

# The Impact of Bank Consolidation on the Performance of SMES in Nigeria

Okolo Chimaobi Valentine

**Abstract**—This paper seeks to assess the implications of bank consolidation on the performance of small and medium scale enterprises in the Nigerian economy. Multiple linear regression technique and correlation matrix test were employed to measure the extent to which small and medium scale enterprises asset size, survival and access to credit were influenced. The result showed that bank deposit (BD) and bank credit (L or BC) impacted on asset size and survival of small and medium scale enterprises. None of the variables had significant impact on SMEs access to credit. There is a shift of focus by commercial banks away from small and medium scale enterprises (small customers), which is evidenced by the significant negative influence of bank credit to both the survival and asset size of small and medium enterprises. 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. 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.

**Keywords**—Bank consolidation, small and medium enterprises.

## I. INTRODUCTION

THE importance of small and medium enterprises has not been in doubt; nonetheless classifying businesses and organizations into large and medium scale is subjective and depends on different value parameters such as employment, total assets or total investment.

In the case of Nigeria, hardly do we have a clear-cut definition that distinguishes small and medium scale enterprises. The first attempt to define SMEs in Nigeria was by the Central Bank of Nigeria in its monetary policies circular No. 22 of 1988, where SMEs was defined as those enterprises with annual turnover not exceeding 500,000 naira. In 1993, the definition of SMEs was reviewed by the Federal Government, which increased their total asset to five million as a result of the introduction of the Second Tier Foreign Exchange Market (SFEM), and the spiral inflation fuelled by the Structural Adjustment Programme.

Reference [12] opined that the changing dynamics in the economy has also prompted scholars and practitioners to reclassify SMEs into micro and super-micro businesses, with a view to providing adequate incentives and protection for the former.

One of the factors militating against the development of SMEs in Nigeria is lack of funding. This is so because, SMEs

in Nigeria depends on owners equity (personal savings), borrowings from friends and relations, borrowing from government agencies (example; Small and Medium Scale Equity Investment scheme), and borrowing from commercial banks.

Reference [4] examines the issues and challenges arising from the banking sector reform programme in Nigeria. He noted that since the consolidation programme was policy induced, the 18 months given for total compliance appeared inadequate, following the number of activities required for consolidation to be successfully consummated, he however acknowledged that the programme could lead to the emergence of a sound and efficient financial system that would support the growth and development needs and aspirations of the Nigerian economy, to fully harness the synergies and potentials of the consolidation programme. He therefore, advocated for proper handling of post consolidation challenges such as continuous flow of fund to small and medium enterprises.

The bulk of small and medium enterprise credit is said to come primarily from banks therefore institutional changes through consolidation could have an adverse effect on small business credits and the performance of SMEs. Reference [19] states that, small banks are said to be major source of credits for small business outfit, unlike large firms which have access to the capital market, small and medium enterprises rely heavily on bank credit. If small banks are increasingly acquired by large banks in the form of consolidation, it may be strongly contended that it will have a negative effect on the availability of credit to small and medium enterprises. Furthermore, as reported in [19], a survey of small credit to small firms conducted by Cole, Wolken, and Woodburn (1996) established a fairly strong link between size of banks and the supply of small business credit, with bigger banks devoting less proportions of their assets to small business lending than smaller banks. Therefore, the need to empirically investigate the impact of bank consolidation on the performance of SMEs in Nigeria motivated the study. This is especially necessary, given that bank consolidation was aimed at ensuring bank stability, promoting good corporate governance, establish mega banks and promote bank lending to the private sector. The rest of the paper is organized into five 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.

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## II. LITERATURE REVIEW

The role of banking industry is crucial in the pattern and pace of economic growth and development. Banks occupy a position in the financial system that supplies credits needs of the economy. Justifying the need for consolidation in Nigerian banks, Soludo questioned where is Nigeria - Africa's most populous country and potentially its largest economy? He continues that in Nigeria, we have 89 banks with many of them having capital base of less than US\$ 10 million, and about 3,300 branches. He continued that 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 [17].

Reference [3] states that the banking sector reforms and recapitalization resulted from deliberate policy response to correct perceived or impending banking sector crises and subsequent failures. Similarly, [22] argues that the reforms in the banking sector proceeded against the backdrop of banking crisis due to high undercapitalization, poor 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. The primary objective of the reforms therefore is to guarantee an efficient and sound financial system by equilibrating the competitive muscles of the existing weak banks through mergers and acquisitions [21].

Having established a strong link between banks and small and medium enterprises [19], it is worrisome that despite incentives, favorable policies and regulations and preferential support by government aimed at improving small and medium scale enterprises, SMEs, has performed below expectation in Nigeria. While the challenges associated to small and medium scale enterprises and their failure has been a widely acclaimed, empirical evidence show that finance contributes to about 25percent of the success of SMEs [13].

