THE 2004 BANKING SECTOR REFORMS IN NIGERIA AND FUNDING CHALLENGES TO SMES: SHARING THE CULPABILITY BETWEEN LENDERS AND BORROWERS

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ABSTRACT
The beginning of Nigeria's Fourth Republic in 1999 was characterized by reforms that led to the overhaul of both public and private sectors of the economy under the NEEDS programme. While the Nigerian banks have improved in performance and operations following the 2004 reforms, the effect has not been felt significantly by the Small and Medium scale Enterprises (SMEs). The study examined both internal and external factors constraining SMEs' access to bank loan. We relied on the qualitative data collected through primary sources such as interviews, and secondary sources such as scholarly works, official documents, and media reports; and were analyzed descriptively. The study revealed that high interest rates have adverse effects on the SMEs. Also, the study found among others that circumvention of banks by most SMEs in their business and financial transactions is a barrier to accessing bank loans. We recommended inter alia that the CBN should review lending rates to SMEs with a view to ensuring that loan rates, moratorium and loan tenure are complementary and designed to support business profitability, continuity and expansion while comprehensive enlightenment programmes should be developed to educate SME operators on the critical need to use banks for their business and financial transactions.

Keywords: Bank, Business, Economy, Enterprise, Loan, Interest, Reform, Transaction.

JEL Codes: E5, E3, E02, L3, H81, E4, P11, D23

1. INTRODUCTION
Reforms in the banking sector are essential in improving the performance and operations of the banks, keeping them in good shapes, and adapting to new technologies or modalities of doing business. Ugwu & Onyeabor (2012) conceptualized banking reform to mean an aspect

of socio-economic reforms driven to set standards necessary for the banking industry to provide direction leading to the growth and development of an economy. Banks are reformed either because of crises or the need to increase their competitiveness especially in the face of increasing economic integrations in the world. Accordingly, Olokoyo (2013) argued that the banking sector reforms are undertaken following banks failure in meeting the required obligations or inability to satisfy their stakeholders resulting in subsequent failures and crises. Adegbaju & Olokoyo (2008) are of the view that banking crisis results from underlying weaknesses in the banking system orchestrated by overarching illiquidity, insolvency, undercapitalization, high level of non-performing loans and weak corporate governance.

Banking reform is fundamental in eliminating distress, boosting stakeholder's confidence, providing good funding climate for socio-economic activities, increasing offshore operation of banks, enhancing returns to investment and reducing the cost of banking operations (Agba & Enofe, 2007). Furthermore, banking sector reforms are aimed at transforming banks to strong and reliable financial institutions that provide safety of depositors' money and play active developmental roles (Sere-Ejembi, 2008). Similarly, Ejong, Ekpuk, Ogar & Emori (2014), Abdullahi (2007) and Ebong (2006) argued that financial reforms are deliberate policy measures aimed at remedying perceived or impending financial crises and subsequent failure and addressing issues such as bad governance, risks management and operational ineffiencies. However, irrespective of the forces driving reforms in any organization, the ultimate goal is to strengthen their operations and increase their efficiency, business-friendliness and profitability.

The Nigerian banking sector hitherto 2004 reforms was bedeviled by myriads of structural inadequacies which were articulated by Onodje (2009, p. 10) to include:

> "Low capital base, large number of small banks with relatively few branches, poor rating, weak corporate governance including inaccurate reporting and non-compliance with regulatory requirements, declining ethics and huge non-performing insider-related credits as well as overdependence on public sector deposits and foreign exchange trading".

Most Nigerian banks prior to 2004 consolidation had weak capital base and lacked the ability to finance large businesses and investment portfolios in the country. Hence, their overall contributions to the growth and development were inadequate. Nwankwo (2013) stressed that most banks in Nigeria prior to reforms operated under a weak capital base. The banks only survived largely by depending on deposits from the Nigerian government ministries and agencies, and could barely stimulate any economic activities in the country or meet the expectations of their customers. They strove to remain in business at all costs, and most of them were found culpable meddling in sundry sharp and fraudulent practices.

In order to reposition the Nigerian banking industry and meet with the challenges associated with 21st century banking, the Central Bank of Nigeria (CBN) initiated a policy under the mantra of consolidation. According to Soludo (2004) as cited in Nwankwo (2013, p. 74):

> "The major objectives of banking sector consolidation or reforms were to increase intermediation process, ensure financial sector stability, promote economic growth, increase the capital base of banks, enhance liquidity and capitalization of stock market, enhance expansion of shareholders base to promote good corporate governance, facilitate evolution of strong and safe banking system, ensure efficiency in risk management and bank operation, and to ensure healthy domestic and cross-border competition".

Indeed, the reforms generally increased the capital base and performance of the Nigerian banks, enhanced their liquidity ratio and solvency and as well increased inflow of currencies into the banks from both domestic and international financial markets.

