A CRITICAL EXAMINATION OP MEDIUM AND LONG TERM INDUSTRIAL FINANCING BY SOME SELECTED MERCHANT BANKS

BY

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I

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DECLARATION

I hereby declare that this Project was written by me - under the able guidance of my Supervisor. The study is original and any references made to texts, journals and other person's work have been duly acknowledged and footnoted.

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CERTIFICATION

This Project titled, A CRITICAL EXAMINATION OF MEDIUM AND LONG TERM INDUSTRIAL FINANCING BY SOME SELECTED MERCHANT BANKS by LAWAN, BAKURA MOHAMMED meets the regulations governing the award of Master of Business Administration (MBA) Degree of Ahmadu Bello University and is approved for its contribution to knowledge and literary presentation.

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DEDICATION

To the sweet and loving memory of my late Parents who have consistently encouraged me to seek for further knowledge during their life time.

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First and foremost, my appreciation goes to Allah for his guidance during one of the most challenging and trying periods of my life.

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ABSTRACT

The changing structure of the Nigerian economy towards increased industrialization requires the services of merchant banks, especially in the area of provision of medium and long term loans. The Federal Government through the Central Bank of Nigeria, issues a yearly credit and policy guidelines to th«se merchant banks - specifying the sectoral allocation of their loans and advances and also the percentages of their loans and advances which should be of medium and long term nature. Unfortunately, these banks never meet the requirements of the guidelines especially with regards to the preferred sector, whose loan needs are mostly of medium and long term nature. This study found out the reasons for not meeting the retirements of the guidelines and offered recommendation on how to meet the guidelines and thereby aid the Federal government's efforts in the industrialization of the country.

Furthermore, the need for merchant banks to increase their role in the specialised activities such as equipment leasing and corporate finance was highlighted so as to, not only earn a substantial amount of their income from such areas, but also to be seen as engaging in their proper merchant banking roles, as practiced by their counterparts in the developed countries.

Chapter one, started with the introduction briefly stating

the growth of merchant "bank in Nigeria. The methodology and objectives of the study were also stated and key terms. were defined.

In chapter two, the evolution and growth of merchant banking in Nigeria was dwelled on. Services provided by merchant banks were also extensively stated.

Chapter three, dwelled on data analysis and findings were made. The findings includes-

1) Short term nature of deposit liabilities
2) Poor incentives to keep equipment on lease
3) Dependence on interest income
4) Poor marketing of services

Chapter four, was on procedure for analysing Business loan application.

Chapter five, was on loan syndication. This is not only one of the specialized activities of merchant banks, but also due to the fact that its importance has grown in recent times especially with regards to arranging jumbo loans which are mostly of medium and long term nature to industries in Nigeria.

Lastly, chapter six concluded the whole exercise and recommended solutions.

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CHAPTER 1

1.1. Introduction

The changing structure of the Nigerian economy towards increased industrialization has led to the increased demand for services that merchant banks provide such as wholesale banking, corporate finance, medium and long term financing, equipment leasing etc. Although merchant banking is a relatively recent development, but its impact is now perceptible. From ₦7.66 million at the end of 1966, the total assets of the banks rose rapidly to ₦9.9 billion in April 1987, while some of the growth can be attributed to increases in the number of banks, a great deal of it is accounted by increased activities. Total loans and advances rose from a small figure of ₦3.2 million 1966 to ₦3.3 billion as at December ending 1986. Compared to commercial banks which provided ₦20.4 billion as at December 1986, the merchant banks remained small providers of loans and advances. Their deposits grew from ₦2.35 million in 1966 to ₦2.4 billion in 1987. Equipment leasing which is one of their specialised services also rose from ₦3.2 in 1976 to ₦153.1 million as at December ending 1986.[1] With these figures, the merchant banks can therefore be said to have grown phenominally over the years. The impact of their activities has been increasingly noticed and felt.

However, of recent, opinions have often been expressed that merchant banks in Nigeria have limited their roles to those activities which have been performed creditably over the years

by commercial banks, giving the impression that they have merely been duplicating and in some instances competing with commercial banks.[2] Others feel that merchant banks are expected to concentrate more on medium and long term financing so that merchant banks can concentrate on short term financing. Some people also think that merchant banks would make a greater contribution to the economic development of the country if they were to concentrate on their specialised activities such as equipment leasing, loan syndication, corporate finance, etc.

Essentially, the aim of this study is therefore to find out whether or not merchant banks are properly equipped to finance the medium and long term loan requirements of industries and engage in their other services and if not to give suggestions on how to attain them.

1.2 Objectives Of The Study

This study aims to achieve the following objectives:-

1) To find out whether monetary policies can be used efficiently to meet developmental objectives through the Merchant Banks.

2) To find out what are the factors militating against the merchant banks' non-compliance with some of the Central Bank of Nigeria credit policy and guidelines and offer feasible recommendations on ways to meet the requirements of the guidelines.

3) To find out the sources of merchant banks' income in Nigeria.

4) What, if any, are the hinderances to the existence of proper merchant banking in Nigeria and how they can be eliminated.

5) To find out whether or not merchant banks depend on interest as their main source of income as claimed by some quarters, instead of their specialised services as found in the developed countries and so, to give suggestions on ways to imrpve on their specialised sources.

1.3 Methods Of Data Collection

The data used for this study was obtained from the main sources. They are: (a) Primary Sources and (b) Secondary Sources.

a) Primary Sources:- The only media used here was interviews. The writer interviewed top merchant bank executives where a lot of useful information was obtained. Questionnaires were not used by the writer as it was not really necessary for the purposes of the study and above all the high possibility of poor response due to the short duration of the study.

b) Secondary Sources:- The writer depended alot on this source as it gave a clearer picture, better and more accurate information. These included Central Bank publications such as

the economic and financial review, Bullion, Textbooks, annual reports of merchant banks, seminar papers, Federal government gazettee, papers presented at workshops, etc.

1.4 Limitations Of The Study

The writer encountered alot of problems in the course of the study. The most serious of which was the time required to carry out the study. The duration of the time was too short to carry out an indepth analysis of the study as it required booking of appointments with top executives which ran into weeks. That was a serious limitation as it was a main source of information to the writer.

Another serious limitation was the distance from Zaria to Lagos. This required alot of money for transportation, accomodation etc. Furthermore, most of the banks were not willing to provide some useful data on their past activities as they considered such data 'top secret' which can only be used by members of staff and purely for the purposes of the bank.

However, in spite of these limitations alot has been achieved and the writer hopes the study will help students and other interested parties who might use it for further research on the study.

1.5 Order Of Presentation

The first chapter tried to introduce the topic of the study.

The objectives and the justifications of the study were also stated. Key terms used during the study were also defined. The methods of data collection and lastly limitations of the study were also stated.

The second chapter dealt with the evolution and growth of the merchant banking industry within Nigeria and dwelled extensively on the services rendereder by merchant banks within the country.

The third chapter was concerned with the analysis of data which the whole project is centred around.

The fourth and fifth chapters dwelled on procedures for analysing loan application and loan syndication respectively.

Finally, chapter six which is the last chapter concluded and gave recommendations.

1.6 Definition Of Key Terms

Term Loan:- A Term Loan is a loan transaction which has a final maturity exceeding one year, which may or may not be secured and which usually specifies repayment in monthly, quarterly, semi-annually or annual payments. It is evidenced by a note or notes embodying the terms and conditions of the loan, or is subject to a separate formal agreement between the borrower and the lender.

Consortium Lending:- "A temporary cooperation of a number

of powers, companies, banks etc. for a common purpose".[3] Consortium lending therefore takes place when a number of lenders cooperate to grant a loan to a single borrower.

Merchant Banks:- "These are banks that engage in banking operations of long term nature. They can issue and underwrite new securities and engage in activities such as counselling, feasibility and viability appraisal. They also provide short term finance by acceptance credits covering both exports and imports. Advice is also available for companies on mergers and acquisitions, capital structure and steps to be taken in seeking quotation in the Nigerian E Stock Exchange. They also provide specialised services such as equipment leasing and investment advice and management".[4]

Industrial Financing:- The raising of capital for firms through Bank Issues, Loans and Advances etc. for the purposes of working capital, expansion of facilities or the purpose of plant and equipment.

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CHAPTER 2

EVOLUTION AND DEVELOPMENT OF MERCHANT BANKING INDUSTRY IN NIGERIA

2.1 DEFINITION OF MERCHANT BANKING

If there is any concept that has defied definition, it is the concept of merchant banking. The few who can claim to know the institution and are possibly able to describe it, are often incapable of providing a precise instructive and generally acceptable definition. As Bank of America's John Lucchesi Puts it "merchant banking is like being in love - different for everybody. No two people experience it the same way. But when you see it, feel it - you know".[1] Another distinguished banker, Sir Edward Reid (1983) described the term merchant bank as one that "is sometimes applied to banks who are not merchants, sometimes merchants who are not banks and sometimes to houses who are neither merchants nor houses".[2] In his book, "Service Banking", Hanon (1979) referred to merchant banking as 'service banking' to distinguish it from the traditional banking function of the commercial banks of accepting deposits, advancing loans and providing money transfer services. He sees merchant banking as a departure from those traditional banking functions. At one time there departures were even termed 'ancilliary services' but this has lost its relevance for the obvious reason that the term implies sub-servience or inferiority to the traditional banking. It was

then replaced by the term 'related banking service' but even this does not help us much in understanding the concept of merchant banking since all banking is a service.

Skully (1980) tried to define merchant banking by identifying them through licencing and through association membership qualification. He cites the examples of Korea, where only six firm licenced under the merchant banking act 1976 qualify as merchant banks, and Malaysia, where the membership of the merchant banks association determines who a merchant bank is. Not only does this fail to tell us what a merchant bank does, the method breaks down in countries where such licencing could associations are absent. A fundamental definition could help us not of the first problem. In this way a merchant bank could be defined as one that engages in the money market, wholesale banking, underwriting, corporate finance, international finance and investment management. The limitations with this approach is that many other institutions which are not merchant banks also engage in these activities. Nwankwo (1981) defined merchant banking as;

> banks that engage in banking operations of long term nature. She can issue and underwrite new securities and engage in other such such miscellaneous activities like counselling, feasibility and viability appraisal. They also provide short-term finance by acceptance credits covering both exports and imports. Advise is also available for companies on mergers and acquisitions, capital structure and steps to be taken in seeking quotation in the Nigerian Stock Exchange. She also provide specialised services such as equipment leasing and investment advice and management.3

The institutions are difficult to define for various reasons. One, until very recently, in no country was any attempt made at providing a legal definition of the merchant banks or merchant banking. Attempts were made to determine them, in U.K. and Nigeria in 1979 and in the United States of America in 1973 by way of specifying what they can do and cannot do. Another problem is that these institutions vary very widely within the same country and between countries in their sizes, shapes and permitted functions. Furthermore, the extent to which they specialize in one or more major activities varies almost endlessly.

