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Article — Digitized Version

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Intereconomics

Suggested Citation: Eze, Agom (1971) : An appraisal of development banking, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 06, Iss. 4, pp. 121-123, https://doi.org/10.1007/BF02926998

An Appraisal of Development Banking

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In Nigeria commercial banking practices and conventions are similar to those in Britain: Loans by commercial banks are usually short-term and not medium or long-term for fixed capitals. The conventional arguments often used to justify this preference for short-term loans are mainly two: First, that the bulk of commercial banks capital or stock-in-trade are demand deposits by the public generally repayable at short notice; hence it would be imprudent for the banks to commit these to medium or long-term loans. And secondly, that commercial banks may not be in a position to assess the economic rationality of long-term investments to which they are required to commit their capital; long-term lending should be done by specialised agencies.

The first argument that most commercial banks' liabilities are short-term payable on demand is theoretically true. In practice, however, every banker knows that all depositors do not generally demand their deposits at the same time. Hence banks usually have only a small percentage of their liabilities in liquid assets. In Nigeria the minimum percentage is 25 and is mandatory on all commercial banks. In some countries as Great Britain it is about 30 p.c. and is conventional. Banks therefore make more profits by investing the rest in assets of longer duration and maturity.

There is no doubt that a banker who is indiscreet and does not have enough liquid assets can run into difficulties in meeting his bank's liabilities. This was one of the main causes of many bank failures in Nigeria in the early 1950's before the enactment of 1952 Banking Ordinance.

Aim of NIDB

The Nigerian Industrial Development Bank (NIDB) was set up in January 1964 with the aim of "providing direct financial assistance on a medium and long-term basis to enterprises in Nigeria which are privately owned and managed". However, since July 1970 it has modified its original aim and can now lend to government owned enterprises or those owned by quasi-government agencies. The NIDB is a partnership between the Government and private enterprise but is run on commercial basis.

The NIDB was established with an initial capital of £N 4.25 mn as a result of merger of the Federal Loans Board and the Investment Company of Nigeria Ltd (ICON). The Federal Loans Board itself was set up by the Nigerian Federal Government as a result of the Industrial Loans Act No. 17 of 1956 which gave it power to grant loans "for projects designed to further industrial development of the country". ICON, on the other hand, is a British owned industrial finance company formed in 1959. Today it is a subsidiary of NIDB specialising in stock broking business.

51 p.c. of NIDB voting capital is designated "A" ordinary shares and reserved for Nigerian subscribers, the Central Bank of Nigeria as well as such international an organisation as the International Finance Corporation, a subsidiary of the World Bank, of which Nigeria is a member. The remainder of voting capital, designated as "B" ordinary shares, can be subscribed by any interested investor whether Nigerian or foreign. In all, about 8 investment companies in USA, Europe and Japan have subscribed to this class of share capital.

Of the £N 4.25 mn initial paid-up capital, £N 2 mn was in the form of interest free loan granted to it by the Nigerian Federal Government. The NIDB has power to borrow up to three times of its capital at the time of incorporation. At the end of 1968 its potential reserves had risen to £N 13.2 mn. These increased reserves were given an additional impetus in March 1969 when the World Bank granted it a $ 6 mn loan to enable it to finance the foreign exchange part of any loans it might make.

Combination of Foreign and Domestic Capital

In an evaluation of the Bank's capitalisation two points are worth emphasising. First, NIDB is a successful marriage of foreign and indigenous capital. Thus it is in a position to attract capital much needed for development from abroad. Since some of its foreign owned capital is in the form of equity shares–designated "B" shares–expert management is also attracted into the country.

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Thus, as the Board of Directors was constituted in 1969, seven of the twelve directors are foreigners, some representing the World Bank and others different foreign shareholders. In Nigeria as in other less developed countries it is not only capital that is scarce; there is also scarcity of entrepreneurial skill. Sometimes there has been too much emphasis on the former to the neglect of the latter with the result that capital has not always been efficiently utilised.

Second, since NIDB does not accept demand deposits it is thereby in a better position to commit its funds to medium and long-term projects, a function which a commercial bank cannot adequately perform. In this connection it is also to be noted that apart from its own share capital it raises loans internally and externally for relending.

Until July 1970 it could only give loans for manufacturing or mining industry and also for semi-agricultral and animal husbandary projects which were not considered of pronounced hazards. Now it can also give loans for tourism i.e. building of hotels and their equipment. But NIDB still cannot invest in transport or commerce, nor can it invest in social infrastructural projects such as schools, hospitals and roads.

While it can be argued that NIDB should try to concentrate its investments in mining and manufacturing industries as well as semi-agriculture projects because these sectors of the economy are the most efficient and hence the fastest growing sector of the economy, this policy is also open to criticism. The Nigerian transport system and method of distribution are inefficient and need urgent improvement. That the Bank should exclude itself from developing this vital sector of the economy is regrettable.

Concentration on Large Enterprises

NIDB can only invest in large concerns which "by nature of their size will make a significant contribution to the economic development of the country". The company to be invested in must be incorporated in Nigeria, i.e. it has to be either private or public limited company. Small enterprises are ruled out. This is further emphasised by the fact that the minimum loan for one enterprise is £N 10,000 and the maximum loan could be up to £N 280,000. It cannot take more than 25 p.c. of equity in any one project. This, however, can be relaxed but not to exceed 49 p.c. of the share capital in such a company.