Obviously, the small and medium scale enterprises play key role in the growth and socio-economic development of every society. SMEs are mostly defined in terms of the firms employing 10 to 250 people (World Trade Organization, 2016). Buttressing the importance of SMEs to the global economy, the World Trade Organization (WTO) cited in Fadnis & Arnold (2018) noted that SMEs represent over 90 percent of the business population, 60 to 70 percent of employment and 55 percent of gross domestic product (GDP) in developed economies. While there is increasing awareness about the role of SMEs in economic growth and development, the subsector has been confronted with several challenges in Nigeria. In Nigeria, micro, small and medium enterprises (MSMEs) represent approximately 1 percent of GDP compared to 40 percent in Asian countries, and 50 percent in the United States or Europe respectively (Oyelaran-Oyeyinka, 2020).

However, SMEs in Nigeria are faced with many challenges such lack of management capacities, low access to funds, indiscriminate tax levies, low entrepreneurial skills and return on investment, intermittent electricity supply and humongous production costs, among others which have been some of the reasons for the high mortality rates of SMEs in Nigeria (Dabor & Oserogho, 2017; Oluboba, 2011). Among these problems, funding remains a top priority. The CBN has adopted several measures in the past decade to ensure that funds are made accessible to various business enterprises in Nigeria. One of the measures taken by the CBN is the quarterly review of loan-to-deposit ratio (LDR) which led to an increase in the LDR from 60 to 65 percent and this mandated all money deposit money banks (MDBs) to lend out 65 percent of every N100 profit with effect from the last quarter of 2019 (CBN, 2019).

Consequently, the question of why funding is a major concern to SMEs in Nigeria, has triggered a wide range of debate among the academia, policy makers and the media. The review of extant studies revealed that some scholars carried out one-sided analysis and unsophisticated focus which only found the banks culpable of funding limitations to SMEs in Nigeria. For instance, John-Akamelu & Muogbo (2018) argued that SMEs fail in procuring banks' loans for lack of collateral. Conversely, Imafidon & Itoya (2014) and Imoughele & Ismaila (2014) averred that part of the problems confronting SMEs in Nigeria is lack of access to banks' credit. Also, in a World Bank assessment of SMEs across Sub-Sahara Africa, SMEs in Nigeria were found to suffer from low level provision of credits (World Bank, 2016).

Arising from the gap in literature, the paper therefore diagnosed those exogenous and endogenous factors constraining most SMEs in Nigeria from exploring various funding opportunities available at deposit money banks between 2004 and 2020. The study is organized into different sections. Section 1 is introduction while Section 2 is the literature review. Section 3 is methodology while the Section 4 dealt with results and discussion of findings of the study. However, Section 5 is comprised of conclusion and policy recommendations.

2. LITERATURE REVIEW

The study adopted different thematic approaches in order to explore related literature on the problem of the study. These themes include the overview of Nigeria's banking sector before the 2004 reforms, overview of the 2004 banking sector reforms and consolidation in Nigeria, overview of the socio-economic gains of the 2004 banking sector reforms in Nigeria, and review of the measures adopted by the CBN to provide funding to SMEs in Nigeria.

Overview of the Banking Sector of Nigeria before 2004 Reforms

Prior to the 2004 banking reforms and consolidation of the financial institutions in Nigeria, the financial sectors of the economy were in abysmal state. This was confirmed by the CBN's 2004 reports which showed that 89 banks in Nigeria (with branches scattered across the country) lacked economic viability. Corroborating this assertion, Odufu (2005) stressed that the best capitalized banks in Nigeria were weaker than the least capitalized banks in other emerging economies such as Malaysia, South Korea, South Africa, Taiwan, et cetera. The Nigeria's banking industry was dominated by large number of small banks with few branches which were fragmented into weakly capitalized banks with most of them having a capital base of US $10 million or less (Jegede, 2014; Nwankwo, 2013; Soludo, 2004). Also, Nwanma (2007) emphasized that while the terminally sick banks managed to postpone their inevitable demise, they prepared the ground for the failure of the entire system. However, though the 89 banks were at various levels of soundness, none of them had an A-grade score

in a standard scale introduced by the CBN's grading system (Soludo, 2004). The Nigerian banks were considered marginal relative to its potential and huge market at their disposal. Meanwhile, in an attempt to examine the health of the Nigerian banks prior to 2004 reforms, the CBN classified the banks into different categories using several criteria to indicate their levels of financial decibel. On this basis, the criteria used were "very sound; sound; satisfactory; marginal; and unsound" (CBN, 2004). Regrettably, none of the Nigerian banks was rated "very sound" on the above scale. On the basis of capital adequacy and liquidity ratio, only some of the banks were able to measure 20 and 30 percents respectively but still fall short of the requirement which stated that capital adequacy and liquidity ratio should be at least 40 percent (CBN, 2004). On the scale of corporate governance, the CBN stated that the 89 banks still failed and were ravaged by boardroom disagreements, disputes and squabbles; and non-performing loans which resulted in humongous liabilities.