The way these institutions have evolve/ over the past two centuries can be said to be the major reason for the lack of a working definition. Historically, they were identified with families who were principally involved in overseas trade by either using their own or chartered vessels to carry manufactured goods from Europe to the countries of North and South America as well as the far East. This is why most of the well known merchant banks in Europe have their tell names today. To name a few the Samuel Company, Hambros Bank Limited. Generally, these merchant banks by a combination of qualities such as integrity, tenacity of purpose, adaptability and skill became not only merchants for their own accounts but also bankers for other merchants and hence the coinage merchant banks. It is

worthy to note that not all of today's merchant banks were originally merchants. And this is one of the sources of enormous varieties in merchant banking institutions of today. For example, Henry Ansbacher and Company Limited started as a firm of stock brokers in 1894, ventured into merchant banking only in 1949 and became an authorised bank in 1961.[4] In recent years there also came into the industry merchant banks with different beginnings. These include principally the merchant banks of the London clearing banks. Barclays merchant bank limited, which was established, which was established as a wholesale money market operator in 1967 and which moved into merchant banking in 1972, is a case in point.[5]

Today, after all these development, the merchant banks have come to be associated with certain characteristics. The hall marks of merchant banking would include, among others, high level, specified expertise, imagination, adaptability, integrity, innovativeness, manoevrability, flexibility and individuality. In the main and in particular two of these characteristics distinguish the merchant banks. They are:-

a) Their entrepreneural instinct, which is borne out in many ways - at one time by their merchanting activities and their handling of government loans which in the early days they would talk on to their own books is full before placing them with the public, usually at a large profit; and

b) Their adaptability, borne out not only by the catholic nature of their present day activities but by their ability to adjust to changing circumstances over the years. The perfect example is their invention of the Euro-dollar (Euro-currency) - the making of a market which enabled the principal currencies of the world to be used outside their currencies of origin.[6]

For the prupose of this study, we are going to define merchant banking by using the statutory definition given to it. The need to regulate merchant banks and draw a clear line of distinction between them and commercial banks can be said to have prompted the legislations that in 1979 provided for the definition through the Banking Amendment Decree (No. 88) of 1979. Earlier on, the 1969 Banking decree had provided a general definition of a bank which is still relevant for a comprehensive definition of a merchant bank in Nigeria. Section 41 (i) of the 1969 Decree explains that: 'Bank' means any person who carries on banking business and includes a commercial bank, an acceptance house, discount house and financial institution. For our purpose, sub-sections (i) (b) and (c) explain what an acceptance house and a discount house are. These sub-sections state that 'acceptance house' means any person in Nigeria who transacts banking business and whose business mainly consists of granting acceptance facilities or whose operations are in the opinion of the central bank, those of an acceptance house and 'discount house' means

any person in Nigeria who transacts banking business and whose business mainly consists of trading in and holding commercial bills of exchange, treasury bills or other securities, or whose operations are, in the opinion of the central bank, those of a discount house. The 1979 Amendments adds two new dimensions to the definition of a bank, it mentions merchant banks and spells out their major functions. The legislation states that 'merchant bank' means any person in Nigeria who is engaged in wholesale banking, medium and long term financing, Equipment leasing, debt functioning, investment management, Issue and acceptance of bills and the management of unit trusts.

From the list of activities which merchant banks, traditionally engage in and the activities of Nigerian merchant banks, it would appear that these institutions are acceptance houses, discount houses and merchant banks as defined by the 1969 and 1979 Banking decrees. In addition to engaging in the major activities of acceptance houses, discount houses and merchant banks as highlighted by the Decrees, merchant banks perform a common activity of all banks - the business of banking which the 1969 Decree defines as:

> ...the business of receiving monies from outside sources as deposits irrespective of the payment of interest or the granting of money loans and acceptance of credits or the purchase of bills and cheques or the purchase and sale of securities for account of others or the incurring of the obligation to acquire claims in respect of loans prior to their maturity or the assumption of

guarantees and other warrantees for others or others or the effecting of transfers or clearings and such other transactions as the commissioner may, on the recommendation of the central bank.[7]

2.2 HISTORY AND GROWTH OF MERCHANT BANKING IN NIGERIA

Merchant banking in Nigeria is a recent phenomenon. The two institutions that commenced merchant banking business in Nigeria were both registered in 1960. These institutions i.e. Nigerian Acceptances Limited and Philip Hill (Nigeria) Limited were engaged in identical set of activities. These included:-

a) Financing of commodity exports by grantings credits to the marketing boards.

b) Acceptance of deposits from institutions

c) Lending monies to businessmen and businesses

d) Provision of issuing house services.

The fact that these two institutions were engaged in the same field of business prompted them to merge in 1969 thereby leading to the absorptions of Nigerian Acceptances Limited by Philip Hill Nigeria Limited. The name Nigerian Acceptances Limited was retained and given to the new institution. NAL remained the only licenced merchant bank operating in the country until later in 1973. The UDT Bank (Nigeria) Limited was born out of the reconstruction of the United Dominion Corporation (Nigeria) Limited, a wholly owned subsidiary of UDT International, which in turn was a wholly owned subsidiary of United Dominion

Trust Limited. The name of the banks was changed to Nigerian Merchant Bank Limited.

Two merchant banks came on to the merchant banking scene in each of the following two years. First to come in 1974 were two American banks - First National City Bank of New York and First National Bank of Chicago Limited which were licenced during the year it commenced operation. The latter had changed its name to the International Merchant Bank (Nigeria) Limited.

Five merchant banks were licenced in 1974, but only two opened for business that year. Two others - ICON Limited (merchant Bankers) and Chase Merchant Bank (Nigeria) Limited commenced operations in 1975. Chase Merchant Bank has since changed its name to Continental Merchant Bank. ICON Limited (Merchant Bankers) on the other hand was created as a result of the reconstruction and re-organisation of ICON Securities Limited a wholly owned subsidiary of Nigeria Industrial Development Bank (NIDB). As a result of the reconstruction the ownership structure changed with the Nigerian Insurance Corporation (NICON) a wholly owned Federal government Insurance Company, Norgan Guaranty Trust Company of New York and Basing Brothers of London now participating with the NIDB.

In 1979, the Nigerian-American merchant bank limited owned by another reputable American bank - the Bank of Boston and Private Nigerian Persons was established. Thus entry is significant because this is the first Nigerian Merchant Bank organised by Private Nigerian Investors in collaboration with

foreign banking interest.

In 1982 five new merchant banks were granted licences and commenced operations the same year. They are Merchant Banking Corporation Limited, Indo-Nigeria Merchant Bank, Merchant Bank of Africa, First City Merchant Bank Limited and ABC Merchant Bank Limited.

In 1987 another four new merchant banks were granted licences but are yet to commence operations.

2.3 OWNERSHIP STRUCTURE AND BRANCHING OF MERCHANT BANKS IN NIGERIA

2.3.1 OWNERSHIP

As can be seen below on table 2.1 the Federal government has direct equity interest in 5 of the existing merchant banks in Nigeria. The shares in the four older banks were acquired in trust for the public in 1976 as a result of the inability of the banks to arrange to sell these interest to the public through the stock exchange within the three months they were allowed to comply with a directive to process 60:40 percent - Nigerian/ foreign equity distribution. A detailed analysis of who owns what in the equity of merchant banks is presented in Table 1.2. The distribution of the ownership of the equities of these institutions can also be seen from Table 1.3.

TABLE 2.1

MERCHANT BANKS - STRUCTURE OF OWNERSHIP

	BANK	SHAREHOLDERS	HOLDING (%)
1.	NAL MERCHANT BANK	Federal Ministry of Finance Incorporated	20
		Nigerian Insurance Corporation (NICON)	25
		New Nigerian Development Company (NNDC)	10
		NAL Employees & other Nigerians	5
		American Express Bank Limited	26
		John Holt Group	10
		Credit Cyonnais	4
			100%
2.	NIGERIAN MERCHANT BANK	Federal Ministry of Finance Incorporated	60
		United Bank for Africa Limited (UBA)	40
			100
3.	INTERNATIONAL MERCHANT BANK (IMB)	Federal Ministry of Finance Incorporated	60
		First National Bank of Chicago	40
			100
4.	INCON LIMITED (MERCHANT BANKERS	Nigerian Industrial Development Bank (NIDB)	45
		National Insurance Corporation of Nigeria (NICON)	15
		Trustees of ICON Staff Trust Fund	5
		Shares warehoused	35
			100
5.	CONTINENTAL MERCHANT BANK LTD.	Federal Ministry of Finance Incorporated	60
		Shares warehoused	40
			100

	BANK	SHAREHOLDERS	HOLDING (%)
6.	NIGERIAN-AMERICAN MERCHANT BANK LTD.	Private Nigerian Investors	60
		Bank of Boston	40/100
7.	INDO-NIGERIAN MERCHANT BANK LTD.	Private Nigerian Investors	42
		Nigerian Re-insurance Corporation	15
		Staff of the Bank	3
		State Bank of India	40/100
8.	FIRST CITY MERCHANT BANK LIMITED	Private Nigerian Investors	60
		Paribas of Paris (France)	40/100
9.	MERCHANT BANKING CORPORATION	Private Nigerian Investors	60
		Paribas of Paris (France)	40
10.	MERCHANT BANK OF AFRICA (NIG.) LTD.	Federal Ministry of Finance Incorporated	5
		Private Nigerian Investors	55
		Bank of America	40/100
11.	ABC MERCHANT BANK (NIG.) LTD.	Private Nigerian Investors	100
12.	GRINOCAYS MERCHANT BANK OF (NIGE) LTD.	Private Nigerian Investors	60
		Grinocays Holdings	40/100

SOURCE: Annual Reports of Merchant Banks.

2.3.2 BRANCHING

The branches of the merchant banks grow with their members only until 1974 when NAL Merchant Bank Limited established the first merchant bank branch outside Lagos, in Kaduna. Since then

the number of merchant bank branches has out-paced the number of the banks as other banks started to establish operational outposts outside Lagos. The number of branch offices of merchant banks has increased during the last twenty-seven years from one in 1960 to 32 by the end of September, 1987.

The largest concentration of these branches is in Lagos where 15 of the branches are located. Other industrial/ commercial centres in the country with noticeable presence of merchant banks include Kaduna with 5 branches, Kano and Port Harcourt with 5 and 3 branches respectively. Ibadan, Aba, Owerri, Calabar and Suleja have one branch each.

MERCHANT BANK - LOCATION OF BRANCHES 1987

	LOCATION	NUMBER OF BRANCHES
1.	Lagos	15
2.	Kaduna	4
3.	Kano	5
4.	Port Harcourt	3
5.	Ibadan	1
6.	Owerri	1
7.	Calabar	1
8.	Suleja	1
9.	Aba	1
	TOTAL =	32

SOURCE: Merchant Bank's Annual Reports.

2.4 MERCHANT BANK SERVICES

The diverse and complex financing needs of clients remain the focus in the design and delivery of merchant bank services. To meet these needs, merchant banks have developed a broad range of merchant banking services and have adapted their organisational structure so as to ensure that these services are provided timely and efficiently.

Merchant banks serve their clients through the following functional divisions:-

a) Banking Division
b) Corporate Finance Division
c) Operations Division
d) Export and Correspondence Banking Division
e) Project and Research Division

a) Banking Division

The banking division mobilize funds to finance short, medium and long term requirements of clients for working capital and investment in fixed assets. The services under this division includes deposits and treasury investment services. Merchant banks accept deposits of various maturities at competitive rates of interest from corporate clients such as commercial and industrial companies, Pension Funds Insurance Companies, banks and financial institutions. They also advice clients in investing their short term funds in any one of the following institutions:- Negotiable certificates of deposits, Commercial rates, Treasury

certificates and treasury bills.[8]

i) Term Loans and Advances: Merchant banks provide finance by way of overdrafts, letters of credit or term loans for working capital, trade finance, plant expansion, equipment purchase and other corporate purposes.

ii) Loan Syndication: Where a client's borrowing requirements are extremely large and exceed the capacities of one bank as is often the case with major industrial, commercial and agricultural undertakings, merchant banks in close association with customer/offer syndicated facilities by grouping a consortion of banks to meet such financing requirements.

iii) Foreign Exchange Services: Merchant Banks assist clients in processing their applications for remittances of foreign exchange and to complete the necessary documentation. This group works closely with the central bank of Nigeria, other government entities and the various units to ensure strict compliance with prevailing exchange regulations and requirements relating to remittances of foreign exchange.

iv) Agricultural Credit Services: This is provided through a specialised agricultural credit unit. In recognition of prevailing national priorities, merchant banks offer direct and syndicated credit for the funding of agricultural projects.

b) OPERATIONS DIVISION

This division provides a variety of support services to facilitate the timely and efficient delivery of credit and corporate finance services according to the particular needs of clients. This division's major area of activity include: Documentary and clean collections: This is for transactions not covered by letters of credit when it was in use. The bank provide clients with efficient services in the handling of documentary and clean bills for collection entrusted to the bank by clients correspondence banks or foreign suppliers.

i) Remittances: The future of a large number of Nigerian business as well as the economy linger on the timely reittance of funds in settlement of international transactions. Merchant banks through their network of correspondent banks assist clients in effecting remittance of funds in payment of trade and non-trade transactions to beneficiaries in Nigeria and abroad.

