

# The Impact of Bank Consolidation on Lending to SMES in Nigeria

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**Abstract**—This paper seeks to assess the implications of bank consolidation on lending, which largely determine the survival and performance of small and medium scale enterprises and in turn the development of the Nigerian economy. Ordinary least square technique, correlation matrix test and Granger –causality test were employed to measure the extent to which lending to small and medium scale enterprises were influenced. The result showed that bank deposit (BD) impacted on lending to small and medium scale enterprises. Commercial and merchant bank lending rate had statistically insignificant effect on the dependent variable. There is a shift of focus by commercial banks from small and medium scale enterprises (small customers) to major investors (big customers). While micro finance banks work hard at providing funds to small and medium scale entrepreneurs, their capacity to meet the needs of these entrepreneurs is constrained. The capital and deposits of micro finance bank should be boosted in order to effectively support small and medium scale enterprises through loans.

**Keywords**—Asset size, bank consolidation, lending, small and medium enterprises.

## I. INTRODUCTION

THE banking industry in Nigeria which started approximately in 1891 has evolved through several stages of regulatory frameworks to its present state [9]. The Fourth stage which could be described as the era of consolidation (2004 to 2008) focused on recapitalization and proactive regulation based on risk supervision framework. It has been asserted that bank consolidation has been the major policy instrument adopted in correcting deficiencies in the financial sector all over the world [14]. In their words, [2] opined that the momentum and wave of bank consolidation intensified in recent times because of the impact of globalization precipitated by continuous integration of world markets and economies.

Studies have shown that all over the world and given the internationalization of finance, size has become an important ingredient for success in the globalizing world. In the world of finance, no country can afford to operate in isolation. The last few years have witnessed the creation of the world's banking group through mergers and acquisitions and the trend has been influenced by factors such as prospects of cost-savings due to economies of scale as well as more efficient allocation of resources; enhanced efficiency in resource allocation; and risk reduction arising from improved management [13]. Concurring with the above, [5], observed that the banking

sector consolidation programme in Nigeria will yield veritable goldmine of superior returns such as: an unmatched array of financial solutions provided through a sophisticated and wide branch network throughout Nigeria; and a banking sector with clearly defined growth strategy and expertise that offers full spectrum of financial products and services and also engender economies of scale, save cost, leading to synergies and shareholders' returns on a level yet unparalleled by any other financial institution in Africa.

In his address to Nigerian bankers, [13] canvassed that the goal of the reforms is to help the banks become stronger players, and in a manner that will ensure longevity and hence higher returns to the shareholders over time and hence lead to greater impact on the Nigerian economy. It is strongly believed that the ultimate beneficiaries of this policy shift would be the Nigerian economy - the ordinary men and women who can put their deposits in the banks and have a restful sleep; the entrepreneurial Nigerians who can now have stronger financial system to finance their businesses; and Nigerian economy which will benefit from internationally connected and competitive banks that would also mobilize international capital for Nigerian development. This measure is about the Nigerian people. It is about meeting their NEEDS [13].

This paper seeks to assess the implications of bank consolidation on lending (financing) to small businesses, which largely determines its survival and performance and in turn the development of the Nigerian economy. The study is significant because preliminary investigation reveals that limited literature exist in this area. Therefore, it adds to the existing literature on bank consolidation. The rest of the paper is organized into four sections. Section two is devoted to the review of the related literature. Section three presents the methodological framework while the discussion of results is in section four. The conclusion and recommendations are presented in section five.

## II. LITERATURE REVIEW

Small businesses are major sources of most job growth in any country [6]. Since the bulk of small business credit is primarily from banks, institutional changes through consolidation will likely have an adverse effect on small business credits. This is a major issue for any country particularly a developing country like Nigeria. Experts argue that consolidation of the banking industry in Nigeria will have negative impact on the amount of credit available to small and medium scale enterprises. Small banks are major source of credits for small and medium enterprises. Unlike large firms

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which have access to the capital market, small and medium scale enterprises rely heavily on bank credit. If small banks are increasingly acquired by large banks in the form of consolidation, it is argued that it will have a negative effect on the availability of credit to small and medium scale enterprises.