The 2004 Banking Sector Reforms and Consolidation in Nigeria

The National Economic Empowerment and Development Strategy (NEEDS) which was a brain child of President Olusegun Obasanjo's administration provided the template for the 2004 banking sector reforms. The key objectives of NEEDS included but not limited to wealth creation, poverty reduction, fight against corruption, privatization and deregulation, and achieving self-sufficiency. Jegede (2014, p. 249) stated that:

> *"One of the priority areas as stated in the NEEDS document was the financial sector reforms which were aimed at achieving the implementation of monetary and fiscal policies; ensuring the efficiency of the financial system; and dealing with the contradiction, that in spite of high profit levels, the sector does not appear to be playing a catalytic role in the real sector".*

Consequently, Soludo (2004) delivered a policy blueprint which was aimed at consolidating the Nigerian banking industry to meet the development challenges of the 21st century. Following this policy, the CBN introduced stringent policy measures to improve the performance of the Nigerian banks. One of which was raising the capital benchmark from ₦2billion to ₦25 billion. According to Ibrahim (2015), the main thrust of the 13-point reform agenda of the CBN was the prescription of a minimum shareholder's funds of ₦ 25 billion for a Nigerian deposit money bank not later than December 31, 2005.

Also, the banking sector policy reform was harped on strengthening the market and providing banking firms greater financial capacity to underwrite risks arising from the economy. Thus, the underlying objectives of the 2004 banking sector reforms include the following:

a. Creating a sound and more secure banking system that depositors can trust;

b. Building domestic banks that investors can rely upon to finance investments in the Nigerian economy;
c. Encouraging industry consolidation and reducing systemic risks;
d. Fighting corruption and white-collar crimes through improved transparency and accountability, and insisting on sound corporate governance practices in the financial services sector;
e. Driving down cost structure of banks, improving banks' efficiency and encouraging competition with the goals of lowering interest rates and providing cheap credit to the economy; and
f. Meeting international benchmarks and minimum requirements for the integration of regional financial systems (CBN, 2004).

However, the potential gains of the reforms were summarized by (Somoye, 2008) to include increase in the volume and value of trading in the stock market; to ensure more foreign investment inflow and attract a significant level of foreign banks and partnerships; to ensure fall of interest rates through increased intermediation thereby increasing lending opportunities to the real sector; and increase efficiency in cost of operation, risk management and profitability. Following the CBN recapitalization policy, 14 banks failed and were purchased by other banks which inherited their assets and liabilities under the “Purchase and Assumption” policy of the CBN. The 89 Nigerian banks prior to consolidation shrunk to 25 bigger, stronger banks through merger and acquisition (CBN, 2005). According to Eriemo (2014), this era witnessed the introduction of universal banking which empowered the banking and non-banking financial markets.

Overview of the Socio-Economic Gains of 2004 Banking Sector Reform in Nigeria

Interestingly, extant literature has shown that the 2004 banking sector reforms yielded a number of positive results. Lemo (2005) is of the view that these reforms in the banking sector is saddled to guarantee a platform to support banks efficiency, safety of depositors fund and become a major player in the global financial market. However, Okpara (2012) is averse to Lomo’s assertion and argued that following the reforms in the banking sector, the distressed and unsound banks reorganized under new names or merged into existing perceived strong banks not necessarily to correct the underlying anomalies in the system but as a ploy to remain in business. Similarly, Olokoyo (2013) corroborated Okpara and stated that the overall gains of the 2004 reforms appear not to have been achieved as banks were declared as insolvent and distressed by the Lamido Sanusi’s administration. This is an indication that the persistent reforms embarked by the Central Bank of Nigeria had seemingly little or no effect on bank performance (Ali, Ekpe & Aigba, 2016).

However, in spite of the opposing views of scholars on the gains of the 2004 banking sector reforms in Nigeria, a number of studies have established some notable achievements in the

sector in terms of increased branches, subsidiaries and wider presence. Accordingly, Ejong, Ekpuk, Ogar & Emori (2014, p. 167) averred that:

> *The fact that the banking sector has contributed in no small measure to the development of the national economy through its financial intermediation and other developmental roles is undisputed. This is evidenced by the sprawling number of branches of deposit-taking banks which rose from 3,247 to 5,837 and 6,605 in 2003, 2010 and 2011 respectively*

In this light, consolidation exercise helped banks to redefine their strategy (Nwanma, 2007). Also, in the past, many of the Nigerian banks were largely urban banks but the new alliances following the reforms through merger and acquisition, extended their presence in the semi-urban and rural areas and facilitated socio-economic activities in those areas. With strong capital base and improved operational performances, the Nigerian banks for the first time were ranked among the top banks in Africa, in which at least 16 of them were among the top 1000 in the world (Saturday Independent Newspaper, May 26, 2007 as cited in Onuoha, 2008).The ₦25 billion capitalization benchmark for the Nigerian banks increased the confidence of stakeholders and depositors who hitherto resorted to unconventional means of saving their money.