ii) Checking Account: Merchant banks provide facilities to clients wishing to operate accounts denominated in foreign currency. Deposits of convertible currencies like the Dollar, Pound Sterling, French Frac, Deutsche mark Swiss France etc. may be made into the accounts in form of travellers cheques, foreign bank notes, drafts, telegraphic/mail transfers and approved retention from proceeds of export. Interests are paid

on such accounts at Central Bank of Nigeria approved rates.

iv) Equipment Leasing: Merchant banks secure funds by arranging direct leasing or sale and lease back of premises, equipment and machinery. Items of equipment on lease include:-

a) Mamufacturing Equipment - Finances, Plastic extrusion machines, thermoforming machines, Blow moulding machines.

b) Construction Equipment - motor vehicles, cranes etc.

c) Quarrying equipment

d) Drinking Equipment - water rigs etc.

e) Printing machines

f) Rolling Mill Equipment - strangeteing and clothing machine wire coil drawing machine.

g) Agricultural Equipment - tractors etc.

h) Fishing Equipment - trawlers etc.

i) Baking and confectionary equipment.

j) Dry-cleaning and laundry equipment.

k) Office Equipment - computers etc.

l) Transport Equipment 0 cranes, forklifts, motor vehicles.

c) CORPORATE FINANCE DIVISION

The corporate finance division mainly deals with helping clients in raising of funds through the issuing house and also offering of advice to its corporate clients on investment and financial matters.[9]

i) Issuing house services: In the issuing house, the bank helps its clients in raising funds either for development or whatever. The bank here is an agent to its clients. The funds can be raised through the following ways:

i) Public Equity and Debt Issues:- Merchant banks manage public equity and debt issues through the Nigerian Stock Exchange to ensure that clients capital requirements can be funded from the widest possible sources. In the process, merchant banks provide issuing house services such as introduction to the stock exchange, advice on relevant regulations, government policy, the pricing and proper terms for an issue and market conditions, drafting the offering documents, representation on the company's behalf to the authorities and finally marketing of the issues among investors.

ii) Private Equity and Debt Issues:- Certain companies because of size, limited financial requirements or specialised operations may prefer to raise new equity and debt capital through private placement in the capital market, merchant banks in such cases are able to advice on procedures, draft relevant documents and select individual and institutional investors to provide the necessary funds.

iii) Risk Bearing:- Underwriting connotes risk-bearing. By presenting an issues with a cheque for an agreed amount of shares, a merchant bank frees the company from the burden of

finding investors for its offering. It also assumes the risk of adverse price development during the distribution period. Fees are charged for underwriting bonds and the full amount for the value of the bonds so underwritten is never paid. If the prices of the bonds underitten charge during the distribution of the purchased securities the bank sustains losses. Underwriting therefore involves risk. Bonds are therefore analysed before they are underwritten by merchant banks.

iv) Pricing of Securities:- Issuers usually want the lowest possible rate to attach to their debt issues but at the same time investors want maximum yields. Similarly issuers want the highest proceeds for their stock offering but investors would like to bargain prices. Merchant banks strive to reconsile these conflicting objectives by gauging markets accurately.

v) Market Support:- Not all security offers in which merchant bankers participate are underwritten. In some cases, merchant banks confine their contribution to marketing support. This means that they agree to use their skill in finding investors willing to purchase the securities being offered. They do not guarantee the successful placement of the issue. This is common when marketing the securities of small or new un-proven companies.

vi) Price Stabilization Function:- This is normally carried out during the distribution phase. Orders are placed to purchase any of the underwritten securities at a fixed price usually at or

near that at which the issue is being offered publicly. By pegging the price at which they stand-by to purchase the securities being distributed, merchant bankers hope to achieve two objectives:-

a) To ward-off precipitors drop in the securities prices and the concomittant underwriting loss that would ensue, and

b) To maintain favourable publicity for the issue and thereby encourage its acceptance among investors.

d) INVESTMENT AND FINANCIAL ADVISORY SERVICES

Under this, there are certain specialised services offered to corporate units. These include:-

i) Advice on Capital Structure:- Some companies have problems in determining what percentage of their total capital structure should consist of long-term debt instrument. Merchant banks can render help here. The capital structure of a company will depend on the nature of business and on other factors which may be of analytical interest to merchant bankers. Research into industry conditions and investor requirements enables them to advice on optimal capital structure. The merchant banks knowledge of money and capital markets enables them to advice financial strategies to make companies achieve desired mixes of debt and equity in their capitalizations.

ii) Feasibility Studies:- Often merchant bankers investigate the practicability of setting up a subsidiary of a company. For

a group of companies contemplating a joint project they will present financing options and point out the benefit of each, as well as its pittfalls.

iii) Project Finance:- Merchant banks have act as financial adviser for large projects undertaken by clients, it also provides guidance on the implementation of the financing including the syndication of medium and key terms finds through the capital markets.

iv) General Finance Advice:- Through their knowledge of events and developments in the financial markets, they are able to advice includes guidance on matters such as company's optimum financial structure, proper type of finding investments, market acceptance, the most efficient use of funds, government policy and regulations and independent assessment of short and longer term economic prospects.[10]

v) Mergers and Acquisitions:- Merchant banks here act as financial adviser to corporate management in identifying and evaluating merger and acquisition opportunities and in providing strategic, tactical and financial advice for achieving particular corporate objectives.

vi) Investment Advice and Management:- This is aimed at assisting institutional fund managers and trustees of staff pension, endowment and unit trust funds in developing overall investment objectives and strategy.

vii) Trustee Service:- Merchant Banks here act as either solely or jointly as trustees of settlements of all kinds including pension, endowment and unit trust funds and for public and private debenture issues.

e) STOCK BROKING SERVICES

This basically deals with the Nigerian Stock Exchange. The services offered include:

i) Introduction to Nigerian Stock Exchange:- Companies seeking quotation for their securities may use the service of the company to be introduced to the Nigerian Stock Exchange. The company then sponsors the applications for listing to the council of the stock exchange and advices the company through the issuing house on the requirements of the council.

ii) Purchase and Sale of Stocks and Shares:- The bank here buy and sell stocks and shares on behalf of their clients on the floor of the stock exchange.

iii) Portfolio Structuring:- Merchant banks advice both institutional and individual clients on the structuring of their portfolio of securities. She also provide safe keeping services for securities for a nominal fee.

iv) Acceptance of Bills:- A bill of exchange ordinarily

is a document drawn by a seller on a buyer in the international or domestic market by which the cuyer undertakes to pay the stated amount in the bill either at sight or at a given time. To the sellers, the bill represent an acknowledgement of indebtedness by the buyer. But the lenders or investors of funds or even the seller of goods would not take such a bill as a good security for loan or good investment security unless it is accepted by a reputable finance house. Here the merchant bank comes in. As acceptance houses, they endorse bills of exchange arising from foreign trade as "accepted" with their corporate seal and signature, thus making those bills very liquid and carrying low discounting charges.

f) EXPORT PROMOTION AND FINANCE DIVISION

This division provides input to assist Nigerian export promotion council and other government authorities in developing modalities that will remove bottlenecks to exports and ensure development of effective policies so as to increase the boost of the non-oil export.

The division also provides services to clients in:

a) Identifying export products from the banks contact with local potential exporters.

b) Identifying markets for Nigerian products and matching of Nigerian exporters with reputable foreign buyers.

c) Guidance on local documentation.

d) Liaising between the regulatory authorities and exporters in interpreting policy matters on exports.

2.5 Literature Review

Merchant banking is a recent development in the Nigerian financial system. In view of this very little has been written on it.

Nwankwo (1981) in 'The Nigerian Financial System' touched a bit on the activities of merchant banks in Nigeria. His brief history of merchant banks in Nigeria is fair considering the little space he gave to the whole topic. However, a little more about the origins of the firms that later formed merchant banks would be needed for a meaningful analysis of their activities. His discription of the operation of merchant banks and how they have measured below Federal government guidelines is a good foundation for assessing the impact of merchant banks in financing industries in Nigeria.

Okigbo (1980) also did a similar work in his book, 'Nigeria's financial system - structure and growth' devoting a chapter to merchant banking in Nigeria 1970 - 1978, even though, as he admitted, it is actually from 1975 - 1978, since then there was not much merchant banking business in Nigeria prior to 1975. The only difference between Okigbo's work from that of Nwanko, was his observation of section's / sectors of the banking decree 1969 that to him impair on the efficient operations of merchant banks in Nigeria.

Ogundipe (1979) wrote an elaborate article in "The Buchion" titled 'merchant banks and Nigeria's economic growth'. He made a

lot of observations on the activities of merchant banks that are almost parallel to the views presented in this write-up. An example of such views is that as far as functions are concerned, merchant banks do not seem to be indispensable. They appear to do nothing that cannot be done by other banks, and investment institutions. However, a distinguishing characteristics is their skill especially in arranging large loans through issues of bonds placed locally and loans syndications.

Gayus (1982) in his MBA Project, did some work on lease financing in Nigeria. He touched on the activities of merchant banks only because they are the dominant parties in equipment leasing in Nigeria. However, equipment leasing is just one of the functions of merchant banks in Nigerian. The writer intends to make a more detailed study of merchant banking in Nigeria with special reference to industrial financing.

Okigbo (1981) feels that the public criticisms of merchant banks performance between 1970 and 1977 was due to a misconception of their functions. The writer intends to vary with this view and feel that public oriticism were genuine as vindicated by the banks adjustment following the Central Bank's strict surveillance of their activities.

The banks committed large proportions of their funds to Federal government treasury bills and treasury certificates. In

1970 13% of merchant banks total funds were invested in such bills, in fact as late as 1977, the figure was still about 40 percent. Thus the hope of the Federal government that these banks will assist in mobilizing the excess liquidity of the economy into medium and long-term investment was dashed. In operation, the merchant banks became commercial banks. In the commissioner's words, the merchant banks were licenced, "to perform other specialised services in the area of equipment leasing, corporate financing, project preparations and other areas of specialization for which merchant banks are renowned. So far their performance has not justified the expectations".[11]

While the government expected the banks to devote a minimum of 60% of their resources to such productive sectors as agriculture, mining, manufacturing, real estate, construction and services. In 1976, the banks were devoting only 41.5% to these preferred sectors. In addition, the banks exceeded the minimum of 30 percent of their funds to the less productive sectors and were employing as much as 58.5% for this purpose. With regards to the maturities of their loans and advances, only 25% was in medium and long term instead of a minimum of 50 percent. They also exceeded the limit of 10 percent for short term loans and were giving as much as 46 percent. Equipment leasing which should have been at least 15 percent of their total assets got only 1.9 percent.[12]

As the government frowned at these shortfalls, the banks suddenly started adjusting their operations so as to meet up the Federal government's requirements. Whether they are actually meeting up to these requirements will be seen later in chapter three.

There is an explanation to every criticism and so the merchant banks have their excess. That from 1975 through 1978, merchant banks sources of funds were of volative nature made up of of balances for, and loans and advances from other banks and demand deposits. The most reliable sources, the lion share of the bank's sources was time deposits which do not have maturities exceeding one year. Therefore, the merchant banks just like commercial banks cannot borrow short and lend long.

With a little bit of initiative, the merchant banks can develop an effective discount market where depositors can see their certificates of deposit when in need of liquid funds without having to withdraw. This will create medium term funds for the merchant banks. When this is combined with loan syndications, the merchant banks can meet any kind of request from their clients, be it of huge amounts or of long-term or both. The merchant banks, and most writers have blamed the inability of the merchant banks on the under-developed nature of the Nigerian capital market.

Like their counterparts in the United Kingdom and the United States, merchant banks in Nigeria are said to be wholesale

bankers accepting deposits from their customers, most of whom are supposed to be corporations, such deposits (at least as per banking act 1969) should not be less than ₦50,000. They are also supposed to advance large huge sums of medium and long term duration.

They offer short term deposit facilities to their customers with negotiable interest and maturity, but within Central Bank's guidelines. They provide short-term finance to customers in the form of acceptance credit which covers mostly imports. The bills of exchange which they offer are discountable with the Central Bank.

