Development Finance Institutions in Nigeria: Structure, Roles and Assessment

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DEVELOPMENT FINANCE INSTITUTIONS IN NIGERIA: STRUCTURE, ROLES AND ASSESSMENT

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Development Finance Institutions in Nigeria: Structure, Roles and Assessment*

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Abstract

The efficient channelling of funds and allocation of financial resources are roles expected to be undertaken in the financial system to facilitate productive growth in the real sector of the economy. There have been overlapping roles in the Nigerian financial system and this has resulted to inefficient intermediation and under-development of vibrant sectors of the economy. Thus, necessitated the emergence of development financial institutions to render services to the large un-catered economics agents (especially in the rural areas) by the universal banks. The institutions are expected to offer specialized and micro financial services, offer relative cheap and accessible financing options, provide long-term finance for infrastructure development, industrial growth, agriculture, small and medium enterprises (SME) development and provide financial products for certain sections of the people. However, this paper evaluates the roles and structure of the development financial institutions in Nigeria and also assesses their performance over time.

Keywords: Development Finance Institutions, Financial Institutions, Financial Intermediation, Real Sectors, Financial Services, Financial Products, Small and Medium Scale Enterprises, Nigeria

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1. INTRODUCTION

An efficient and robust financial system acts as a powerful engine of economic development by mobilising resources and allocating the same to their productive uses. It reduces the transaction cost of the economy through provision of an efficient payment mechanism, helps in pooling of risks and making available long-term capital through maturity transformation. By making funds available for entrepreneurial activity and through its impact on economic efficiency and growth, a well-functioning financial sector also helps alleviate poverty both directly and indirectly.

In both developed and developing countries, the need for efficient financial institutions in facilitating financial intermediation as a growth channel in the economy has been recognized in literature in recent years. Although, the lack of efficient financial intermediation in developing countries like Nigeria is widely evidenced by the mismatch between institutional savings, lending and investment. It is however clear that the need for investment in the real vibrant sectors of these countries resulted to the introduction of development finance institutions and other financial vehicles programmes to provide credit at below market rates for the purchase of capital. According to the Development Finance Forum (2004), the purchase of capital includes financial capital and other kinds of capital: land, water, and forests; infrastructure, utilities, and housing; education, skills, and training; and functioning institutions. All these forms of capital are termed “Capital Plus”. Also, the lack of functioning financial institutions to coordinate financial intermediation at its peak has resulted in post independence African countries carrying out tightly regulated financial system which were motivated in principle by prudential considerations until the 80s.

In a developing country like Nigeria, however, financial sectors are usually incomplete in as much as they lack a full range of markets and institutions that meet all the financing needs of the economy. For example, there is generally a lack of availability of long-term finance for infrastructure and industry, finance for agriculture and small and medium enterprises (SME) development and financial products for certain sections of the people. The role of development finance is to identify the gaps in institutions and markets in a country’s financial sector and act as a ‘gap-filler’. The
principal motivation for developmental finance is, therefore, to make up for the failure of financial markets and institutions to provide certain kinds of finance to certain kinds of economic agents. The failure may arise because the expected return to the provider of finance is lower than the market-related return (notwithstanding the higher social return) or the credit risk involved cannot be covered by high risk premium as economic activity to be financed becomes unviable at such risk-based price. Development finance is, thus, targeted at economic agents, which are rationed out of market. The vehicle for extending development finance is called development financial institution (DFI) or development bank.

2. DEVELOPMENT FINANCE INSTITUTIONS, STRUCTURE AND ITS PRINCIPAL COMPONENTS

Development finance institution (DFI) is generic term used to refer to a range of alternative financial institutions including microfinance institutions, community development financial institution and revolving loan funds. Also, DFI is defined as "an institution promoted or assisted by Government mainly to provide development finance to one or more sectors or sub-sectors of the economy. The institution distinguishes itself by a judicious balance as between commercial norms of operation, as adopted by any private financial institution, and developmental obligations; it emphasizes the "project approach" - meaning the viability of the project to be financed – against the "collateral approach"; apart from provision of long-term loans, equity capital, guarantees and underwriting functions, a development bank normally is also expected to upgrade the managerial and the other operational pre-requisites of the assisted projects. Its insurance against default is the integrity, competence and resourcefulness of the management, the commercial and technical viability of the project and above all the speed of implementation and efficiency of operations of the assisted projects. Its relationship with its clients is of a continuing nature and of being a "partner" in the project than that of a mere "financier" (Scharf and Shetty,1972).
These institutions play a crucial role in providing credit in the form of higher risk loans, equity positions and risk guarantee instruments in support of private sector investments in developing countries for infrastructure and real sectors development. DFIs have substantial resources backed by guarantees and capital endowments from government in developed countries. In 2005, total commitments (as loans, equity, guarantees and debt securities) of the major regional, multilateral and bilateral DFIs totalled US$45 billion (US$21.3 billion of which went to support the private sector in developing the high capacity growth real sectors).