Furthermore, the CBN (2019) and Zenith Economic Quarterly (2007) demonstrated rise in overseas growth and investments of the Nigerian commercial banks. Since the 2004 reforms, consolidation of commercial banks has unlocked offshore potentials and opportunities to the Nigerian banks with increasing transnational operations recorded in the last decade. Meanwhile, a number of Nigerian banks have established international operations. In the past 15 years, the Nigerian banks have expanded rapidly throughout the region of Africa, starting from the West African sub-region where they account for about 74 percent of the regional banking assets (Oxford Business Group, 2015). Also, 2013 report of the International Monetary Fund (IMF) showed that the number of oversees subsidiaries of the Nigerian banks increased from three (3) in 2002 to 67 by 2013, and have their business operations in more than 21 African countries, with United Bank for Africa PLC (UBA), First Bank PLC, Zenith Bank PLC, among others already increasing their operations in the major economies of Europe, America and Asia.

Another area with visible improvement in the Nigeria's banking industry following the 2004 reforms is global partnerships. The Nigerian banks in the past decade have recorded increased partnerships with leading financial institutions in the world. This new accomplishment has enhanced their global rating and boosted the confidence of foreign partners not only in the banking system but other sectors of the economy. The CBN report has shown that a number of foreign financial firms such as the J.P. Morgan Chase, Hongkong and Shanghai Banking Corporation, United Bank of Switzerland, Bank of New York,

Morgan Stanley, et cetera are involved in different forms of partnerships with the Nigerian banks (CBN, 2007). Other financial firms with increasing operations with the Nigerian banks include the World Bank, European Investment Bank (EIB), the African Development Bank (AfDB), Germany's KfW and the French Agence Française de Développement (AFD), African Export-Import Bank (AFRIEXIM). However, the Development Bank of Nigeria (DBN) was to serve as their anchor to lend helping hand to the private sector investment in Nigeria (Omodele, 2018). However, while the existing studies have enumerated extensively various positive effects of the 2004 banking reforms on the economy, little efforts have been made to examine the impact of these reforms on the growth of SMEs in Nigeria as an engine of wealth creation and employment generation.

Review of Measures by the CBN to provide Funding to SMEs in Nigeria

SMEs have enormous potentials for employment generation, advancement of local technology, economic diversification, development of indigenous entrepreneurship and forward integration with large-scale industries (CBN, 2010). A review of sources of funding to SMEs in Nigeria revealed that greater proportion of their financing is derived from deposit money banks (DMBs), micro finance banks (MFBs), government agencies, and intergovernmental institutions especially the World Bank.

Since the Nigeria's independence in 1960, successive governments have taken different measures to support the growth of SMEs through various schemes, policies and interventions. For instance, in 1962, the Nigerian government created the Nigerian Industrial Development Bank while the Small Scale Industries Credit Scheme and the Nigerian Bank for Commerce and Industry were established in 1971 and 1973 respectively under General Yakubu Gowon's military regime. However, the Nigerian Bank of Industry (BoI) was created in 2001 by the President Olusegun Obasanjo's administration. There were also CBN's interventions such as the 2009 ₦200 billion each for Restructuring/Refinancing Scheme (which was to be issued by the Bank of Industry with effect from May, 2010) (CBN, 2010), and the Commercial Agricultural Credit Scheme.

In 2011, President Goodluck Jonathan's administration established the Nigerian Incentive-Based Risk Sharing System for Agricultural Lending. Meanwhile, other financial institutions such as the World Bank, Nigerian Bankers' Committee, etc. have also rendered their supports towards improving SMEs operations in Nigeria. For instance, in 1984 and 1990, the World Bank rolled out the US$41 million World Bank SME I Loan Scheme and US$270 million SME II Loan Scheme respectively to stimulate the socio-economic activities of SMEs in Nigeria. Similarly, the Nigerian Bankers' Committee formed the Small and Medium Enterprises Equity Investment Scheme in 2001 to encourage SMEs in Nigeria. Also, in 2019, the CBN increased the loan-to-deposit (LDR) ratio from 60 to 65 percents in order to enhance access to bank credits by the business enterprises in Nigeria (CBN, 2019 cited in Agabi, 2020). However, most of these government interventions did not yield the

intended outcomes. The programmes failed either because of mismanagement and diversion of funds by the public officials or misapplication of these funds by the operators of SMEs.

3. METHODOLOGY

This explored the theoretical underpinnings of the research as well as methods adopted for data collection and analysis.