Reference [6] examined the implication of consolidation on the amount of credit available to small business and found that access to credit was significantly reduced by banking consolidation. The consequence is a reduction in the productivity of small businesses and their overall contribution to the economy in terms of increasing employment creation and social welfare. The implication of lack of credit to small and medium scale enterprises is that they now increasingly turn to non-bank sources of finance to provide access to credit. However this source comes with a cost to this class of business hence increasing the cost of production.

The rational option for many small scale businesses following their diminished options for access to funds is to consider the option of relationship lending. The term relationship lending refers to loans that require borrowers to establish a relationship with the lender before recording credit. Relationship lending is important to small business and small banks engage more in relationship lending than do large banks. Small businesses concentrate their borrowing at financial institutions with which they have long-term relationship. This relationship according to [15] can be mutually beneficial. Mutual benefits enable banks to collect information about the borrower's ability to repay and reduces their cost of providing credits; on the other hand it allows the borrower better access to credit and lower cost of borrowing. Relationship loans, however, require tighter control and oversight over loan officers by senior management than do loans based on simple accounting and financial ratios. The complexities of large banks make relationship loans infeasible or at least more difficult [15]. Since senior management of small banks can monitor lending decisions closely, they can authorize more non-standard relationship loans to small businesses. Consolidation of smaller banks will however reduce the amount of credit available for on-lending to small businesses.

The economic rationale for domestic consolidation is indisputable. An early view of consolidation in banking was that it makes banking more cost efficient because larger banks can eliminate excess capacity in areas like data processing, personnel, marketing, or overlapping branch networks. Cost efficiency also could increase if more efficient banks acquired less efficient ones. Though studies on efficiency in banking raised doubts about the extent of overcapacity, they did point to considerable potential for improvement in cost efficiency through mergers [14].

Reference [16] asserts that the reforms in the banking sector proceeded against the backdrop of banking crisis due to highly undercapitalization deposit taking banks; weakness in the regulatory and supervisory framework; weak management practices; and the tolerance of deficiencies in the corporate governance behaviour of banks. According to [2], the banking

sector reforms and recapitalization resulted from deliberate policy response to correct perceived or impending banking sector crises and subsequent failures. A banking crisis can be triggered by weakness in banking system characterized by persistent illiquidity, insolvency, undercapitalization, high level of non-performing loans and weak corporate governance, among others they added.

Justifying the need for consolidation in Nigerian banks, Soludo asks, "Where is Nigeria - Africa's most populous country and potentially its largest economy?" He continues that in Nigeria, we have 89 banks with many banks having capital base of less than US\$ 10 million, and about 3,300 branches. Compare this to 8 banks in South Korea with about 4,500 branches or the one bank in South Africa with larger assets than all our 89 banks. The truth is that the Nigerian banking system remains very marginal relative to its potentials and in comparison to other countries - even in Africa. We have a duty to be proactive, and to strategically position Nigerian banks to be active players and not spectators in the emerging world. The inability of the Nigerian banking system to voluntarily embark on consolidation in line with the global trend has necessitated the need to consider the adoption of appropriate legal and supervisory frameworks as well as a comprehensive incentive package to facilitate mergers and acquisition in the industry as a crisis resolution option and to promote the soundness, stability and enhanced efficiency of the system [13].

In line with this argument, [4] comments as: "This new policy has the intention of repositioning the Nigerian banking industry for the development challenges of the 21st century. It hopes to place the industry in a better stead to compete at the global level, more so that national barriers have been dismantled by Information and Communication Technology (ICT). Also, [7] and [12] reported that bank recapitalization will allow for emergence of mega banks that enjoy hidden subsidy referred to as 'too-big-to-fail' subsidy due to the market's perception of an illusion of government backing of a mega bank in times of crisis. Experts equally predict a change from the usual banking method to retail banking by most banks.