The principal components of development finance institutions (DFI) consist of both regional and multilateral DFIs. Although, there are bi-lateral development finance institutions mainly in developed economies but not predominant in less developing countries. These DFI components are mainly referred to as the multilateral development bank (MDB) formed through either regional or multilateral collaborations. The multilateral development banks (MDB) are institutions, created by a group of countries that provide financing and professional advising for the purpose of development. MDBs have large memberships including both developed donor countries and developing borrower countries. MDBs finance projects in the form of long-term loans at market rates, very-long term loans (also known as credits) below market rates, and through grants. The combined portfolio was US$182 billion in 2005.

The main multilateral DFIs include:

- WB- World Bank
- EBRD- European bank for Reconstruction and Development
- AsDB- Asian Development Bank
- IADB- Inter American Development Bank
- AfDB- African Development Bank
- IFC-International Finance Corporation
- MIGA- Multilateral Investment Guarantee Agency
There are also several "Sub-Regional" Multilateral Development Banks which serve as regional DFIs. Their membership typically includes only borrowing nations. The banks borrow from and lend to their members. These banks include:

- Caribbean Development Bank (CDB)
- Central American Bank for Economic Integration (CABEI)
- East African Development Bank (EADB)
- West African Development Bank (BOAD)
- Black Sea Trade and Development Bank (BSTDB)
- Corporación Andina de Fomento (CAF)

3. ROLES AND SIGNIFICANCE OF DEVELOPMENT FINANCE INSTITUTIONS

DFIs have a general mandate to provide finance to the private sector for investments that promote economic growth and development. The purpose of DFIs is to ensure investment in areas where otherwise, the market fails to invest sufficiently i.e. areas where private sectors are discouraged to investment as a result of long-gestation periods and low return on investment (ROI). DFIs aim to be catalysts, helping companies implement investment plans and especially seek to engage in countries where there is restricted access to domestic and foreign capital markets and provide risk mitigation that enables investors to proceed with plans they might otherwise abandon. DFIs specialise in loans with longer maturities and other financial products. DFIs have a unique advantage in providing finance that is related to the design and implementation of reforms and capacity-building programmes adopted by governments.
Thus, the basic emphasis of a DFI is on long-term finance and on assistance for activities or sectors of the economy where the risks may be higher than that the ordinary financial system is willing to bear. DFIs may also play a large role in stimulating equity and debt markets by (i) selling their own stocks and bonds; (ii) helping the assisted enterprises float or place their securities and (iii) selling from their own portfolio of investments.

Also, DFIs provides technical assistance for the preparation and execution of development programmes projects like infrastructure and utilities. Over the last fifteen years there has been general underinvestment by the private sector in infrastructure in many developing countries. Total commitments to public-private investments (PPI) in infrastructure in developing countries was US$ 47.8 billion in 2007. Of this, telecommunications accounted for 25% and energy for 29%. Other key sectors include transportation and, to a lesser extent, water supply. Investments have been higher in East Asia, moderate across Latin America as a whole, and low in Africa. Sub Saharan Africa accounted for only 3.8% of total PPI investments in infrastructure in developing countries over 1984-2007. Over the 1990-2002: PPI investment was 0.6% of GDP in Africa compared to 1.7% in LAC. Total DFI commitments to private sector infrastructure were around US$7.5billion in 2007 – or 16% of total PPI investment. On the basis of lack of social amenities and low infrastructure investment in developing countries like Nigeria which its availability are necessary for development, justify the dominants roles played by development finance institutions and its programmes adoption in Sub-Sahara Africa (SSA).

4. STRUCTURE OF DFIs IN AFRICA AND NIGERIA

The Nigerian financial system is one of the largest and most diversified in Sub-Saharan Africa. The system became liberalised when structural adjustment programme was introduced in the 1980s. In recent years, the system has undergone significant changes in terms of the policy environment, number of institutions, ownership structure, depth and breadth of markets, as well as in the regulatory
framework. However, in spite of the far-reaching reforms of the past 20 years, the Nigerian financial system is not yet in a position to fulfil its potential as a propeller of economic growth and development. The financial system is relatively superficial and the apparent diversified nature of the financial system is suspicious. This is because although a wide variety of financial institutions and markets exist, commercial banks overwhelmingly dominate the financial (Afandigeh, 2007).

