed property would also promote leasing and working capital loans to smaller businesses.

Sanitization of the financial system cannot be complete if the present trend of frauds and malpractices committed by banks' staff, and in most cases in conjunction with borrowers, are not tamed. The Bank Employees Etc. (Declaration of Assets) Act of 1986, which imposed stiff penalties on offences committed under the Act, should be fully enforced. The Act, apart from prescribing long jail term for offences under the Act, also recommends immediate forfeiture of assets illegitimately acquired in the process. The long jail term forecloses convicts enjoying his loots through payment of fines while forfeiture signals the futility of engaging in such malpractices. This law should be strictly enforced. The snags in the

Act have made it to be a good candidate for review or amendment. One snag of the law is vesting the power or authority to initiate investigation of declaration of assets on the Secretary to the Federal Government, a politician always engaged in political issues and matters of civil service administration. Pending the time Commercial or Banking courts will be created, the Central Bank should be saddled with this responsibility. It is, however, important to note that its staff is also subject to the Act. Pending the time a special banking crimes outfit with full power to investigate bank frauds and malpractices, and other economic crimes exclusive to the financial sector, will be established, a Unit should be created in the Central Bank to handle this responsibility. The second snag is that it is tangential with the provisions of BOFI Decree particularly as it relates to sections 51 and 61, which exclude profit and loss making banks and community banks; and development finance institutions, respectively as part of the definition of banks. The Act should be reviewed to take account of these differences among others.

Since highly leveraged firms run the risk that they may be unable to repay their loans, regulatory authorities may limit the leverage of firms to whom banks lend. Countries beset with financial crises suggest that they were affected by accounting failures. Published financial information did not adequately portray the underlying risks of firms and banks. The prevalence of weak accounting system provided the opportunity for firms and banks to mask the discrepancies between accounting values and the real value of assets. Even in more transparent economies, than Nigeria, like Indonesia (after Suharto), Malaysia, the Philippines, South Korea and Thailand, financial instabilities have been linked to deviation from actual accounting practices and published accounting statistics. Lack of rigorous accounting conventions and absence of penalties for publishing false information did not only prevent investors from distinguishing between weak and strong banks but also exacerbated the difficulty of assessing the credit worthiness of borrowers. This suggests a strong case for strict accounting system; information must be reliable, based on sound principles and standards that allow borrowers and lenders to make assessment of firms' activities and risk profiles. Meaningful debugging of the Nigerian financial system will include, among others, improving rules and regulations governing disclosures, institutionalizing sound accounting practices to enforce quality and designing safety net to limit moral hazard.

Imprudent lending and banks' incentives for looting are commonplace where social returns and private incentives are not aligned properly. An important way of promoting alignment between social returns and private incentives is to increase banks capital base. This can take the form of standard capital requirements and franchise value. If risks are not properly weighted or adjusted, it can be counter productive because there is tendency to take higher risks with larger capital base.

V CONCLUSIONS

This paper provides a framework for examining the centrality of man in financial stability either as a borrower or user or manager of funds. Using a concentric circle analysis, the individual borrower represents the nucleus of the circle, a black box. Complex and multidimensional forces influence the behaviour of borrowers and, consequently, the way they treat loan contracts. In this approach, whoever borrows without repaying, or even repaying less than he borrowed is seen as a 'bug' and such must be disinfected or 'debugged' from the financial system before it becomes cancerous to the system.

Given the web of forces that the borrower has to contend with, the debugging process has to be all embracing, and not limited to the financial sub-sector alone. This includes, among others, rejuvenating the country's value system, banks involvement in project ideas and packaging, establishing project clinics for business enterprises, institutionalization and implementation of bankruptcy laws, improving rules and regulations governing disclosures, designing safety nets to limit moral hazards and putting in place sound accounting practices to enforce quality. Finally, the application of incentives and sanctions constitutes the essence of a market system and should therefore be deployed to drive the sanitization of the financial system.

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