Reference [10] enunciated that banks have always collaborated and cooperated with government in lending especially with respect to lending to macro, small and medium scale enterprises (SME) as well as real sector. Up till 1997, when compulsory sectorial allocation was phased out as a policy instrument used by CBN, mainstream banks were made to meet specific targets in their lending to the productive sectors especially agriculture, manufacturing, particularly the export and solid mineral. Reference [8] reveals that commercial banks total loans to small scale enterprises increased from N20.4 Billion in 1992 to about N42.63 Billion in 1998, representing an average of about 21.5% of the aggregate loan granted by commercial banks during the period.

The availability and cost of finance are regarded among the factors militating against the growth of SMEs. Although access to finance does not by itself guarantee growth and

sustenance of small business, it has been shown that absence of adequate level of finance can frustrate the formation or growth of SMEs. Reference [1] says that if the people of Nigeria have a limited capacity to invest in capital, productivity is restricted, incomes are inhibited, and domestic savings remain low. A lack of access to financial institutions also hinders the ability for entrepreneurs in Nigeria to engage in new business ventures, inhibiting economic growth and often the sources and consequences of entrepreneurial activities are neither financially nor environmentally sustained. Reference [3], however, documents that despite decades of public provision and direction of provision of microcredit, policy reorientation, and the entry of new players, the supply of microfinance in Nigeria is still inadequate in relation to demand. This suggests that there is some inefficiency in microfinance operations in Nigeria due to some institutional inadequacies such as undercapitalization, inefficient management and regulatory and supervisory loopholes. Reference [11] argues that finance alone is not enough. Other complementary strategies must be adopted if we are to realize the goal of poverty reduction in Nigeria. Some of these factors are reviewed as the type and size of the project, the credit history of the borrower, the prevailing economic conditions, the level of competition in the industry and the judicial processes in credit recovery.

Finance sources are established for purpose of the poor that one can talk of appraisal and disbursement technique. After all the poor know what to do but securing funds to actualize their vision turns to a nightmare fantasy.

### III. METHODOLOGY

The study employed econometric analysis. The econometric analysis used is the multiple regression method. This was specified to help examine the influence of the bank consolidation on lending to Small Medium Enterprises in the economy. Furthermore, a correlation matrix test will be done to show the strength or weakness of the relationship between variables and granger causality test to show the direction of causation. Data was sourced from Central Bank of Nigeria (CBN) Statistical Bulletin.

We hypothesize that bank consolidation has not significantly affected lending to micro, small and medium enterprises in Nigeria.

This can be estimated using the model:

$$L = f(BD, CBLr, MBLr, M_2)$$

Therefore;

$$L = B_0 + B_1BD + B_2BC + B_3Lr + B_4M_2 + \mu \quad (1)$$

where, L = Lending to SME (dependent variable);  $B_0$  = constant variable; Lr = Lending rate; BD = Bank Deposit; BC = Bank Capitalization;  $M_2$  = Money Supply;  $\mu$  = error term.

Lending to SME is a summation of “commercial bank lending to SME, merchant bank lending to SME, and

community/microfinance bank lending to SME”. Bank deposit is a summation of “deposit money bank deposits and community/microfinance bank deposit”.  $B_0, B_1, B_2, B_3, B_4$  = denotes unknown parameters to be estimated.