While [14] says that credit has been recognized as an essential tool for promoting Small and Micro Enterprises (SMEs) in Nigeria, [13] in a report on SMEs claimed that 20 percent of SMEs have reported being constrained in receiving long term loan and this has forced SMEs to use their internal financing which is usually unsustainable as a result of low capital base.

Reference [14] explains that community banking/microfinance banking concept was introduced into the financial landscape. They provide banking and financial services for the rural economies and micro-enterprises in the urban centers and are structured on communal ownership. Reference [11] further argued that finance alone is not enough. Other complementary strategies must be adopted if we are to realize the goal of poverty reduction in Nigeria.

The CBN recognized micro finance as an important tool for poverty alleviation through empowering the micro and small entrepreneurs [14]. Currently microfinance banks are of two

forms, as all licensed community banks in Nigeria that met CBN guidelines have been transformed to Microfinance Banks. The two forms of Microfinance Banks (MFBs) are; (i) microfinance Banks (MFBs) licensed to operate as a unit with minimum paid-up capital of N20m for each branch. The branching should be gradual within a local council before it spreads to other local councils and state (ii) Micro-Financed Banks licensed to operate in a state with minimum paid up capital of is N1 billion and without recourse to gradual spread [6].

Reference [5] in her study of the attitudinal response of small and medium scale business owners to micro finance banking in Nigeria, sought to uncover areas of necessary modification in the policy before it becomes moribund like SMEEIS. She said that in the event of the failure of Small and Medium Enterprise Equity Investment Scheme (SMEEIS) initiated in 2001, the government of Nigeria decided to introduce microfinance banks to bridge the gap between the commercial banks and small and medium business owners. She concluded that every action of the business owners are gauged by the expectations conceived before commencement of banking relationship and these expectations and not present relationship determines their future decision. Her paper recommended that the effectiveness of microfinance banks as a development strategy is contingent not on conventional banking skills but rather on business management skills that would help in delivering both financial and business counseling to the operators.

Reference [10] opined that the Nigerian banking sector was highly oligopolistic with remarkable features of market concentration and leadership. The CBN recent reform to consolidate the banking sector through drastic increase to N25 billion as minimum capital base has led to a remarkable reduction in number of banks changed their mode of operation and their contribution to the economy. This paper through review of literature explores the impact of the reform on the Nigerian economy and found that, the CBN decision has changed the market structure of the banking sector, increased the efficiency and reliability of the banks, created opportunities for financial institutions and market participants, and raised their intermediation potentials. It also became evident that for such strategy to be effective, Central Bank of Nigeria needs to make banks recapitalization a continuous exercise at interval of 5-10 years to catch up with inflation and happenings in other parts of the world. It is equally important to establishing branches by mega banks in the rural areas of the country so as to ensure adequate access to credit facilities and other services.

Reference [1] in their examination the role of Micro-finance banks in reducing poverty and the development of entrepreneurship identified high rate of loan default among the SMEs, which poses serious consequences for microfinance banks. They concluded that microfinance banks have played a great role especially in developing entrepreneurs in rural areas; they are however facing problems of high operating cost. It is recommended that the banks should encourage the formation of cooperatives so that a number of beneficiaries

that are engaged in the similar business can collectively enjoy their services and hence a reduction in operating cost as well as a reduction in the likelihood for borrowers to default.

Reference [20] x-rayed the effect of bank consolidation on credit risk reduction. They showed that banks recorded decreases and increases at various periods of the pre and post-consolidation periods and one bank out of the sample had significant credit risk reduction. Further Look at the impact of post-bank consolidation on the performance of Small and Medium Scale enterprises (SMEs) in Nigeria, with special reference to Lagos State, [15] assessed the trends of post-bank consolidation on the development of the Nigerian economy, highlighting the ancillary benefits that may have accrued to the economy and SMEs as a result of post bank consolidation. They revealed that SMEs in Nigeria, with reference to Lagos State metropolis, did not have better access to finance through banks, due to neo-reorganization in banks as a result of post bank consolidation and recommended that government should encourage small and medium enterprises by providing enabling ground for better access to credit from financial institutions at an affordable price.

Reference [2] asserted that the consolidation of banks around the globe has fuelled an active policy debate on the impact of consolidation on financial stability. His paper theoretically outlined, on the basis of existing bank concentration theories, the term effects the bank consolidation exercise will likely have on the Nigerian banking system via concentration. Based on the findings, the researcher recommended that the Central Bank of Nigeria (CBN) should tighten its regulatory role over the Nigerian banking industry and make it clear that none of the twenty-five surviving banks is "too big to fail".