The financial system comprises various institutions, instruments and regulators. The According to the Central Bank of Nigeria (1993) the financial system refers to the set of rules and regulations and the aggregation of financial arrangements, institutions, agents, that interact with each other and the rest of the world to foster economic growth and development of a nation. According to Nzotta (2004) the financial system serves as a catalyst to economic development through various institutional structures. The system vigorously seek out and attract the reservoir of savings and idle funds and allocate same to entrepreneurs, businesses, households and government for investments projects and other purposes with a view of returns. This forms the basis for economic development. The financial system play a key role in the mobilization and allocation of savings for productive, use provide structures for monetary management, the basis for managing liquidity in the system. It also assists in the reduction of risks faced by firms and businesses in their productive processes, improvement of portfolio diversification and the insulation of the economy from the vicissitudes of international economic changes. Additionally, the system provides linkages for the different sectors of the economy and encourages a high level of specialization expertise and economies of scale. Nzotta (2004) further contends that the financial system, additionally, provides the necessary environment for the implementation of various economic policies of the government which is intended to achieve non-inflationary growth, exchange rate stability, balance of payments equilibrium foreign exchange management and high levels of employment.

The Nigerian financial system can be broadly divided into two sub-sectors, the informal and formal sectors. The informal sector has no formalized institutional framework, no formal structure of rates and comprises the local money lenders, thrifts,
savings and loans associations and all forms of ‘isusu’ associations. According to Olofin and Afandigeh (2008) this sector is poorly developed, limited in reach and not integrated into the formal financial system. Its exact size and effect on the economy remain unknown and a matter of speculation. The formal sector, on the other hand, could be clearly distinguished into the money and capital market institutions. The money market is the short-term end of the market and institutions here deal on short term instruments and funds. The capital market encompasses the institutions that deal on long-term funds and securities.

Since the DFIs predominantly render financial services roles, they can also provide an additional funding source to the microfinance institutions (MFI), on lending basis, instead of the current practice of dealing directly with micro enterprise owners that are in need of capital. As posited by Anyanwu (2004), using MFIs by DFIs as an intermediary could be more efficient because the MFIs have grass root orientation and greater expertise in financing smaller enterprises. Therefore, this justifies the need for evaluating the roles of MFIs in facilitating effective financial intermediation at the grass root level. Between 1964 and 1977, various development finance institutions (DFIs) were established at both the national and state levels in Nigeria. The national DFIs included the Nigerian Industrial Development Bank (NIDB), Nigerian Bank for Commerce and Industry (NBCI), Nigerian Agricultural and Cooperative Bank (NACB) and Federal Mortgage Bank of Nigeria (FMBN). Each institution was given the responsibility of promoting the development of a specific sector or sub-sector (CBN, 2000). The NIDB was established in 1964, from the restructuring of an existing Investment Corporation of Nigeria (ICON), and given the mandate of developing new industrial enterprises and expanding existing ones through the provision of medium and long term loans and equity participation. A decade later in 1973, the NBCI was established to provide funding to small and medium scale enterprises. Of more relevance to micro enterprises, the NACB was also established in 1973 to promote the development of the agricultural sector in which most of the operators are micro enterprises. Also the FMBN, which took over the assets and liabilities of the Nigerian Building Society (NBS) was established in 1977, with the mandate to provide funding for residential and other housing needs of individuals and
corporate organizations. Two other DFIs, the Urban Development Bank and Education Bank, were established in 1992 and 1993, respectively, to cater for these two important sectors. These DFIs made varying contributions to their various sectors of responsibility. They funded various projects and enterprises, many of which are in operation today. However, with the drastic reduction in government subventions to them in the 1990s, their operations reduced drastically and by late 1990, they all ceased operating, as all of them depended mainly on government funding. Pervasive incidence of non-performing loans and generalized distress in the financial services sector constrained reliance on internally generated funds. Other militating factors included political instability and build-up of external debt which reduced both the country’s credit worthiness abroad and the associated off-shore funding. There was also the deregulation of the financial sector and lifting of control on credit allocation by banks, which stopped channelling of penalty funds to the DFIs. Also, the global financial meltdown that started in August 2007 as result of the U.S mortgage sub-prime crisis which engulfed the activities and operations of most of the DFIs in Sub-Saharan Africa (including Nigeria) have deterred adequate channelling of resource funds to the real sectors of the Nigerian economy as result of tight liquidity and high risk characterizing the financial market up still date.