## IV. DISCUSSION

### A Empirical Results

TABLE I  
REGRESSION RESULT OF BANK LENDING TO SMALL AND MEDIUM ENTERPRISES, BANK DEPOSITS, BANK CAPITAL, LENDING RATE AND MONEY SUPPLY

Dependent Variable: LNBL				
Method: Least Squares				
Included observations: 21				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.757672	0.146854	5.159354	0.0001
LNBD	0.057379	0.020244	2.834318	0.0120
LNBC	0.181436	0.019269	9.415914	0.0000
LNLR	0.014567	0.032240	0.451830	0.6575
LNLM2	0.754227	0.032180	23.43750	0.0000
R-squared	0.999849	Mean dependent var		14.58210
Adjusted R-squared	0.999811	S.D. dependent var		1.510128
S.E. of regression	0.020747	Akaike info criterion		-4.708611
Sum squared resid	0.006887	Schwarz criterion		-4.459915
Log likelihood	54.44042	F-statistic		26487.31
Durbin-Watson stat	0.580173	Prob(F-statistic)		0.000000

Author's computation with E-views software

The test carried out at 5% level of significance and 16 degree of freedom shows that the coefficient of bank deposit, bank capitalization and money supply has a statistically significant effect on lending to SME (i.e.  $2.834318 > 2.110$ ,  $9.415914 > 2.110$ , and  $23.43750 > 2.110$  respectively). Lending rate effect was non-significant. It also failed the a priori expectation. As bank consolidate, their capital increase as well as their deposit. Lending also increase and credit is created. Furthermore, lending rate influences borrowing and lending to SMEs. As lending rate increase, fewer SMEs will access funds through borrowing from banks. The empirical results show the coefficient of multiple determinations ( $R^2$ ) to be 0.999811 (i.e. 99%) which implies that variation in the dependent variables are attributable to variations in lending to SMEs.

### B. Correlation Matrix and Granger Causality

TABLE II  
CORRELATION MATRIX TEST

	LNBC	LNBD	LNBL	LNLR	LNLM2
LNBC	1	0.849596657218	0.975831672994	-0.385614688817	0.967485278288
LNBD	0.849596657218	1	0.905567542005	-0.368751749684	0.895295446964
LNBL	0.975831672994	0.905567542005	1	-0.493885659049	0.998788349153
LNLR	-0.385614688817	-0.368751749684	-0.493885659049	1	-0.522249708918
LNLM2	0.967485278288	0.895295446964	0.998788349153	-0.522249708918	1

Author's computation with E-views software

TABLE III  
GRANGER CAUSALITY TEST

Pairwise Granger Causality Tests			
Sample: 1992 2012			
Lags: 2			
Null Hypothesis:	Obs	F-Statistic	Probability
LNBL does not Granger Cause LNBC	19	0.76754	0.48273
LNBC does not Granger Cause LNBL		0.11712	0.89034
LNBL does not Granger Cause LNBD	19	1.06753	0.37026
LNBD does not Granger Cause LNBL		0.79308	0.47176
LNLR does not Granger Cause LNBL	19	0.32647	0.72682
LNBL does not Granger Cause LNLR		0.28130	0.75897
LNLM2 does not Granger Cause LNBL	19	1.55246	0.24606
LNBL does not Granger Cause LNLM2		0.38328	0.68856

Author's computation with E-views software

A further investigation on the strength of the relationship and direction of causation reveals that the relationship between the coefficients of bank deposit, bank capitalization, money supply and lending to SMEs is strong and positive (90%, 97%, and 99%). Furthermore, the relationship between lending rate and lending to SMEs is negative and weak (-49%). The test of direction of causation shows that the bank lending to SMEs caused bank capitalization and bank deposit while bank deposit and money supply caused bank lending to SMEs. Interestingly, lending rate and bank lending did not cause each other. This outcome further support that Lending rate failed the a priori expectation with respect to bank lending to SMEs

### C. Graphical Representation of Community/Microfinance Bank Deposit and Lending to SMEs

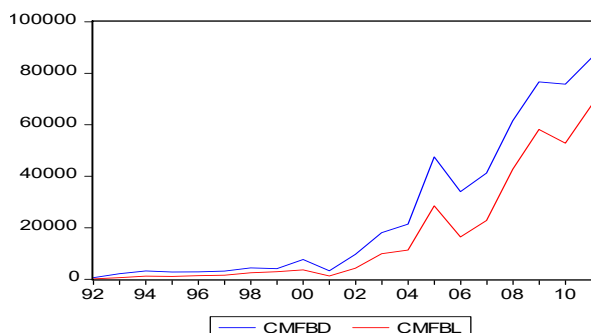


Fig. 1 Trend Analysis of Community/Microfinance Bank Deposit (CMFBD) And Community/Microfinance Bank Lending (CMFBL)  
(Source: computed using e-views statistical software)