Reference [11] argued 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.

As much as other complementary strategies outlined by [11] are necessary, they are of secondary concern. It is when 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. In line with [16] and [7], the econometric analysis used was multiple regression method. This was specified to help examine the influence of the bank consolidation on the performance of Small Medium Enterprises in the economy. This was backed up with relevant time series data, which span a period from 1991-2005, fifteen years before and during consolidation, and 2006-2010 five years after consolidation [i.e. a total of twenty (20) years (1991-2010)]. It was necessary to analyze or test the theory in order to supply numerical estimate of the coefficient

of SME survival, SME asset size and lending to SME in relationship to bank consolidation (proxied by bank capital base and bank deposit). Furthermore, a correlation matrix test was done to show the strength or weakness of the relationship between variables. Data was sourced from Central Bank of Nigeria (CBN) Statistical Bulletin and Corporate Affairs Commission (CAC).

We hypothesize that;

- i. Bank consolidation in Nigeria does not have significant and positive impact on the survival of small and medium enterprises
- ii. Consolidation of banks in Nigeria does not have significant effect on asset size of small and medium enterprises in Nigeria.
- iii. Consolidation does not have any significant contribution on lending to small and medium enterprises in Nigeria

This can be estimated using the model:

$$(i) S = B_0 + B_1CB + B_2BD + B_3L + \mu \quad (1)$$

$$(ii) AS = B_0 + B_1CB + B_2BD + B_3L + \mu \quad (2)$$

$$(iii) L = B_0 + B_1BD + B_2DMBLr + B_3MBLr + \mu \quad (3)$$

where, S = Survival of SME; AS = Asset Size of SME; L = Lending to SME [Bank Credit to SME (BCSME)]; CB = Capital Base; DMBLr = Deposit Money Bank Lending rate; MBLr = Merchant Bank Lending rate; BD = Bank Deposit;  $B_0$  = constant variable;  $\mu$  = error term. **Note:** 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 "commercial bank deposit, merchant bank deposit, and community/microfinance bank deposit".

### IV. DISCUSSION

#### A. Unit Root Test

The Phillips-Perron test for unit root and stationarity conducted at level, 1<sup>st</sup> and 2<sup>nd</sup> difference showed that observed t-statistics are all greater than the critical values. Therefore, we conclude that there is no unit root problem with the data.

#### B. Empirical Result

The test carried out at 5% level of significance showed that bank deposits and bank credit to small and medium scale enterprises impact significantly on the survival and asset size of small and medium scale enterprises in Nigeria. While bank deposit impacted positively on survival and asset size of small and medium scale enterprises, bank credit impacted negatively on them. Commercial bank capitalization had a positive effect on asset size and a negative effect on survival. Bank capitalization effect on both dependent variables was insignificant.

The result showed that the coefficient of bank deposit contributed a significant 60% and 59% to the survival and asset size of small and medium scale enterprises respectively. Bank credit to small and medium scale enterprises contributed

-40.6% and -38.15 to survival and asset size. While commercial bank capitalization contributed 24.3% to asset size, its contribution to survival of small and medium scale enterprises negative and insignificant (-6%). Bank credit to SMEs failed the a priori expectation, given that an increase in bank credit to SMEs should increase their survival and asset size.

Banks are primary source of credit for small and medium scale enterprises [9]. The negative effect of commercial bank capitalization on survival of small and medium scale enterprises supports that as commercial banks consolidated in Nigeria, especially due to recapitalisation in 2004, small and medium scale enterprises in Nigeria suffer poor access to credit. The significant and positive effect of Bank credit to SMEs on their survival and asset size is due to the increased contribution of microfinance banks as shown in Figs. 1 and 2 below. The  $R^2$  suggests that variations in the dependent variables are as a result of variations in the independent variables (95.8% and 80%, considering the survival and asset size respectively).

The result further revealed that coefficients of commercial bank capitalization, bank deposit, lending rate and money supply were all insignificant with respect to bank credit to small and medium scale enterprises in Nigeria. The coefficients of money supply and lending rate failed the a priori expectation. An increase in lending rate should cause small and medium scale enterprises to turn to other sources of funding as opined by [8]. Therefore, while money supply should have a positive effect on bank credit to small and medium scale enterprises and lending rate a negative effect on the same variable, the reverse was the case. Commercial bank capitalization and money supply made significant contribution to bank credit to small and medium scale enterprises in Nigeria. For every unit increase in bank credit to small and medium scale enterprises, commercial bank capitalization and money supply contributed 68% and -57.6%. 56.3% variations in the dependent variables could be attributed to variations in commercial bank capital, total bank deposits, lending rate and money supply.