The real business of corporate financing and advice is also said to be performed by merchant banks. They advice their clients on new issues and on portfolio investment, corporate customers are helped on how to get quotation with the stock exchange, on the kind of capital structure to maintain what stocks to buy debt or equity and from which company.

A function that is becoming increasingly important to merchant banks in Nigeria is equipment leasing. By this an organisation acquires the use of an asset without actually tieing down its limited resources.

In conclusion, at the end of this study we will se whether or not merchant banks have met the medium and long term financing requirements of industrialist and if not to give suggestions on how to meet such requirements.

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CHAPTER 3

MERCHANT BANKS AND INDUSTRIAL FINANCING

3.1 Analysis Of Merchant Banks Deposit Liabilities

Deposits are the main source of merchant bank's funds to finance their loans and advances. These deposits are obtained from depositors such as industrial or commercial or private individuals or by bidding for deposits from other banks. Individual banks prefer deposits from the other sources rather than the commercial banks partly because deposits from the former are likely to be cheaper and can result in volatility in times of confused or delicate market conditions.

Commercial banks obviously set a limit on the amount of funds it is preferred to place with any other bank, according to the size and standing of the latter and thus any bidder for deposits must recognise that its capacity as a borrower in the market is ultimately limited. Most deposits of merchant banks in Nigeria are of "time" and "call" nature. The period for which individual deposits are obtained will normally reflect the depositors wishes and the rate of interest paid. The maturity of individual deposits thus varies and the merchant banks will have in their book and will seek to maintain as a reflection of the way in which they employ their funds, a spread of maturities ranging from call to, say, five years, with typically the bulk in periods of less than 12 months.[1]

The aim of this analysis is to find out whether the merchant banks are capable of advancing loans and advances of long duration from the composition of their deposit liabilities.

Table 3a: MERCHANT BANKS: ANALYSIS OF DEPOSIT LIABILITIES ₦'M

CATEGORIES	1976	1977	1978	1979	1980	1981	1982	1983	1984
A) REPAYABLE ON DEMAND	2,826,893	3,614,268	12,340,608	53,702,362	66,467,470	122,425,264	272,288,279	484,641,389	510,978,835
B) OTHER DEPOSITS REPAYABLE									
1. WITHIN 3 MONTHS	19,085,796	28,957,744	69,784,444	62,787,722	85,728,395	183,737,747	481,542,218	453,626,250	636,323,340
2. BETWEEN 3 AND 6 MONTHS	9,537,132	15,244,967	17,104,885	23,278,812	86,570,200	75,655,716	101,361,317	177,866,774	189,561,224
3. BETWEEN 6 AND 12 MONTHS	24,166,405	18,592,455	18,036,584	24,354,710	38,760,347	63,601,415	97,402,046	151,641,236	130,411,740
4. LATER THAN 12 MONTH	6,121,000	13,349,611	5,751,784	6,437,037	8,606,000	4,982,104	17,247,480	19,602,222	74,411,740
TOTAL (B)	58,910,393	76,144,777	110,677,697	117,308,481	219,976,982	327,976,982	691,256,066	793,739,481	970,616,813
TOTAL DEPOSIT LIABILITIES	61,737,286	79,759,045	123,018,305	171,010,843	286,132,412	450,402,246	963,544,346	1278,380,870	1481,595,648

SOURCE: Central Bank of Nigeria Research Department.

Table 3.8: MERCHANT BANKS: ANALYSIS OF DEPOSIT LIABILITIES IN PERCENTAGE TERMS

	1976	1977	1978	1979	1980	1981	1982	1983	1984
A) REPAYABLE ON DEMAND	4.58	4.53	10.03	31.40	23.23	27.18	28.08	37.91	34.49
B) OTHER DEPOSIT LIABILITIES:									
1) WITHIN 3 MONTHS	30.91	36.31	56.73	36.72	29.96	40.79	49.65	35.48	42.95
2) BETWEEN 3 AND 6 MONTHS	15.45	19.11	13.90	13.88	30.25	16.80	10.45	13.91	12.79
3) BETWEEN 6 AND 12 MONTHS	39.14	23.31	14.67	14.24	13.55	14.12	10.04	11.86	8.80
4) LATER THAN 12 MONTHS	9.91	16.74	4.67	3.76	3.01	1.12	1.76	0.83	0.97
TOTAL (B)	95.42	95.47	89.97	68.60	76.77	72.82	71.92	62.09	65.51
C) TOTAL DEPOSIT LIABILITIES	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

SOURCE: Central Bank of Nigeria Research Department.

From the analysis of the deposit liabilities of merchant banks between the years 1976 - 1984, shown in Table 3.0 it can be seen that on the average, the deposit liabilities maturing within less than twelve months accounted for between 90 and 60 percent of the total deposits for that period. Deposits on demand accounted for only between 4 and 37 percent within that period. Deposits maturing later than twelve months accounted for only between 1 and 16 percent during the the same period.

Medium and long-term loans can only be given when the deposit liabilities of the banks are of longer duration. It can therefore be said that the merchant banks have justified why they have not been able to meet the central bank of Nigeria credit guidelines with regards to the percentage of loans and advances which should be of medium and long term maturities. If these merchant banks are to remain in business and run profitable organisations, they dare not meet the requirements of the central bank of Nigeria as it will mean exposing themselves to severe risk. In the present era of the structural adjustment program, if the merchant banks are to continue to finance industries for their medium and long-term needs, they have to attract more longer-term maturity deposits by way of substantial increase in the interest given to owners of the deposits or through the help from large funds of the Central Bank of Nigeria.

Analysis Of Some Selected Merchant Banks
Deposits Liabilities

Table 3c: NAL MERCHANT BANK: ANALYSIS OF DEPOSIT LIABILITIES

TYPES	1984	1985	1986
Current Deposits and other Accounts	252,534	316,369	357,827
Negoatiable certificate of deposits	13,000	8,000	6,000
Bankers Deposits	7,000	46, 00	25,000
Total =	272,534	370,869	388,827

SOURCE: NAL Merchant Bank Annual reports.

It can be seen from the Table 3c that the bulk of its deposits are current deposits. The current deposits constituted 92, 85 and 92 percents of the total deposits for the years 1984, 1985 and 1986 respectively. The current deposits are short term deposits mostly of call nature.

Table 3d: ICON MERCHANT BANK: ANALYSIS OF DEPOSIT LIABILITIES

	1984	1985	1986
Demand	61,520,565	47,652,072	53,857,448
Certificate of Deposits	49,343,098	41,893,501	34,406,255
Time and call	235,010,680	290,567,010	493,194,411
Others	5,132,212	382,152,736	3,049,006
Total =	351,006,555	382,152,736	583,507,120

SOURCE: ICON Merchant Bank Annual reports.

The bulk of its deposits consisted of Time and Call deposits. These deposits are also short term deposits. The time and call

constituted 63, 73 and 84 percents of the total deposits for the years 1984, 1985 and 1986 respectively.

Table 3e: NIGERIAN MERCHANT BANK: ANALYSIS OF DEPOSIT LIABILITIES

TYPES	N'000m 1984	N'000m 1985	N'000m 1986
Time and Demand Deposits	215,544	231,404	321,212
Other customer Accounts	22,945	50,413	29,410
TOTAL	238,489	281,817	350,622

A very large proportion of its deposits consisted of Time and Demand deposits which are mostly of short term maturities. The time/demand deposits constituted 90, 82 and 91 percents of the total deposits for the years 1984, 1985 and 1986 respectively.

Table 3f: CONTINENTAL MERCHANT BANK: ANALYSIS OF DEPOSIT LIABILITIES

TYPES	N'000m 1984	N'000m 1985	N'000m 1986
Time and Demand Deposits	462,634	393,049	258,471
Due to other banks in Nigeria	123.000	111.500	182,866
Foreign Transfer Payable	—	—	333,576
	585,634	504,549	774,853

The time and demand deposits constituted 78, 80 and 77 percents of the total deposits for the years 1984 and 1985 respectively. These are short term deposits. In 1986, Time and Demand deposits constituted 33 percent of the total deposits

while Foreign Transfers Payable constituted 43 percent of the total deposits for that year. The Foreign Transfers Payable deposits are those of manufactuters awaiting letters of credit.

Table 3g: INTERNATIONAL MERCHANT BANK (IMB): ANALYSIS OF DEPOSIT LIABILITIES

	1984	1985	196
Demand Deposits	48,711	29,757	28,086
Time Deposits	149,080	191,936	144,510
Certificate of Deposits	12,937	5,102	2,057
Others	277,666	289,910	547,556
Total	488,394	516,705	722,209

Time and demand deposits constituted 40, 43 and 23 percents of the total deposits for the year 1984, 1985 and 1986 respectively. Other types of deposits which mostly consisted of foreign transfers payable, which are of short term duration constituted the majority of the deposits. These deposits constituted 57, 56 and 75 percents of the deposits for the years 1984, 1985 and 1986 respectively.

From the analysis of the deposits of the five merchant banks for the 1984 - 1986, it can be seen clearly that the bulk of their deposits are of short term duration. Consequently, the duration or maturity of their loans and advances will also have to be of a short term nature as it is the main source of their funds. In view of this dangerous situation, the industrial loans which

are mostly of medium and long term nature will be seriously affected as the banks are not in a position to give a substantial amount of their loans and advances. No wonder, merchant banks do not meet the Central Bank of Nigerian credit guidelines with regards to the percentage of medium and long term loans and advances which they should give to the preferred sector. These merchant banks analysised being the leading ones in the country should set the pace of attracting deposits of long term maturities by using their innovative skills which they are known for.

3.2 Analysis of Merchant Bank's Loans and Advances As Classified By Purpose

The utilization of loans and advances as a vehicle for industrial development is of paramount importance to any developing country. In view of this, over the years, the Federal government through the Central Bank issues yearly credit guidelines to the Merchant Banks with regards to the sectoral allocation of their loans and advances. These credit and policy guidelines are to help the Federal government in meeting not only its priorities but also the general economic development of the country.

The aim of this analysis is to find out whether or not the merchant banks have been meeting the requirement of the guidelines and if not to find out the root causes and offer recommendations in order to meet the requirements of the guidelines in order to meet the developmental objectives of the Federal government.

Though this study is essentially concerned with some selected merchant banks and their roles in industrial financing, due to lack of enough data from the merchant banks concerned to carry out an indepth analysis of the merchant banking industries' loans and advances as classified by purpose is therefore analysed. The period covered is from 1982 - 1986.

Table 3h: MERCHANT BANKS LOANS AND ADVANCES CLASSIFIED BY PURPOSE

CATEGORY OF BORROWER	1982		1983			
	MONTHLY PRESCRIBED PERCENTAGE	MONTHLY AVERAGE PERCENTAGE	DEVIATION FROM TARGET	AVERAGE PERCENTAGE	PRESCRIBED PERCENTAGE	EVIATION FROM TARGET
A) PREFERRED SECTOR						
) Production	61.9	69.0	-7.1	55.0	69.0	-14.0
a) Agriculture	4.1	5.0	-0.9	4.0	5.0	-1.0
b) Minning & Quarring	1.2	3.0	-1.8	0.9	3.0	-2.1
c) Manufacturing	40.7	41.0	-6.3	33.6	41.0	-7.4
i) Agro-Allied Industries	(0.8)	(5.0)	(-4.2	(0.7)	(5.0)	(-4.3)
ii) Others	(39.9)	(36.0)	(+3.9)	(32.9)	(36.0)	(-3.1)
d) Construction	15.9	20.0	-4.1	16.5	20.0	-3.5
i) Residential Building	(5.0)	(6.0)	(-1.0)	(5.7)	(6.0)	(-0.3)
ii) Others	(10.0)	14.0	(-3.1)	(10.8)	(14.0)	(-3.2)
II) Services	2.5	7.0	-4.5	2.6	7.0	-4.4
a) Public utility	0.9	3.0	-2.1	0.6	3.0	2.4
b) Transport and communications	1.6	4.0	-2.4	2.0	4.0	2.0
III) Exports	0.1	3.0	-2.9	0.1	3.0	2.9
Total (A)	64.5	79.0	-14.5	57.7	79.0	-21.3
B) LESS PREFERRED SECTOR:						
IV) General Commerce	14.8	14.0	+0.8	11.8	14.0	-2.2
a) Imports	9.4	8.0	+1.4	6.7	8.0	-1.3
b) Domestic Trade	5.4	6.0	-0.6	5.1	6.0	-0.9
V) Others	20.7	7.0	+13.7	30.5	7.0	+23.5
a) Credit and Financial Institutions	19.0	3.0	+16.0	28.0	3.0	+25.0
b) Government	0.3	2.0	-1.7	0.4	2.0	-1.6
c) Miscellaneous	1.4	2.0	-0.6	2.1	2.0	+0.1
TOTAL (B)	35.5	21.0	+15.4	42.3	21.0	+21.3
TOTAL (A) & (B)	100.0	100.0	-	100.0	100.0	-

SOURCE: Central Bank of Nigeria, Annual Report.