Theoretical framework

In order to situate the increasing discrimination against SMEs in the credit market in a proper analytical context, the study adopted the Credit Rationing Theory (CRT).The theory focuses on credit gap analysis. Generally, credit rationing refers to a situation whereby the lenders (banks) demonstrate unwillingness to advance further funds to borrowers (businesses) irrespective of the prevailing interest rates in the financial market. According to Jaffee & Modigliani (1969), credit rationing refers to a situation in which the demand for bank loans exceeds the supply at the interest rates quoted by the banks. Stiglitz & Weiss (1981, pp. 394-5) conceptualized credit rationing as follows:

> *"We reserve the term credit rationing for circumstances in which either (a) among loan applicants who appear to be identical, some receive a loan and others do not, and the rejected applicants would not receive a loan even if they offered to pay a higher interest rate; or (b) there are identifiable groups of individuals in the population who, with a given supply of credit, are unable to obtain loans at any interest rate, even though with a larger supply of credit, they would".*

The above definitions appear to be one-sided and only characterized those endogenous factors from the supply side (banks) while ignoring other hindrances to access to credit which may emanate from the potential borrowers (SMEs). However, Akerlof (1970) intervened and brought a more holistic argument about the theory. He drew attention to information problems (that is, information asymmetry) among business enterprises in retarding the development of lending markets especially in developing economies. Akerlof argued that in the absence of any restrictive government policies on beneficial lending, all businesses (borrowers) with positive projects would be able to procure external funding. This will allow for proper screening of potential borrowers. Akerlof further argued that if the lenders (financial markets) cannot categorically separate good risks from bad one, lending might not be possible. In the case of the deposit money banks, credit rationing can take the form of a response to either incentive or information problems in relation to the banks and depositors, or the nature of monetary policies made by the regulatory agencies.

SMEs in Nigeria just like other developing markets in Africa are highly fragmented and the failure of the government to develop effective institutions capable of producing credible information about businesses and using the information as reliable data to process loan

applications, has resulted in financial underdevelopment of the country. Therefore, credit rationing by the lending institutions becomes a necessary device to mitigate adverse selection of applicants for credits, borrower's default, monitoring of borrower's actions in order to check misapplication of funds, and to ensure limited liability upon defaults. According to Hodgman (1960), credit rationing helps to ensure maximum repayment that the borrower can credibly promise, which effectively limits how much the lender will offer the borrower regardless of the interest rate.

Methods of data collection and analysis

The study adopted an Ex-post facto design, the justification being that events which we observed, in this case, the 2004 banking sector reforms have already taken place. Time series design was also used to enable us extract information relating to the recurring funding challenges to the ailing SMEs in Nigeria. The study relied on the qualitative data collected through primary sources such as interview, and secondary sources such as scholarly works, official documents (such as the CBN Statistical Bulletin, NBS, IMF and the World Bank reports), and media reports to carry out literature review and discussion of results and findings. We interviewed some officials of the deposit money banks and sections of SME operators such as welders, shoe makers, fashion designers, et cetera. Finally, the data were analyzed descriptively which enabled us to provide detailed presentation and explanation of results and findings of the study.

4. DISCUSSION OF RESULTS AND FINDINGS

Discussion of results and findings of the study shall consider some key issues such as the high interest rates on SMEs, inadequate financial records and documentation, high cost of perfection of legal mortgage for collaterals, and inadequate credit management capacity.

High Interest Rates

On record, several funding options are available to Nigerians who either want to start-up a novel business or expand the existing ones. High interest rate is one of the major challenges in Nigeria with severe impact on SMEs. In evaluating the limitations of SMEs in Nigeria, Ugwu-Oju, Onodugo & Mbah (2019) observed that high interest rates, combined with stringent requirements for sureties dissuade SMEs from accessing loans. They argued that government interventions through the monetary authorities provided palliative measures which failed to address the age long problems associated with bank loans to SMEs in Nigeria. Also, Olusola, Alao & Bhaumik (2020) examined the influence of commercial banks in financing SMEs in Nigeria and concluded that SMEs have inadequate access to credits from commercial and micro-finance banks due to high interest rates.
However, it is important to note that the deposit money banks (DMB) are not solely to be blamed. Nigeria has one of the highest Monetary Policy Rates (MPR) in Africa. Operationally, MPR is the interest rate at which the apex banks of nations lend to the

commercial banks. With high MPR is Nigeria, it is quite impossible for DMB to issue loans at moderate rates. The Nigeria's current MPR is at 11.50 percent compared to 3.50, 3.75, 4.50, and 7 percents in South Africa, Namibia, Rwanda, and Kenya as at September 22, 2020 (CBN, 2020; South African Reserve Bank, 2020; Bank of Namibia, 2020; National Bank of Rwanda, 2020; Central Bank of Kenya, 2020). This MPR which serves as a benchmark for the minimum price of credits lent to bank customers is very high in Nigeria as shown in the above figures, hence the reason most SMEs show little interest on bank credits.