Reference [9] opined that while banks consolidated in Nigeria and became mega, they focused on bigger customers to the neglect of smaller ones. This explains the insignificance of commercial bank lending to small and medium scale enterprises in Nigeria in Fig. 1.

A close look at the graphic trend of various bank lending to SMEs in Nigeria showed horizontal and steady movement in lending to small and medium scale enterprises until year 2000. In the same year saw the consolidation of commercial and merchant banking functions into a universal bank. This and many other monetary policies over a period of time till 2004 resulted in the increase of bank lending to small and medium scale enterprises. While commercial bank lending to small and medium scale enterprises dropped drastically from a peak of over -N- 90billion in 2004 to less than -N-15billion in 2012, microfinance bank lending, which generally is to small and medium scale enterprises, rose from close to -N-10 billion in 2003 to over -N-80billion in 2012. Interestingly,

community/Micro finance bank (CMFB) lending to small and medium scale enterprises moved in the same trend with its bank deposit. This implies that as community/microfinance bank deposits increased, it's lending to SMEs increased. Nonetheless, Nigerian microfinance banks have not been able to satisfy for the growing needs of these small and medium scale enterprises in Nigeria due to low capital and poor deposit.

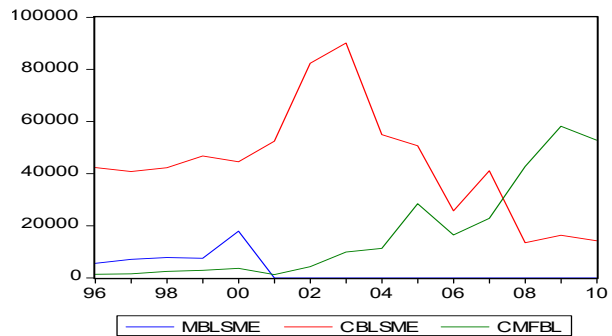


Fig. 1 Trend Analysis of Merchant Bank Lending to SME (MBLSME), Commercial Bank Lending to SME (CBL SME) and Community/Microfinance Bank Lending (CMFBL) (Source: computed using e-views statistical software)

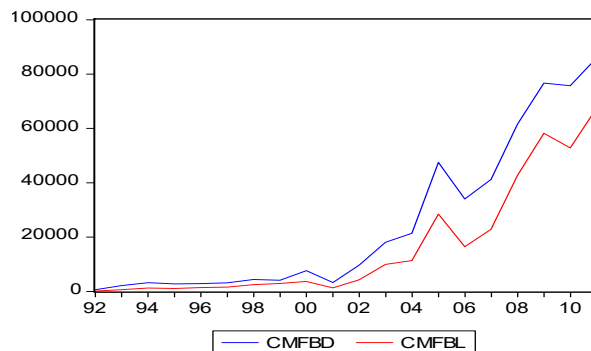


Fig. 2 Trend Analysis of Community/Microfinance Bank Deposit (CMFBD) and Community/Microfinance Bank Lending (CMFBL) (Source: computed using e-views statistical software)

### C. Correlation Matrix

A further investigation on the strength of relationship reveals that the relationship between the coefficients of bank deposit, bank capitalization, bank credit to SMEs and is strong and positive (96.8%, 95.8%, and 61%). The relationship between bank deposit, commercial bank capitalization and survival of small and medium scale enterprises is strong and positive (83.8% and 79% respectively), while bank credit to SMEs had a weak relationship with the dependent variable (SSME). Furthermore, bank deposit, bank capitalization and money supply had strong and positive relationship with bank credit to small and medium scale enterprises. Lending rate had a weak relationship with bank credit to small and medium scale enterprises in Nigeria.

#### D. Test of Hypotheses

For the first two hypotheses we reject the null hypothesis and conclude that bank consolidation did have positive and significant impact on small and medium enterprises asset size and survival. However, for the third hypothesis, we conclude that bank consolidation had positive but insignificant impact on access to credit. This determined by the decision rule ( $t^* < t_{0.025}$ ).

#### V. CONCLUSION AND RECOMMENDATIONS

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 [18].

Reference [17] canvassed that the goal of the reforms is to help the banks become stronger players in global, 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 national economic emancipation and development strategy (NEEDS) [17].

Consolidation of Nigerian banks has indeed increased the financial muscle of the sector. It has contributed to the major foreign direct investments in the country. While consolidation positively moved towards its goal, it behooves on the microfinance banks to increase its effort in funding small and medium scale enterprises in Nigeria. It is, therefore, recommended that 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. Furthermore, while microfinance grows in Nigeria, CBN should encourage commercial banks to fill the gap. Commercial banks should seriously re-enact their rural banking program which was abandoned in the early 1990s 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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