Aggregate merchant credit credit outstanding to the economy at the end of December 1983 amounted to ₦2.1 billion representing an increase of ₦535.8 million or 35.0 percent over the level a year earlier. Like the preceding years, merchant banks again failed to comply with credit guidelines. "Allocation of loans and advances to the preferred sector/sub-sectors averaged 57.7 percent monthly, showing a shortfall of 21.3 percentage points relative to the prescribed minimum target of 79.0 percent. The allocation to this sector in 1982 averaged 64.5 percent monthly, which represented a better performance than the current year. The less preferred sectors on the other hand, got a monthly average of ₦536.1 million or 42.3 percent – 21.3 percentage points higher than the prescribed maximum target."[2]

Loans and advances of medium and long-term nature granted by the merchant banks during 1983 averaged 34.0 percent of total, while short-term loans averaged 66.0 percent. This, however was at variance with the policy guidelines minimum target of 40.0 percent for the former and 22.0 percent for the latter. This variance does not augur well for the Federal government's efforts to promote rapid industrialization of the country. Loans and advances of medium and long-term nature are production oriented which are used by the industrial sector for opening of new plants, expansion of existing ones or purchase of spare parts. The merchant banks continued defiance of the guidelines over the years has led to the slowing down of industrialization of the

country. The short-term loans and advances are mostly consumption oriented which is used for general commerce and other non-productive sectors. The continued surpassing of the limit of the credit that should be made available by the merchant banks to this unproductive sector will only encocurage or further under-develop the economy. Stringent penalties should be strictly enforced to defaulting banks if at all they are to be discouraged from granting loans above the prescribed limit.

Total merchant bank's credit for Equipment leasing increased by ₦22.1 million or 82.5 percent to ₦48.9 million but constituted only 1.1 percent of total assets at end - December, 1983 as against the maximum of 15.0 percent prescribed for this category of assets. Part of the explanation for the poor performance was the bank's grumbles over the capital gains tax imposed on the sales value of leased Equipment after its official life span. Another contributory factor was the low demand for equipment leasing credit which has been depressed by the recession in the economy. Merchant Banks should increase their equipment for lease to meet the prescribed target as credit granted on equipment for lease are not regarded by the monetary authorities as "credit" thereby increasing their aggregate credit lending. This will also lead to gaining more revenue from their specialist services.

Table 3i:

MERCHANT BANKS LOANS AND ADVANCES CLASSIFIED BY PURPOSE

	CATEGORY OF BORROWERS	1984 PRES-CRIBED PERCEN-TAGE	1984 MONTHLY AVERAGE PERFOR-MANCE	1984 DEVIA-TION FROM TARGET	1985 MONTHLY AVERAGE PERFOR-MANCE	1985 PRES-CRIBED PERCEN-TAGE	1985 DEVIA-TION FROM TARGET
A)	PREFERRED SECTOR						
	1) Agricultury, Forestry & Fishing	4.0	4.4	-0.6	5.7	6.0	-0.3
	2) Industrial Enterprises	58.0	45.1	-12.9	46.3	58.0	-11.7
	a) Manufacturing including Agro-allied industries	(41.0)	(31.9)	(-9.1)	(31.6)	(41.0)	(-9.4)
	b) Others (running and Quarrying, other industries	(17.0)	(13.2)	(-3.8	(14.7)	(17.0)	(-2.3)
	3) Residential Building Construction	6.0	6.1	+0.1	6.0	6.0	-
	4) Exports	3.0	0.1	-2.9	0.1	3.0	-2.9
	5) Services (Public utilities and Communications	7.0	3.4	-3.6	3.6	3.0	-2.6
	TOTAL (A)	79.0	59.1	-19.9	61.5	79.0	-17.5
B)	LESS PREFERRED SECTOR:						
	6) General Commerce (Imports, domestic trade)	14.0	13.1	-0.9	13.1	14.0	-0.9
	7) Government	2.0	1.0	-1.9	0.7	2.0	-1.3
	8) Others (credit & financial institutions, persons & pro-fessional	5.0	27.7	22.5	24.7	5.0	19.7
	TOTAL (B)	21.0	40.9	19.9	38.5	21.0	17.5
	TOTAL (A) = (B)	100.0	100.0	-	100.0	100.0	-

SOURCE: Central Bank of Nigeria Annual Report.

At the end of 1985, aggregate credit by the merchant banks to the domestic economy amounted to ₦3.1 billion, reflecting an increase of ₦410.2 million or 15.0 percent during the year. ₦279.1 million or 68.0 percent wait to the government sector, credit to the private sector rose by ₦311.1 million or 7.8 percent to ₦1,802.9 million.

With respect to the sectoral allocation of loans and advances, the banks continued to show marked deviation from the guidelines targets for example, the monthly average allocation of loans and advances outstanding to the preferred sector comprising agriculture, industrial enterprises, residential construction, exports and services was 61.5 percent as against the prescribed minimum target of 79.0 percent. Conversely, the allocation to the less preferred sectors exceeded the prescribed ceiling of 21.0 percent by 17.5 percentage points.

The maturity structure of the merchant banks loans and advances outstanding, continued to defy the guidelines targets. The proportion of loans and advances of medium and long term maturities granted by the banks in 1985 averaged 39.6 percent of the total monthly compared with the stipulated minimum ratio of 50 percent. On the other hand, short term loans constituted 39.5 Percent of the total as against the prescribed maximum of 20.0 percent. The value of equipment on lease increased by ₦30.6

million or 54.7 percent percent to ₦86.6 million, this represented only 1.7 percent of the total assets which is 13.3 percentage points below the 15 percent prescribed maximum.

From the analysis of the loans and advances as classified by purpose for the year 1985, merchant banks have not been able to meet the prescribed target for the preferred sector, in fact they deviated by 17.5 points. The preferred sector loans and advances are mostly for medium and long term purposes which could be used either for setting up new plants or expansion of existing ones. It should be noted that the closer the merchant banks came to meeting the prescribed targets for the preferred sector which is also the productive sector, the closer the merchant banks came to realizing the goals of rapid economic development of the nation. The failure of the merchant banks to meet the targets for the maximum amount of their assets which should be in leasing is quite uncomforting, in fact, it was disgraceful. Leasing which is one of the specialist services of the merchant banks should have been given adequate attention by the merchant banks. By meeting the targets for the leasing, the merchant banks would not only be performing their proper roles but also expanding and generating more income from one of their specialist services.

Table 3k: MERCHANT BANKS LOANS AND AVANCES AS CLASSIFIED BY PURPOSE

	CATEGORY OF BORROWERS	1985 PRES-CRIBED PERCEN-TAGE	1985 MONTHLY AVERAGE PERFOR-MANCE	1985 DEVIA-TION FROM TARGET	1986 MONTHLY AVERAGE PERFOR-MANCE	1986 PRES-CRIBED PERFOR-MANCE	1986 DEVIA-TION FROM TARGET
A)	PREFERRED SECTOR						
	1) Agriculture (Agrc. Forestry & Fishing)	6.0	5.7	-0.3	7.2	8.0	-0.8
	a) Grains production and distribution				(1.8)	(4.0)	(-2.2)
	b) Livestock, Including Poultry				(1.1)	(1.2)	(-0.1)
	c) Others				(4.3)	(2.8)	(-1.5)
	2) Industrial Enterprise	64.0	52.3	-11.7	50.9	62.0	-11.1
	a) Manufacturing (including Agro-allied industries) mining, Quarring, Excluding Residential Construc-tion	(58.0)	46.3)	(-11.7)	(45.3)	(56.0)	(-10.7)
	b) Residential building construc-tion	(6.0)	(6.0)	(-)	(5.6)	(6.0)	(-0.4)
	3) Services (Exports, public utilities, transport and communication	9.0	3.5	-5.5	4.0	9.0	-5.0
	TOTAL (A)	79.0	61.5	-17.5	62.1	79.0	-16.9
B)	LESS PREFERRED SECTOR						
	(Government, Credit and Financial Institution, Personal & Professional	21.0	38.5	17.5	37.9	21.0	-16.9
	TOTAL (B)	21.0	38.5	17.5	37.9	21.0	-16.9
	TOTAL (A) + (B)	100.0	100.0	-	100.0	100.0	-

SOURCE: Central Bank of Nigeria Annual Report, 1986.

Merchant banks aggregate credit oustanding to the domatic economy

(loans and advances, investment and equipment on lease) amounted to ₦3.3 billion in December 1986, an increase of ₦144.1 million or 4.6 percent over the level a year earlier.

Credit to the private sector, by way of loans and advances, money at call outside the Central Bank and bills discounted, rose further by ₦1.0 billion or 53.7 per cent to ₦2.8 billion, compared with ₦0.1 billion or 7.8 percent increase in 1975. This rise in merchant bank's loans and advances during the year was due to demand pressure from the private sector for credit, following increased cost of financing economic activities under the foreign exchange market (FEM).

The performance of the merchant banks with regards to the sectoral distribution of their loans and advances in 1986, though not in compliance with credit guidelines was an improvement over their achievement in 1985. For example, the average monthly allocation to the preferred sectors, comprising agriculture, industrial enterprises, residential building construction, exports and services was 61.2 percent, compared to the 79.0 percent prescribed minimum target. However, that was marginally higher than the 61.5 percent achieved in the same sector in 1985. On the other hand, the allocation to the less preferred sectors exceeded the stipulated maximum target of 21.0 percent by 16.9 percentage points, compared with 17.5 percentage points in the preceding year. This improvement was largely due to the curtailment of imports of consumption oriented goods. Industrial

enterprises received 50.9 percent of the total in 1986 compared with 52.3 percent in 1985. However, allocation to the manufacturing sector declined to 45.3 percent from 46.3 percent in 1985. The prescribed minimum percentage shares for the industrial and manufacturing sectors were 62.0 and 56.0 percent respectively.

"The maturity structure of merchant banks loans and advances showed that the banks failed as usual to attain the desired targets. This was in spite of the increase in their deposit liabilities by ₦579.7 million over that of 1985. Loans of short-term duration (i.e. those maturing in less than 12 months for example, amounted to ₦1.5 billion representing 53.1 percent of the total, thus exceeding the stipulated maximum of 20.0 percent by 35.1 percentage points. On the other hand, loans of medium and long-term duration (i.e. those maturing in not less than 3 years) accounted for only 29.7 percent of the total as against the prescribed minimum ratio of 50 percent."[5] When compared with the previous year, the performance of the merchant bankers with regards to loans of short, medium and long term durations have deteriorated badly. While in 1985, the short-term loans constituted 39.5 percent of the total. In 1986 the short-term loans constituted 55.1 percent of the total as against the presoribed maximum of 20.0 percent in both years. Top officials of merchant banks interviewed on this issue blamed it on the sharp increase in working capital requirements of most

industries which in turn was due to the continuous decline of the naira against other major currencies of the world in the foreign exchange market, which these industries use to import raw materials to keep their factories working.