It is interesting to note that community/Micro finance bank (CMFB) lending to SMEs moved in the same trend with its bank deposit. This implies that as community/microfinance bank deposits increased, it's lending to SMEs increased. Regardless of the direct impact of community/microfinance bank on SMEs, SMEs still cry for lack of funding and lending to SMEs in Nigeria is still poor. This is so because their capital, reserve and deposit are very small and insufficient to meet the needs of small and medium entrepreneurs.

Following the Nigerian banking sector consolidation, there has been tremendous increase in bank capital and deposit which had significant effect on lending to SMEs. Notwithstanding, the number of surviving SMEs have dwindled over the years. Though bank capital and deposit increased drastically, making available funds for lending to investors, SMEs shy away from bank source of funding because of soaring interest rate. The surviving banks after consolidation of the sector in Nigeria became mega banks with big customers. The quest for profit increased and as a result, the interest rate, which is a major source of profit for banks increased (from 18.7% in 2006 to 22.39% in 2011).

### D. Test of Hypotheses

H<sub>0</sub>: The hypothesis states that bank consolidation has not significantly affected lending to micro, small and medium enterprises in Nigeria. The t-test shows the coefficient of bank capital and bank deposit to have a statistically significant effect on lending to small and medium scale enterprises (i.e.  $2.931711 > 2.110$  and  $9.415914 > 2.110$ ). We therefore reject H<sub>0</sub> and conclude that bank consolidation has significant effect on small and medium scale enterprises in Nigeria.

### V. CONCLUSION AND RECOMMENDATIONS

The banking sector drives any economy, as well as Nigerian economy. The consolidation of banks in Nigeria has drastically changed the structure and operation of the surviving banks and impacted on several aspect of the economy. While other studies focus on the profitability and credit reduction of banks after consolidation, this work goes beyond to investigates the Nigerian banking sector consolidation over the years and its effect on lending to SMEs, which is vital ingredient for the growth and development of Nigerian economy. The objective of this paper is to find out the extent to which the Nigerian banking sector consolidation influenced the decrease or increase in lending to SMEs in Nigeria. The study showed that there is a wide margin

between deposit money bank deposits and commercial bank's lending to small and medium scale enterprises.

Looking at the data, the researcher observed that while bank deposits rose high, commercial bank lending to SMEs declined from 2004 to 2010. The gap between commercial bank deposits and its lending to SMEs reveals the shift in focus from lending to SMEs to lending to major investors (customers). Though bank deposit increased drastically, making available funds for lending to investors, SMEs shy away from bank source of funding because of soaring interest rate. The surviving banks after consolidation of the sector in Nigeria became mega banks with big customers. The quest for profit increased and as a result, the interest rate, which is a major source of profit for banks increased.

It is interesting to note that community/micro finance bank directly impacted on SMEs. However, giving the low capital and deposits of community/micro finance banks which are very small and insufficient to meet the needs (finance) of small and medium entrepreneurs, SMEs still cry for lack of funding. It is therefore recommended that the CBN should make policies that will boost micro finance bank's capital and also monitor closely the management of the banks to ensure prudent financing of small and medium scale investments. Micro finance banks on the other hand should consider a capital market option in order to increase their capital base and put money in their hands for business. Micro finance banks should also employ strategic and juicy methods of attracting deposits.

While micro finance is growing in Nigeria, the CBN should encourage commercial banks to fill the gap. Commercial banks should seriously continue rural banking seeing that micro finance banks have very small capacity to lend to an overwhelming number of small and medium scale enterprises in Nigeria.

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