Apart from the MPR, another debacle that SMEs face is the Treasury Bill (T-Bill) rate. The T-Bill rate is the interest rate which the government had to pay on its short term bonds and has become the basis of monetary policy especially in recent time. The Nigerian government borrows from the commercial banks at higher interest rates. Therefore, most Nigerian banks prefer lending to government since there is minimum risk doing so, and when they lend to private businesses, they usually do so at T-Bills rate. Furthermore, the 2018 report of the National Bureau of Statistics showed that 85 percent of the SMEs were unable to secure bank loans between 2013 and 2017 due to high interest rates. Also, Nlebem (2019) decried the malevolent conditionality given to the SME operators in accessing loans from Nigerian banks. He stressed that:

> *The conditions for getting a loan of 15 million naira are taxing, requiring a plot of land worth almost twice the amount, 23 percent interest rate and repayment within a year. Hence, repaying the loan could shut down a business; defeating the purpose for which it was taken (Nlebem, 2019).*

Additionally, Governor AminuWaziriTambuwal of Sokoto state in a chat with the Group Managing Director of the United Bank for Africa (UBA) Plc, Ken Uzoka, reiterated that the prevailing interest rate charged by the commercial banks is hurting small business operations in Nigeria, denying many individuals and small-holder enterprises access to credit, thereby limiting their ability to expand (Meya, 2018). Gruesomely, as large as the Nigeria's economy appears to be, its interest rate is the highest among her peers in Africa which has negative effects on SME operations in the country.

Inadequate Financial Records

To determine an SME's capacity to access a loan and repay, banks and other financial institutions rely on the potential borrower's financial records as captured in bank statements. One of the critical indices extracted from the statement of accounts is the cash-flow of the business. A bank customer's cash-flow is a measure of the amount of money passing through the customer's bank account over a defined period of time which can be ascertained through the statement of account detailing streams of cash deposits and withdrawals. It reflects the difference between the total money deposits (inflows) into a bank account and

total withdrawals (outflows). The difference is called Average Collected Balance. Cash-flow analysis enables the banks to determine the customer's borrowing need given his level of business activity. It also helps to measure the ability of a customer to repay loan when given. The banks are commercial ventures which are service driven and profit oriented. Therefore, when banks are unable to ascertain the flow of funds through a customer's account or regular transactions being channeled through his bank account, it is impossible to grant credit to such customer as that may lead to loan defaults. Customers seeking for loans are expected to demonstrate ability to repay them within the stipulated tenor of the loan. However, because most of the SMEs in Nigeria do not route their transactions through the banks in a bid to evade bank charges, securing loans becomes difficult since there is no physical evidence (cash-flow) to backup their application. Furthermore, Mrs. Ebere Ijeoma Ubesie FCA, ACCA (Branch Deputy Manager with Zenith Bank PLC) (personal communication, 7th September, 2020), noted as follows:

> *The banks are profit organizations and not "Father Christmas". In as much as banks have funds available to support different layers of businesses in Nigeria, there are conditions required that prospective customers seeking for credit facilities should meet before securing bank loans. Again, while it is sustainable for banks to do businesses with large scale enterprises (because, it is easy to track their records) since most of their financial transactions pass through the banks, however, micro, small and medium scale enterprises (MSMEs) are difficult to deal with for obvious reasons. Most of the MSMEs do not allow their financial transactions to go through their bank accounts thereby making it difficult to have a template for giving them loans. Analysis of the account credit turnover and the average collected balance neither support their loan request, nor repayment sum. This is very crucial else the loans would go bad which is antithetical to best practices in banking operation. The funds are available especially now that the CBN is encouraging the deposit money banks to expand their lending portfolios but there are requirements which serve as basis for securing those funds. Every bank wants to recover their money. No bank wants to incur more liability and grow insolvent.*

In Nigeria, it is worrisome that most businesses, especially the SMEs avoid the banks because of charges and taxation. Conversely, the big businesses understand the importance of routing their transactions through the banks; they have track records and that is why commercial banks in Nigeria prefer doing business with them because they can repay. Therefore, circumvention of banks by most SME operators in Nigeria is a major impediment hindering them from access to funds from the money deposit banks. The view of the Mrs. Ebere supports Sajuyigbe, Odetayo & Adeyemi (2020) who claimed that *majority of business operators in Nigeria did not have financial knowledge such as working capital*

management, accounting records system, financial reporting, cashbook maintenance, income statement, daily cash reconciliation, internal control on cash, and cash budget.

However, while the concerns expressed by the Mrs. Ebere and Sajuyigbe et al cannot be debunked, other studies have shown that the problem of SMEs in accessing bank loans in Nigeria is quite beyond inadequate financial records. According to Oyelaran-Oyeyinka (2020), Nigeria has a low amount of domestic investment through loans compared to other emerging economies. He stressed that majority of the deposit money bank loans are issued to large corporations and government agencies. He further stated that the total loan as of percentage of GDP in Nigeria is 19.7 percent, compared to 47.2, 54.3, 90.0, and 104.1 percents in Kazakh, Egypt, South Africa and Eurozone respectively. Similarly, the result of Saari (2020) study on SMEs financing by the commercial banks in Nigeria showed SMEs either have their loans applications rejected or are given very short loan maturity period and are denied access to loans even though most them have their business plan.