In the case of the medium and long term loans, while in 1985 it constituted 39.6 percent of the total in 1986 it constituted for only 29.7 percent of the total as against the prescribed minimum ratio of 50 percent in both years. Merchant bank's officials blamed this situation on the bad state of the economy. Through their discussions with industrialist, they found out that the industrialist were less concerned about expanding their plants or setting up of new plants due to the tremendous increase in the cost of procurement of new plants and equipments. It should be noted therefore that the demands by industrialist for medium and long term loans was lesser than that of 1985. Consequently, the merchant banks shifted their loans and advances to those of short term duration which was in higher demand.

The value of equipment on lease increased by ₦66.5 million or 76.8 percent to 153.1 million but represented only 1.8 percent of total assets outstanding. The prescribed minimum is 15.0 percent of total assets of merchant banks. This tremendous increase in value of equipment on lease is a healthy development both for the merchant banks and the economy. It is a clear sign that merchant banks are increasingly involved in their specialised

role. From information found out by the writer with regards to the causes of this sharp increase in value of equipment on lease, it can be said that it was largely due to the high cost of procurement of plant and equipment hence businesses preferred leasing to outright purchase of the equipments. Purchasing involves foreign exchange which has been dear not only due to the limited foreign exchange at the foreign exchange market but also due to the continuous decline of the naira as against major currencies of the world. This in effect means very high cost of procurement of raw plants and equipments.

From the analysis of the merchant banks loans and advances as classified by purpose for the period 1982 - 1986, the merchant banks have failed to meet the minimum requirements for the preferred sector, while they have always exceeded the maximum limit for the less preferred sector. This the merchant bank officials interviewed have always blamed it largely on the short term nature of their deposit liabilities which is their main source of funds. It can therefore be safely argued by the writer that the merchant banks have tried with regards to compling with the sectoral allocation of their loans and advances when one looks at it from the background of the short term nature of their deposit liabilities which is a serious limitation. (See tables 3a - b)

3.3 Equipment Leasing

This is one area in which merchant banks finance industries. The Central Bank over the years has prescribed a maximum of 15 percent of merchant banks assets can be on lease, unfortunately non of the banks have been able to come to close to the prescribed target. It was only in 1976 and 1977 that the merchant banks met nearly 50 percent of the prescribed target, 7.6 and 6.9 percent respectively. For the other years, the average for the period has only been 1.5 percent of their total assets. This does augur well for the increased industrialization of the country. As at December ending 1985, the total amount of equipment on lease was with ₦86 million while the merchant banks total assets were worth ₦5,001,1

Table 31: MERCHANT BANKS: VALUE OF EQUIPMENT ON LEASE (₦'M)

YEAR	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
AMOUNT	3.2	12.5	13.4	15.5	18.0	14.6	26.8	48.9	56.0	86.0	153.1

SOURCE: Central Bank of Nigeria, Economic and Financial Review, Volume 17, No. 2, December 1979 and Volume 23, No. 2, 1985.

Table 3m: MERCHANT BANKS: EQUIPMENT ON LEASE AS A PERCENTAGE OF TOTAL ASSETS

YEAR	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
PRESCRIBED MAXIMUM	15	15	15	15	15	15	15	15	15	15	15
ACTUAL	1.9	7.6	6.9	2.5	1.8	0.8	0.8	1.1	1.24	1.7	1.8
DEVIATION	13.1	7.4	8.1	12.5	13.2	14.2	14.2	13.9	13.75	13.3	13.2

SOURCE: Central Bank of Nigeria Annual Reports and Statements of Accounts (Various Years).

million representing only 1.7 percent of the total assets. The poor performance of the merchant banks with regards to leasing as highlighted by some of the officials of the merchant banks interviewed was due to the tax imposed by government on capital gains when the life of the lease equipment expires and the bank decides to sell them off. Another reason was that clients were not forthcoming. This the writer believes was encouraged by the merchant banks poor marketing of their services to the public. One of the advantages to the potential leasee when marketing this merchant bank service that should be highlighted is that it saves the leasee the problem of making a huge initial cash outlay for the equipment as he will be paying the rent instalmentally. Another advantage to the leasee is that he gets a tax advantage on account of the rental payments because they are treated as expenses are deducted before tax is charged to the income. Furthermore, since the total amount of rent to be paid

is not treated in the books of accounts as debt, the leasee's debt position is not impaired. By effective marketing of the leasing service of merchant banks, there is bound to be increased activity in this area hence the merchant banks income from their specialized service will increase.

3.3.1 ANALYSIS OF SOME SELECTED MERCHANT BANK'S EQUIPMENT ON LEASE

Equipment leasing has not been given the desired attention by the five merchant banks undertaken for this study. Between the period 1981 - 1986, Continental Merchant Bank had ₦47.1 million worth of equipment on lease representing 5.3 percent of its total assets in 1986. This is the highest amount in naira terms devoted to equipment on lease by any of the five merchant banks for the period under study. On table 3o it can be seen that the highest equipment on lease as a percentage of total assets was recorded by Nigeria Merchant Bank in 1982 representing 5.6 percent of its total assets. This is a far cry from the prescribed amount of 15 percent.

Table 3n:

MERCHANT BANKS EQUIPMENT ON LEASE IN NIGERIA AS AT NET BOOK VALUE IN ₦ MILLION

	1981	1982	1983	1984	1985	1986
Continental Merchant Bank	6.8	13.3	18.9	15.9	12.5	47.1
ICON Merchant Bank	12.4	16.3	14.0	13.9	14.2	11.6
International Merchant Bank	-	7.9	8.4	-	-	-
NAL Merchant Bank	-	6.8	6.8	.012	12.5	15.5
Nigerian Merchant Bank	1.8	6.3	11.8	-	-	-

SOURCE: Annual Reports of the various Merchant Banks.

Table 3o: MERCHANT BANKS EQUIPMENT ON LEASE AS A PERCENTAGE OF TOTAL ASSETS

	1981	1982	1983	1984	1985	1986
Continental Merchant Bank	3.1	3.5	3.3	2.2	2	5.3
ICON Merchant Bank	2.6	2.5	2.6	2.1	2	0.9
International Merchant Bank	-	1.7	1.6	-	-	-
NAL Merchant Bank	-	3.4	2.0	.0000287	2.5	2.9
Nigerian Merchant Bank	3	5.6	5.2	-	-	-

SOURCE: Annual Reports of the various Merchant Banks.

For the same period, NAL merchant bank recorded the lowest amount both in Naira terms and percentage of total assets in 1984. It recorded only ₦12,000 worth of equipment on lease representing less than 0.025 percent of its total assets.

On the average, these merchant banks had less than 5 percent

of their total assets in equipment on lease while they are allowed to have as much as 15 percent of their assets in equipment on lease. No wonder their gross income from equipment on lease was negligible when compared with their gross income from interest on loans and advances. In the present era of the structural adjustment programme where the liquidity position of most business is tight, effective marketing of this aspect of industrial financing will produce clients for the merchant banks as the clients will prefer to lease equipment than to make an outright purchase of equipment. This will consequently lead to higher income from this specialised service rendered by merchant banks.

3.4 Sources Of Income Of Some Selected Merchant Banks

One of the objectives of this study is to find out whether or not merchant banks depend on interest as their main source of income as claimed by some quarters, and if so to give suggestions as to how to tap the other sources more effectively so that a substantial part of their income would come from their specialised activities which is what ideally it should be.

Table 3p shows the main sources of income for the merchant banks selected for this study. Generally, for the period 1974 - 1983, their main source of income has been from the banking services sector. Interest income constituted 90

percent of the income for this sector.

However, for a detailed analysis of their services of income, the writer analysed seperately each of the bank's sources of income for the period 1974 - 1986. (See tables 3q - u).

Table 3p: MAJOR SOURCES OF INCOME OF SOME SELECTED MERCHANT BANKS

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
NAL MERCHANT BANK										
Banking Services	1,584,493	1,776,435	2,197,232	3,047,496	4,236,401	6,509,994	7,546,671	11,099,000	14,027,000	25,746,000
Others	509,498	830,690	1,288,611	1,983,983	3,342,306	4,262,480	3,146,777	4,664,999	5,496,000	10,879,000
TOTAL	2,093,991	2,607,125	3,485,843	5,031,479	7,578,707	10,772,474	10,693,448	15,763,000	19,523,000	36,625,000
CONTINENTAL MERCHANT BANK										
Banking Services		327,401	1,248,306	2,224,043	5,100,177	6,640,896	10,906,668	16,763,000	31,211,000	38,105,000
Others		64,999	128,761	624,286	846,852	1,038,975	2,514,495	3,996,588	2,130,000	5,855,000
TOTAL		373,400	1,377,147	2,848,324	5,747,029	7,679,871	13,421,243	20,217,439	33,341,00	43,960,000
IGON MERCHANT BANKERS										
Banking Services			784,225	2,863,707	4,348,598	7,293,814	13,904,336	19,267,109	34,988,517	44,874,632
Others			440,645	966,427	1,678,947	3,071,829	6,995,339	8,389,143	9,852,777	6,344,896
TOTAL			1,224,870	3,830,134	6,022,545	10,385,643	20,899,675	27,656,252	44,641,294	51,219,618
NIGERIAN MERCHANT BANK										
Banking Services				913,202	1,204,238	1,855,212	2,478,371	3,945,071	6,593,050	18,354,436
Others				79,202	225,884	997,062	1,044,350	1,190,075	1,766,343	1,788,990
TOTAL				922,477	1,429,622	2,652,274	3,441,620	5,135,146	8,359,393	20,143,426
INTERNATIONAL MERCHANT BANK										
Banking Services						7,982,000	10,060,000	14,992,000	35,882,000	51,108,000
Others						434,000	591,000	1,394,000	3,877,000	5,835,000
TOTAL						8,416,000	10,651,000	16,386,000	39,754,000	56,743,000

SOURCE: Central Bank of Nigeria - Research Department.

3.4.1 Analysis Of Some Selected Merchant Banks' Sources Of Income

Table 3q: NIGERIAN MERCHANT BANK: INCOME SOURCES - N'00

SOURCES	1984	1985	1986
Interest and Discounts	19,654	25,716	31,157
Commissions	1,228	2,247	4,898
Corporate Finance	732	849	310
Leasing Income	5,508	6,043	8,545
Investment Income	70	57	58
Other Income	335	525	2,200
TOTAL GROSS INCOME	27,527	35,437	47,168

SOURCE: Nigerian Merchant Bank Annual Reports.

For the Nigerian Merchant Bank (see Table 3Q) of its total gross income, interest discounts, corporate finances and leasing income accounted for 70, 2, and 18 percents respectively for the year 1984. In 1985, interest income, corporate finance services and leasing income accounted for 71, 2, and 17 percents respectively. Lastly, in 1986, interest income, corporate finance income and leasing income accounted for 65, .06, 17 percents respectively.

This has shown clearly that on the average, 70 percent of their income for the period 1981 - 1986 was from interest alone, while 20 percent of their income was from their specialized activities. In view of this it can rightly be concluded that

the bank has concentrated on traditional banking services which commercial banks are also engaged in instead of their specialist role. There is therefore the need for this bank to concentrate more on its specialized roles in order to gain more income from it.

Table 3r: ICON MERCHANT BANKS: GROSS EARNINGS - ₦

SOURCES	1984	1985	1986
Income from Investments	9,067,796	16,920,411	19,018,217
Interest received	34,588,708	37,187,523	53,196,170
Issuing House Fees	806,465	1,138,574	944,337
Leasing Income	4,049,276	3,469,051	3,956,569
Other Commissions	3,850,450	2,493,230	7,546,192
Commissions on Letters of Credit	1,993,891	2,384,212	3,451,089
Gain on Exchange	—	—	1,563,187
TOTAL	54,356,586	63,592,031	89,675,761

SOURCE: ICON Merchant Bank Annual Reports.

Of its I. CON Merchant Bankers' gross earnings (see Table 3r), interest income, corporate finance services and leasing income accounted for 62, 7, and 7 percents respectively for the year 1984. In 1985, interest income,,corporate finance services and leasing income accounted for 58, 4, and 4.5 percents respectively of the total gross earnings for that year. Lastly, in 1986, interest income, corporate finance services and leasing income accounted for 59, 8, and 3 percents respectively of the total earnings for that year.