This policy of investing in "big enterprise" no doubt is based on Hirschman's theory of "unbalanced growth" which involves, in his own words "staggering economic development so that gross investments or output grow faster in some sectors than in others". The main attraction of this approach is that given scarce resources of capital, entrepreneurship and skilled labour these factors will be channelled to where they are most needed or where growth potentials are higher. In this way there will be faster economic growth than is the case if the scarce resources are spread thinly and, perhaps, less effectively over a wider spectrum of the economy. This is no place to examine in detail some of the weaknesses in this approach to economic development. Suffice it to be mentioned that the "linkage" effect between industries in the sense put forward by Hirschman is more remote here since there is less industrial integration and cohesion than in developed economies.

The Bank further justifies its concentration on large concerns to the neglect of smaller ones by arguing that in countries like Nigeria not many small companies can be viable without a great deal of supervision. This may be true but then it is debatable whether the best course for NIDB is to accept this situation. It is suggested that what the Bank can do in this regard is to aid small companies in the form of business consultancy by providing aid in more modern and basic techniques of business management. Most small businesses in Nigeria do not keep even simple books of accounts, a good many are inefficiently managed. Thus even if more capital is provided to them they cannot absorb it, yet they wrongly regard capital shortage as their main problem. This is what Schatz [1] has correctly referred to as "Capital Shortage Illusion". NIDB could provide this type of service and charge fees for that.

NIDB Commitments

Financial commitments by the Bank to any project normally take the form of direct subscription or underwriting of equity, preference stocks or debentures, or other medium or long-term loan instrument. Loans could be concerted eventually into equity or preferential stocks or debentures. Where it is a shareholder, NIDB expects to be treated as other shareholders of the same class. In case of underwriting it charges commission. With regard to loans it can grant the amount peacemeal, and charges market rates of interest taking into account the risk involved, the duration of the loan, collaterals, etc. In all cases loans must be secured, the form of security being determined as the circumstances require. It could be mortgage of fixed or other assets. In

[1] Sayre P. Schatz, "The Capital Shortage Illusion — The Government Lending in Nigeria", In: The Oxford Economic Papers, July 1965, pp. 309-316.

some cases guarantees by banks, government or other parent companies, are acceptable. Loans are granted for the periods up to 15 years, but longer periods can be considered. Generally loans are not granted for a period less than 5 years.

Before loans are made or before any financial participation in any project it undertakes a thorough investigation of the company according to the following principles as its guideline. First, the company must be reputable and efficiently managed, or in case of a new company this must show evidence that it will be in a position to satisfy this criterion. Secondly, the project must be economically desirable, technically feasible and commercially viable.

Problem of Unemployment

For instance, given the low standard of living, an industry which can raise this by promoting faster economic growth should be placed in the priority list and given financial assistance. The problem of unemployment is now a great social one in many parts of the country and cannot easily be isolated from higher economic growth. If the economy is growing at a fast rate it can succeed in absorbing the army of the unemployed now drifting into many urban areas. A labour intensive industry could be of great value in relieving this problem of unemployment. Given the absence of accurate statistical data, it is difficult to say how high the unemployment rate is in this country. It varies from one area to the other. In the East Central State it is of disproportionate dimension. It is also high in Lagos and the Western States, but not as high in the South Eastern and Mid Western States. In the six Northern States the problem is that of underemployment rather than unemployment. This problem of unemployment in some states existing side by side with underemployment in others could be equilibrated if there is free mobility of labour in the country. But the fact still remains that there are political and social obstructions to free mobility of labour in this country.

It is also desirable that Nigeria should conserve its foreign exchanges in order to enable it to finance its economic developments by importing capital goods and necessary consumer goods. This is particularly so since in the last few years it has been experiencing deficits in the current account of its balance of payments.

Technical feasibility implies that the project for which NIDB's financial commitment is being sought involves such technical processes that can be carried out under existing conditions in the country taking into account availability of raw materials, machinery and equipment, technical and management personnel and labour. And finally commercial viability envisages that the project has to make profit taking into account loans repayment, building up of reserves and ability to pay reasonable dividends. Other factors taken into account include the reasonableness of the cost of the project, cost of production, marketability of the furnished products and quality of management.

Growing Total Disbursement

Despite these demanding criteria NIDB's disbursements i.e. investments in loans and equities have been substantial and growing. For instance in its first year of operation, 1964, its total disbursements were £N 2,096,754, whereby loans and debentures made up £N 1,595,209 and equities £N 501,550.

NIDB has also been a successful company from the point of making profits. Even in its first year of operation it made a gross profit (before taxation) of £N 110,454. Its profits have been growing. In 1968 it made a gross profit of £N 228,434 and in 1969 one of £N 277,371.

Judging from its operations and profitability NIDB is a successful undertaking. But the paradox of its case is that most of the beneficiaries from its financial disbursements had been foreign owned companies incorporated in Nigeria. Most of the Nigerian owned companies, mainly because they do not satisfy the Bank's criteria, do not get financial accommodation from it. Thus in 1969 of the total of 20 companies to which investments had been sanctioned only 7 were wholly Nigerian owned. This, according to the Bank[2], "is the highest so far in the history of NIDB". Even this number overstates the extent of financial assistance to indigenous companies. For instance for the same year, 1969, of the total sanctions, in the form of loans and equity, amounting to £N 2,408,000 to 20 companies, only £N 640,000 or about 25 p.c. was for wholly Nigerian owned companies. Faced with this situation, therefore, it is understandable why the Federal Government has recently, in 1970, drawn the attention of the Bank to this apparent anomaly and directed it to reserve 80 p.c. of its loans to indigenous companies. It is hoped, however, that this will not result in a drastic lowering of standards for loans and investments by the Bank in order to satisfy this nationalistic demand. Otherwise the Bank will simply turn into another relief agency and thereby fail in its primary objective of promoting faster economic development of the country.

[2] NIDB Annual Report and Accounts for 1969, p. 5.