Inadequate Documentation

Documentation is essentially the structured collation of required paperwork which serves as basis or proof of the business structure and activities of an organization that will determine a bank's lending decisions to them. Business documentation is a fundamental requirement in securing a bank loan. Sadly, most SMEs in Nigeria are poorly organized and do not keep adequate records of their business operations. They lack proper documentation of their transactions. Statement of accounts, transaction invoices or purchase receipts (which can give a glimpse of how viable the enterprise is) are part of the documents that the banks require from the SMEs before granting them loans. According to Sajuyigbe et al (2020), lack of adequate accounting records system is one of the key problems affecting micro, small and medium business operations in Nigeria and a barrier to accessing loans. Given the inability of most small and medium businesses to provide this required information, banks are constrained in their inability to avail the loans.

High Cost of Perfection of Legal Mortgage for Collateral

Collateral is usually an asset in the form of houses or properties, lands, cars, etc. guaranteed or pledged before loans are approved and are relinquished for repayment of loans if the borrower is unable to generate enough funds to repay. It is a security offered in exchange for loan. Collateral requirement is often compulsory in the procurement of loans from the banks. On a study of bank finance to SMEs in Nigeria, Afolayan (2016) observed that lack of collateral and unwillingness of individuals to guarantee bank loans pose major obstacles SMEs in accessing loans. Also, Kerr & Nanda (2009) noted that procurement of adequate access to capital is one of the biggest hindrances to starting and growing new businesses.
However, Mrs. Chidiebere Nwankwo (personal communication, 18th July, 2020), a credit officer with First Bank PLC, is averse to Afolayan's submission. Mrs. Chidiebere argued

that most commercial banks do not require collateral from the SMEs which apply for less than ₦10 million loan packages. According to her, what is usually required is the customers' cash-flow analysis (to ensure that he operates a bankable business), combined with life assurance (provided by an insurance company) and personal guarantee (signed by a guarantor). She further stated that loans are not given based on feelings or sentiments but physical evidence, and the physical evidence is the cash-flow, she concluded. On the provision of personal guarantors by the SMEs applying for bank loans, Ugwu-Oju, Onodugo & Mbah (2019) argued that strict requirements for guarantors deter SME owners from applying for loans.

Meanwhile, while the banks may exempt collateral for SMEs that require less than ₦10 million, our findings revealed that it is an important requirement for SMEs doing businesses that may require up to ₦10 million loans or above. However, some of the SMEs that have collateral to secure bank loans usually face difficulty perfecting the legal mortgage.

Perfection of legal mortgage for collateral is legal process which cedes ownership of a borrower's property to the bank within the time frame the customer is expected to repay his loans. Perfecting legal mortgage for collateral is indeed a complex dynamics in Nigeria. This is confirmed by Mazi Anthony Kalu (personal communication, 9th July, 2020), the proprietor of Mazi Shoes, Bags & Allied Leathers in Ariaria International Market Aba, Abia state. He pointed out that the major problem his enterprise faces is not lack of access to funds or providing the needed collateral but perfecting the legal mortgage for the collateral. In his words therefore:

> *The cost of perfecting legal mortgage for collateral in Nigeria is very high. The problem is not with the banks but the general system. First, we have to pay for a search rate to the lawyer contracted by the bank to evaluate our property in order to ensure that they actually belong to us. Second, we have to pay the court to forfeit ownership of the property (collateral) to the bank within the period we are expected to repay the loan should we default. Those payments are quite high. In most cases, after examining the cost implication of securing legal mortgage, we may decide to ignore bank loans.*

Inadequate Credit Management Capacity

Lack of proper understanding on the part of the proprietors of SMEs on how bank loans are structured and operated is another factor preventing most SMEs from securing bank loans. Most SMEs are unable to correctly determine their funding needs; either for working capital or assets acquisition. Misapplication of the loans for the wrong business need will not yield the required profits to ensure loan repayment. Notably, Priti (2019) observed that most MSMEs are confronted by inadequate access to financial service and are considered less creditworthy by the financial institutions because of their incomplete knowledge of financial

markets. This is coupled with lack of technical expertise required to access finance, hence the reason most SMEs are unable to access credits from banks.

Commercial banks also focus majorly on credit turnover and average collected balance in giving out loans. However, Miss. Jane Akwuobi, a banker (personal communication, 4th July, 2020), stated that:

> *There are SMEs in Nigeria whose credit turnover run into millions of naira but the problem is that they bypass the banks in their financial transactions. Accordingly, one of the reasons why some of these SMEs circumvent banks in their financial transactions is to evade taxes and bank charges such as account maintenance fees. Bank loans are structured on the basis of average collected balance for a period of time. So, banks give loans based on the customer's average collected balance, otherwise the loan will go bad. The banks will look at the customer's transactions to run cash-flow analysis. Unfortunately, when banks run the cash-flow analysis of most SMEs, they find out that there is nothing to benchmark the loan, simply because, they boycott the banks in most of their business transactions.*