On the average, 60 percent of its gross earnings for the period 1984 - 1986 came from interest while 7 percent came from their specialist role of corporate finance and leasing of equipment. There is the need for the bank to move away from its dependence on interest income to its specialized fee rewarding services. This dependence on interest income lends credits to the criticism that merchant banks are more of a commercial bank in Nigeria.

Table 3s: CONTINENTAL MERCHANT BANK: GROSS EARNINGS - N'000

SOURCES	1984	1985	1986
Interest Received	41,482	55,357	50,161
Transfer charges	2,563	1,565	1,696
Foreign exchange	723	645	9,695
Leasing income	9,350	9,371	8,727
Commission on Turnover	-	1,286	1,115
Other income	4,568	1,304	2,638
TOTAL	58,686	69,528	74,032

SOURCE: Continental Merchant Bank Annual Reports.

For Continental Merchant Bank, (see Table 3s) out of its total grosss earnings for the year 1984, 70, 17 and 1 percents was accounted for by income from interest, leasing and corporate finance services respectively. In 1985, interest income, leasing leasing income and corporate finance income accounted for 79, 13

and 1 percents respectively for its total gross income. In 1986 interest income, leasing income and corporate finance income accounted for 67, 10 and 4 percents of its total earnings respectively.

On the average, for the period 1983 - 1986, interest income accounted for 74, 3 and 12 percents respectively of the total gross earnings. This also means that like the two previous merchant banks, they also derive a substantial amount of their income from interest loans and advances. The specialist role constituted only a minute amount of its total gross earnings. There is therefore the need for the bank to diversify its source of income to its other specialised services.

Table 3t: NAL MERCHANT BANK: GROSS EARNINGS - N'000

SOURCES	1984	1985	1986
Interest income	28,366	40,305	46,409
Foreign exchange	5,334	5,006	5,401
Commissions received	681	1,362	768
Earnings on new issues	1,004	806	657
Leasing income	42	525	2,085
Other income	1,198	1,869	626
TOTAL	36,625	49,873	55,948

SOURCE: NAL Merchant Bank Annual Reports.

NAL Merchant Bank (see Table 3t) received 77, 5 and 0.1 percents of its total gross earnings from interest income,

corporate finance and leasing respectively in the year 1984. In 1985, Interest Income, corporate finance services and leasing income accounted for 81, 5 and 1 percent of its total gross income. It should be noted that there is a sharp increase in its earnings from equipment leasing in 1985 when compared to 1984. This could be due to its increased equipment leasing services during the year. In 1986, interest income, corporate finance and leasing income accounted for 83, 3 and 3.5 percent of its total gross earnings respectively. On the average, for the period 1984—1986, interest income, corporate finance income and leasing income accounted for 80, 4 and 2 percents of its total gross earnings respectively. When compared with the previous four merchant banks analysed, it can be seen that NAL Merchant bank had the highest percentage in terms of income received from interest. This does not argur well for the oldest merchant bank which is supposed to pioneer increased specialised services activity instead of depending on interest on loans and advances.

Table 3u: INTERNATIONAL MERCHANT BANK: GROSS EARNINGS - N'000

SOURCES	1984	1985	1986
Interest income	56,209	64,453	67,850
Service charge and fees	4,509	2,938	2,905
Bills of exchange	5,296	6,659	10,059
Lease income	2,565	2,812	4,182
Others	70	651	814
TOTAL	68,949	77,513	85,810

SOURCE: International Merchant Bank Annual Reports.

Lastly, the International Merchant Bank (see Table 3u) received from its interest income, corporate finance and leasing income 82, 6 and 2 percents respectively from its total gross earnings for the year 1984. In 1985, of its total gross earnings, interest income, corporate finance and leasing income accounted for 83, 4 and 2.5 percents respectively, on the average for the period 1984 - 1986.r Interest income, corporate finance leasing income accounted for 80, 4.5 and 3 percents respectively of its total gross earnings. Just like the other earlier merchant banks analysed, the bulk of its income came from interest on loans and advances instead of the specialist role which it is supposed to play. The bank needs to expand its specialist role activities so that more income can be earned from the specialist services offered by the bank.

Generally, from the five merchant banks' sources of income

analysed, it can be concluded that up to today the Nigerian merchant banks depend on interest income substantially as their main source of revenue. On the average for the five merchant banks analysed during the period 1984 - 1986 interest on income corporate finance and leasing income accounted for 75, 1 and 5 percents of their total gross earnings respectively. The merchant banks should therefore use their skill and innovativeness to broaden the financial instruments within the Nigerian financial system so that additional revenue can be earned from new specialist services. However, for the moment they can increase their income from leasing by at least meeting the annual Central Bank of Nigeria credit guidelines with regards to the percentage of their assets which can be on lease. This will improve not only their total gross earnings but also reduce their dependence on interest income, hence there will be less criticisms of them being accused of performing the same role with commercial banks.

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CHAPTER 4

PROCEDURE FOR ANASYING LOAN APPLICATION

This chapter deals with the procedure that banks use when evaluating applicants for business loans. This is necessary because loans for industrial purposes which this study is concerned about falls into the category of business loan (see Appendix 1).

4.1 ANALYSIS OF THE CUSTOMER

The first question asked is whether the firm applying for the business loan is already a customer of this bank. If it is the process continues on the main flow, (see Appendix 1), otherwise, it branches to evaluate the potential to be expected from establishing a customer relationship (section B).

Next, assuming that the loan application follows the main flow, the firms general reputation as a customer at that bank is considered. This is a comprehensive evaluation which depends partly on the banks experience with the firm on previous loans, partly on the history of the firm's disposal balances in the bank and partly on the banks past experiences with the firm in other ways.

The general evaluation factor can assume any one of the values on a three-point rating scale, excellent account, satisfactory account and questionable account.

The answer to the question, 'Is an extensive credit check

on the firm required?' depends on the comprehensive evaluation of the firm as a bank customer, If the bank considers the firm to be an excellent account, it will always forego making an extensive credit investigation. If the bank regards the firm as a questionable account, it will always make a detailed credit evaluation of the firm in relation to the proposed loan. If the bank feels that the firm is a satisfactory account, then it will make an extensive credit evaluation only in periods of "tight money".

Any one of three different exists from section 'A' are possible. If the firm is not presently a customer of the bank, section 'B' is entered. If a credit investigation of the firm in relation to the proposed loan is required, section 'C' is entered, otherwise, the exit from section 'A' is directly to section 'D'.

Before presenting a detailed description of section 'B' through 'H', the remainder of the flows shown in Figure 1 will be briefly examined. Every business loan application is processed through section 'D', where checks are made to ensure that the proposed loan does not violate any legal requirements or bank policy requirements. If any loan application is found to be infeasible as a result of these checks, then the reasons why this loan cannot be granted are recorded and no further processing is done on this application.

Answers to five questions are analysed in section 'E'. For

and for the bank's files. This terminates the actual processing on a business loan application.

4.1.2 EVALUATION OF A NEW CUSTOMER RELATIONSHIP

If a business loan applicant is not currently a customer of the bank, the loan officer tries to answer the following four questions in forming his recommendations:[2]

1) Is this firm a sound credit risk?
2) Will this firm become a regular bank customer?
3) Will a customer relationship with this firm "build" the bank?
4) Will a customer relationship with this firm be profitable?

Whether a potential new bank customer is a sound credit risk depends upon the same factors which determine whether a present customer is a sound credit risk. Therefore procedures precisely analogous to those used in section 'C' to evaluate the credit worthiness of a firm in relation to the proposed loan are also employed in section 'B'.

4.2 CREDIT EVALUATION

An evaluation of a firm's credit worthiness in relation to a particular loan application is made in section 'C' whenever an extensive credit investigation is needed for an existing bank customer or whenever a loan for a new customer to the bank is

what purpose or purposes does the firm want the loan? What is the proposed amount of the loan? Is the loan a seasonal or term loan, and what is its proposed maturity? Will the firm be able to repay the loan? Is any security being offered against the loan? The answers to these five questions are first considered independently, and finally together, in order to determine whether the loan should in principle be made. If the loan is recommended, it continues on the main flow to section 'F'. Otherwise, the reasons why this loan is not recommended are recorded and no further processing is done on this application.

In section 'F' the results of all the preceding anayses are resolved into a set of detailed recommendations regarding the terms of the business loan agreement. These include recommendations as to the amount and maturity of the loan, the interest rate, the repayment schedule, the provisions for security and the appropriate restructure convenants. If the amount of the loan is greater than the bank's legal loan limit, then other banks must be invited to participate in the loan. At this stage, recommendations are also made concerning the degree of follow-up and review required by the loan.

Section 'G' consists of relatively simple recording and filing processes in which the results of the analysis and the details of the loan recommendation or the reasons why the application should be reduced are summarized for communication to appropriate people

being considered. In practice, 'there are several different degrees of credit investigation undertaken by banks, depending on the firm general reputation, the amount of the loan, the purpose of the loan, its maturity and repayment schedule, and the extent to which security is offered".[3] Efforts are made to weigh the perceived benefits of obtaining further information and performing more extensive analysis against the costs of obtaining them. Scales and scoring systems are employed. An overall credit rating , S_1 is derived from three subsidiary factors:

1) A rating of management competence, F_1
2) An outside credit rating, F_2
3) A rating based on the results of the bank financial analysis, F_3

One additional factor, F_4 is carried passively through the program to call the loan officers attention to any special features such as a labour difficulties or pending law suits. The existence of such special features may also result in a higher interest rate being charged for the loan.

1) The Rating of management competence. This depends on considerations as

a) The ability of the firms management to recognise change and take appropriate action.

b) The extent of formal planning in the firm, partially indicated by the existence of regular forecasts, budgets and product analysis programmes.

c) Marketing trends in the industry, indicating whether the firm is holding its own, getting ahead or shipping behind a competition.

d) The relation of the firm's present product lines to products offered by other firms in the industry.

e) The extent to which the firm's management has succeeded in the past in getting improvements made within the organisation and in meeting competition.

f) "The management's overall standards of the firm which for a publicly held Corporation is partly reflected in the behaviour of its stock price relative to the market as a whole".[4]

2) An outside credit rating:- Nigeria banks do not use outside credit ratings, instead they analyse the firm's financial statements in order to reach a decision.

3) Financial Analysis:- Here the general statements of the firm is analysed. This includes the income statements, cash flow, balance sheet etc. This helps the bank in arriving at a decision as to grant the loan or reject it.

4.2.1 LEGAL AND POLICY REQUIREMENTS

At the start of section 'D', the amount of the proposed loan is checked against the banks legal loan limit, which is established by bank regulating authorities i.e. the Central Bank.

4.3 APPRAISAL OF THE LOANS PURPOSE, AMOUNT, MATURITY PAYBACK AND SECURITY

Loan applications which are not infeasible are processed through section 'E' where answers to five questions are analysed.

1.) For what purpose will the loan funds to used by the firm?

2) What is the proposed amount of the loan?

3) What is the proposed maturity of the loan?

4) What is the proposed repayment schedule of the loan?

5) What security is offered to the bank in connection with the loan?

It is important for the bank to know the purpose for which the loan is requested to ascertain that the indicated reason will be acceptable to the bank examining authorities. A classification of the purposes for business loan would be:

a) Plant and Equipment, primarily for increased capacity
b) Plant and Equipment, primarily for increased efficiency
c) Investment in a subsidiary or an affiliate
d) Others.

4.3.1 DETAILED RECOMMENDATIONS

The entry of a loan application into section 'F' indicates that a preliminary recommendation to grant the loan has been made (although possibly on a fully secured basis only). The details

of the proposed loan agreement must be developed on the basis of the earlier analyses. After these details have been specified the loan officer will review them before reaching his final decision.

Almost every business loan agreement contains certain standard types of convenants. Some examples of these say, in effect:

a) Continue to provide quarterly operating statements and annual reports.

b) Undertake no more than a specified amount of capital expenditures annually.

c) Agree to no other term loans.

d) Agree to no mergers or consolidations.

e) Keep working capital at its correct level (or at certain stipulated stepped levels) for the duration of the loan.

f) Do not increase the dividend rate for the duration of the loan.