The poor performance of the DFIs notwithstanding, the need to channel financial resources to the productive sectors has remained a major challenge to the government and the monetary authorities. Attempts have therefore been made to restructure the DFIs, give them commercial orientation and make sustainability the guiding principle. And, this has transited in expanding the activities of the established Association of Nigerian Development Finance Institutions (ANDFI), which is the Nigeria adopted replicate of Association of African Development Finance Institutions.

The Association of African Development Finance Institutions (AADFI) is an international organisation created under the auspices of the African Development Bank in 1975. It is a member of the World Federation of Development Finance Institutions (WFDFI) which brings together the AADFI and its counterparts namely the Association of Development Finance Institutions in Asia and the Pacific.
(ADFIAP), the Association of Development Finance Institutions in Latine America (ALIDE), the Association of Development Finance Institutions in Europe (EDFI) and the Association of Development Finance Institutions in member countries of the Islamic Development Bank (ADFIMI). The members of the AADFI are banking and financial institutions engaged in development finance activities in Africa. The Association has its Headquarters in Abidjan, Republic of Côte d'Ivoire. The main activities of the AADFI are the provision of Information and Training in the techniques of banking and finance as well as development policy advice to African bankers and finance officers. The AADFI enables banking and finance institutions to:

- benefit from AADFI assistance for lines of credit from development partners.
- dialogue with multilateral institutions on development policies and issues concerning project financing and promotion in Africa.
- participate in the Association's meetings, symposia, workshops and related activities.
- benefit from technical assistance for in-house training.
- benefit from staff exchange and secondment with member-institutions.

While AADFI Nigeria replicate, the Association of Nigerian Development Finance Institutions (ANDFI) was inaugurated on 15th October 1982 and registered under the Companies and Allied Matters Act of 1990 as an umbrella organisation for all development finance institutions (DFIs) in Nigeria. The aim of the Association is to create a forum for DFIs in Nigeria to discuss and exchange ideas on issues of common interest, provide a platform for members to co-operate in areas of investment, finance and human resources development for the purpose of creating appropriate environment for the operations of the DFIs towards achieving sustainable real sector development. The membership of the Association comprises Federal, Regional, specialised and State DFIs.

The objectives of the AADFI include:
• Encouraging mutual assistance and investment cooperation among the DFIs.

• Presenting a united front on matters of common interest.

• Influencing policy decisions so that they may be conducive to the operational efficiency of the DFIs.

• Promoting and protecting the collective interest of the practice of development banking in Nigeria.

• Carrying out studies on issues of national economic growth with a view to promoting development in Nigeria.

• Promoting cooperation and exchange of experience among member DFIs, and between them and similar organizations in other countries.

The ANDFI is a member of the Joint Cooperation of DFIs in Economic Community of West African States (ECOWAS), and also relates with multilateral institutions whose functions are complementary to the DFIs. The association also maintains relationship with international bodies whose operations are similar and complimentary to the developmental roles of Nigerian DFIs such as the Association of African Development Finance Institutions (AADFI), and other Associations of Development Finance Institutions (ADFI) across the globe. Also, the Association of Nigerian Development Finance Institutions (ANDFI) has 40 members across Nigeria. These include:

1. Abuja Investments Company Ltd.
3. Akwa Ibom Investment & Industrial Promotion Council
4. Bank of Industry Ltd,
7. Benue Investment & Property Company Ltd.
8. Borno Investment Company Ltd.
10. Ebonyi Investment & Property Company Ltd.
11. Equity and Investment Co. Ltd.
12. Federal Mortgage Bank of Nigeria (FMBN)
13. Gombe State Investment & Property Development Company Ltd
14. Ibi Holding Limited
18. Kano State Investment & Properties Ltd.
22. Lagos Building Investment Co. Ltd.
23. Leasing Company of Nigeria Ltd.
24. Nasarawa Investment & Property Development Company Ltd.
30. Nigerian Export-Import Bank
31. Odu’a Investment Co, Ltd.
32. Ondo State Development Co. Ltd
33. Oyo State Inv. & Fin. Co. Ltd.
36. Taraba Investment & Properties Ltd.
37. Universal Investment & Dev. Co. Plc
38. Urban development Bank Nigeria Plc
39. Yobe Investment Co. Ltd.
40. Zamfara State Investment & Property Development Company Ltd.
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