Furthermore, Mr. Uzochukwu Obiechina (personal communication, 24th May, 2020), an owner of a welding workshop, lamented that he was unable to expand his welding business due to lack of funds to procure needed equipment. He stressed that this difficulty arose because most his financial transactions did not go through the banks. Accordingly, Mrs. Charity Nwankwo (personal communication, 13th June, 2020), the proprietor of Charisa & Davis fashion and design outfit, stressed that:

> *Though I have accounts with two commercial banks in Nigeria, I occasionally deposit money in my bank accounts or tell my customers to pay me through those accounts as I needed the money for immediate purchase of new items for my business. So, when I went to the bank to seek for loan so that I could expand my business and employ more people, they refused to grant my request explaining that I have low cash flow into my bank accounts.*

For these SMEs owners and operators, it would be difficult securing bank loans since they lack physical evidence for documentation of their application. This sad development is not peculiar to Mr. Uzochukwu and Mrs. Charity but expresses the ordeals most of the players in the informal sector of Nigeria's economy face in their quest to sustain or expand their business operations.

5. CONCLUSION AND POLICY RECOMMENDATIONS

From our findings, the 2004 banking sector reforms and consolidation exercise has not only strengthened the Nigerian banking system but has significantly increased its competitiveness both in the domestic and international socio-economic space. The financial volume and value of trading by the Nigerian banks have deepened remarkably in the stock market.

Furthermore, the Nigerian banking industry has contributed immensely to the growth of the economy in the last 15 years and has attracted huge volume of foreign direct investment into Nigeria. There is high level of investors' confidence on the Nigerian banks which hitherto was otherwise. This is coupled with improved image of the banking industry both within and outside the shores of Nigeria which has increased its investment portfolios both within and outside the country. Partnerships with international financial institutions have also intensified in the last decade. The level of financial intermediation of the banks has increased.

However, in spite of these enormous gains following the reforms, the growth of small and medium scale businesses has only witnessed a marginal increase. There is gross underdevelopment of the sector due a number of challenges arising from unhealthy monetary policies, hostile business environment, and uncoordinated operation of SMEs in Nigeria. As a catalyst for economic growth, development, SME operators in Nigeria have performed below their potentials in the last decade. Based on findings of the study, we make the following recommendations:

1. The Central Bank of Nigeria should review lending rates to SMEs with a view to ensuring that loan rates, moratorium and loan tenor are complementary and designed to support business profitability, continuity and expansion. To achieve the long-term economic growth targets however, the reduction in interest rates should be considered beyond the initial one year tenor and should also be expanded to include targeted and strategic lending to SMEs with critical employment and GDP indices.
2. Comprehensive enlightenment programmes should be developed to educate SME operators on the critical need to use banks for their business and financial transactions. A very pragmatic means of building a comprehensive credit information structure for SMEs is the development of a robust Credit Reporting System (CRS). CRSs help to bridge the information gap between borrowers and lenders. Credit reporting allows lenders to learn more about borrowers' characteristics, past behavior, repayment history and current debt exposure. With this information, lenders can price their loans using a more comprehensive risk assessment of their clients. Research exploring the positive effects of credit reporting in credit markets has found that the presence of information-sharing arrangements helps to attenuate the problems of adverse selection and moral hazard brought about by asymmetric information. In economies where credit information is shared, bank lending is higher and credit risk is lower than in those economies where these arrangements are not available. The presence of information sharing is also positively associated with a higher ratio of private credit to GDP particularly in developing economies. Small and medium firms also tend to have a higher share of bank financing in economies where private credit bureaus exist.
3. SME operators and owners will need to improve their business structure and documentation processes. This can be achieved by including information storage and

documentation training as an integral part of the various SME training programmes. Proper information storage and documentation helps to expand data sources. Private and public entities that do business with SMEs have payment information that can help other parties to assess a firm's creditworthiness.

4. The relevant regulatory authorities and the legal system will need to comprehensively simplify the process of perfection of legal mortgage with emphasis on costs and inclusion of alternative collateral options. In developing economies like Nigeria, almost 80 percent of SMEs' capital stock consists of movable assets, such as machinery, equipment and receivables. Smaller businesses, in particular, are less likely to have access to fixed assets like a plot of land or building. As such, movable assets are the main type of collateral that a SME can offer as collateral to secure financing. However, due to inadequate legal and institutional protections, banks are often reluctant to accept movable assets as collateral. This can be rectified through the efficient use of a collateral registry. Collateral registries are publicly available databases of interests in or ownership of assets. They record the potential existence of security interest in movable assets. Collateral registries can protect the rights of creditors in secured lending. Effective collateral registries can reduce the costs of credit monitoring by notifying parties about the existence of a security interest and establishing priority of creditors against third parties.
5. Special training programmes designed to improve the financial management capacity of SME operators are of critical importance. This will need to address their understanding of bank loans, the various structures and processes. Additionally, improved SME operator capacity will expose SMEs to alternative methods of financing their business. This will in turn, multiply their financial capacity and ease access to bank loans.

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