4.4 FOLLOW-UP AND REVIEW

The follow-up and review that banks perform on loans to business firms seems to be determined by the following factors:

a) The amount of the loan relative to the firm's total asset.

b) The amount of the loan relative to the bank's legal loan limit.

c) The extent to which the industry has exhibited growth and stability in earnings.

d) The extent to which forecasts made by firms in the industry have proved to be reliable.

This section is essential in determining and maintaining several key items of information used in processing subsequent applications. These include: Payment Performance on Previous Loans, Project experience on Previous Loans (e.g. construction and utilization of new plant and equipment) quality fo forecasts; and general reputation factor.

In addition, periodic review procedures are used to spot unfavourable trends which may require action on the outstanding loans, special attention is paid to the first twelve months after the purpose of the funds is fully accomplished (e.g. when the new facilities can be used for full production, in case the loan was used to finance the construction of new plant).[5]

The average deposit level of the firm is closely observed for all business customers, not only for those with loans outstanding. The firms deposit relationship, i.e. the average size of its balances, very much influences the size of future loans the bank is willing to grant the firm, as well as the general reputation factor the firm has in the bank.

This chapter dealt with the procedures that banks use when evaluating applicants for business loans. Although credit

considerations alone do not determine whether a bank will make a particular loan to a business firm, it is possible to separate the credit evaluation process from the rest of the loan decision. As indicated earlier on, seveal factors including the existence of a customer relationship, the deposit and loan history of the customer and expectations and future profitability are also important.[6]

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CHAPTER 5

LOAN SYNDICATION

5.1 DEFITION

Consortium lending means a loan granted by a consortium of lenders. The Oxford Advanced Learners' Dictionary of current English defines consortium as "a temporary cooperation of a number of powers, companies, banks etc. for a common purpose".[1] Consortium lending therefore takes place when a number of lenders cooperate to grant a loan to a single borrower.

The word Consortium is synonymous with the word syndicate. A syndicate means a combination of commercial firms associated to forward a common interest. Just as we have consortium lending so also do we have syndicated loans. The two terms or phrases are used inter-changeably in the trade. In fact, the term syndicated loan is becoming more current than consortium lending these days.

Loan syndication can be regarded as a process whereby institutions share risks and handle a number of large loans. Three conditions must be fulfilled before a loan can qualify as a syndicated loan via:-

a) The loan must be provided by a number of institutions. In the Nigerian context, the regulation stipulates that there must be at least three lending institutions -

b) The loan must be to a single borrower and the facility be governed by a single loan contract.

c) In the Nigerian context, the amount of the loan must not be less than ₦2.0 million.

A situation where a number of banks grant a particular company loans, independent of each other, the financing arrangement cannot be called a loan syndication, even if, the amount is more than ₦2 million, and all the loans have a common purpose.

Consortium lending takes place when three or more lending institutions grant a single borrower an amount not less than ₦2 million to carry out a common purpose. The lending by all the institutions will be seen as a single transaction, which will be governed by a single enabling deed. All the lenders will have equal rights and duties in the transaction in proportion with the amount of their commitments.

5.2 LOAN SYNDICATION IN NIGERIA

The process of loan syndication as a banking activity evolved when loan requests from clients became overwhelmingly too large for a single bank to handle. This arose as the economy witnessed increased commercial activity. Syndication provided the means for handling large loan requests that would be financially unsound or impossible for one bank to take up. The banks cooperated to accomodate the request thereby sharing the risk.

In Nigeria, the need for syndication arose in the 1970s as an aftermath of the oil boom, which helped to increase the tempo

of economic activity in the country. The banks began to receive large loan requests from companies for the establishment of new factories or the expansion of the existing ones.[1] The increased economic activity also affected the real estate market as the demand for office accomodation in the big cities increased many folds. Because of shortage of office accomodation in the big cities, companies and real estate developers embarked upon gigantic housing schemes for office accomodation. The funds required for these projects were often in excess of what a single bank can reasonably provide, and as a result, banks pooled their resources together in the form of loan syndication to accomodate such requests. Other background factors that contributed to the emergence of consortium lending in the Nigerian scene are as follows:-

a) Low Capitalizations of the Banks

Until very recently, most of the banks were heavily under-capitalized. This is because the paid-up share capital requirements for the establishment of banks in Nigeria was very low. The 1969 Banking Decree made the paid-up share capital requirements for setting up commercial banks at ₦1.5 million, while the 1979 Banking Amendment Decree made that of merchant banks ₦2.0 million. This made lending of substantial amounts to a single borrower very risky and financially imprudent as most of the banks have very thin capital base.

b) Lending Limitod

The banks have lending limit set by the banking decree. The decree stipulates the maximum amount a commercial or merchant bank can lend to a single borrower. A commercial banks is not allowed to lend more than 33⅓% of its adjusted capital (paid-up capital plust statutory reserves) to a single borrower, while the limit for a merchant bank is 100% of its adjusted capital. Requests in excess of the lending limit have to be rejected or financed via loan syndication.

5.3 TYPES OF LOAN SYNDICATION

There are three different ways of accomplishing a loan syndication exercise viz:-

a) The Straight Syndication Methods:

Here, the bank originating the syndication, called the lead-manager structures the package for the borrower without committing for itself the whole amount of the loan. It rather forms a syndicate of lenders to provide the facility.

b) The Club Loan Syndication:

This is more of a variation of the straight syndication method. Here, a borrower that considers itself to be of great credit rating and reputation in the financial circles, structures the loan package and arranges the loan by inviting banks on its own to participate in the facility. It will simply appoint an agent bank to coordinate the participating banks.

c) The Participating Method:

Here, the originating bank structures the loan package and commits singly the total loan amount to the borrower. It will subsequently offer participation in the loan package to other banks. The originating bank in this situation is called the lead-bank.[3]

The most popular syndication method in this country to date is the straight syndication method and in fact, all known syndications in the country to date have been by the straight method. The club loan syndication method has never taken place here in the real sense of the term. Companies with high credit rating only come in to assist the marketing effort of their lead manager during syndication process. They do this by beckoning on their friendly bankers to participate in the syndication arrangement.

5.3.1 DOMESTIC AND INTERNATIONAL SYNDICATION SECTORS

The domestic syndication sector is different from the international syndication sector. In the domestic syndication sector, the loan package is arranged in the local currency for a local company. The participants in the syndication are all local bankers. In the international syndication, the loan package is arranged for a borrower by banks in different countries, and the facility may not be in the currency of the borrower. A good example of the International Syndication Sector is the syndication arranged in the Euro-money market. The Foreign

Exchange Control Act at present, precludes banks in Nigeria from participating in the International Syndication Market.

5.4 LOAN SYNDICATION PROCEDURE

a) LOAN OFFER:- A potential loan syndication situation is identified and decision as to whether it should be pursued. The identification and decision will involve the assessment of the viability of the project, the credit worthiness of the client and marketability of the loan proposal. Assessment of the marketability of the loan may entail pre-syndication sounding out of the other banks on the deal. Recent performance of similar deals in the market can also provide a guide.

A loan proposal, called a loan offer, is made by the bank to the borrower. This will contain the terms and conditions under which the bank will handle the syndication. It will include the terms and conditions of the loan, the fees, and the costs to be incurred in the exercise.[4]

The details of the loan offer is arrived at, after several discussions with the client, thus invariably, the client will have an idea of its content.

b) MANDATE LETTER:- The client on reipt of the loan offer, studies it and if found acceptable, issues the mandate letter, authorizing the bank to handle the syndication on its behalf.

c) CONFIDENTIAL INFORMATION MEMORANDUM:- The bank, in

conjunctuion with the borrower, prepares the confidential information memorandum. The information memorandum will constitute the basis for the participation of prospective lenders in the syndication.

The confidential information memorandum will contain information on the following:-

1) The Borrower
2) The Projects to be financed
3) The parties involved in the implementation of the project such as the contractor, the technical partners etc.
4) The terms and conditions of the credit being arranged, and
5) The records of past performance of the company and the financial projections of the company.

The data required for the preparation of the information memorandum will be supplied by the client, who will acept responsibility for all information contained in the document. The originating bank will shield itself by inserting a disclaimer in the document, indicating that the client has responsibility for correctness and accuracy of the information contained in the recommendation. The above notwithstanding, the lead-manager must endeavour to ensure that the information stated in the document is correct.

b) MARKETING OF THE LOAN PACKAGE:- During the pre-syndication sounding out, the lead-manager will determine the

banks that are likely to be interested in the loan. Copies of information memorandum are sent mainly to such interested banks. The letters inviting the banks to participate in the syndication will normally give a time frame within which the banks have to commit themselves to participate on the syndication. Interested banks commit themselves by sending letters of commitment indicating the amount of their participation. There may be need to follow-up the invitation letters with market calls.[5]

e) ALLOCATION STRATEGY:- At the close of the syndication it may be discovered that the package is either over-subscribed or under-subscribed. In the event of over-subscription, a strategy will be worked out to bring down the level of participation of the banks to the size of the package. The commitment of the banks may be scaled down on pre-rate basis or an agreeable method may be worked out for the allocation of the commitments of the banks. In the case of under-subscription, the lead-manager will double its efforts to get the funds in place.

f) SYNDICATION MEETING:- When the funds are in place, a meeting of all intending participants may be called upon to discuss the following points:

a) Allocation of the level of participation of the banks.

b) Resolution of the issues on which the banks might have had some some differences, such as interest rates and security arrangement.

g) JOINT OFFER LETTER:- The joint offer letter is a letter addressed to the clients by the syndicate and it contains the terms and conditions under which the syndicate is providing the loan. It is prepared by the lead-manager for the execution of all the participating institutions after which it is delivered to the client for acceptance.

h) LOAN DOCUMENTATION:- The lead-manager appoints the solicitors or the special counsel to prepare the credit documents. The solicitors so appointed must be experienced enough to assure the lending banks that the documents are valid, complete and protective enough. The credit documents to be prepared, in addition to the loan agreement and inter-lender agreement may include the following:-

i) Debenture Trust Deed
ii) The Deed of Guarantee, and
iii) Other legal documents.

The solicitors may also have to conduct a legal review of the transactions under the governing law.

The draft credit document will be circulated to the borrower and the lending institutions for their comments before engrossment. The legal advisers of the lending banks may have to meet to resolve some of the issues.

The loan agreement is then signed and this brings and end to the closing procedure of the syndication. The duties of the

lead-manager ends here and it is paid off, while the duties of the agent bank commences here. What remains in the arrangement, is the administration of the loan by the agent bank.

5.4.1 PARTIES INVOLVED IN SYNDICATION AND THEIR DUTIES

With the exception of the borrower, (the guarantor as the case may be) and the solicitors the following are the parties involved in a loan syndication arrangement:-

- The lead-manager
- The agent bank
- The participants

In a large and complicated syndication co-managers may be appointed to assist the lead-manager in the placement of the facility. Responsibilities will be divided amongst them co-managers are hardly used in Nigeria, because the size of the loan packages and the geographical location of the bansk make their use not very necessary. Banks do obtain, at times, joint mandates to co-lead a syndication. This happens, especially where two banks that have relationship with the borrower vie for the mandate. The borrower, in order to maintain good business relationship with the bank may appoint both of them as co-leaders.

THE AGENT BANK:- The agent bank is the administrator of the credit and its duties began after the signing of the loan agreement. More often than not, the lead-manager is also the agent bank, but at times, one of the lending banks may be chosen to perform that role. The duties of the agent bank are as follows:-

a) Checks that the documents submitted on the face of it (prime-facie) match with the requirements of the condition precedent to draw-down as stated in the loan agreement.

b) Receives the draw-down request.

c) Issues notices of draw-down to participants and collects monies for onward payment to the borrower.

d) Sets interest rates by the agreed formular.

e) Collects and distributes interest payment and capital repayment to the banks.

f) Checks the security values and isurance and,

g) Collects and distributes any information called for in the loan agreement such as audited accounts, management accounts etc.

In addition to the above routine duties, the agent bank also carries out the following functions:-

a) Gives notices, in respect of problems, when the agent bank has actual knowledge of such problems.

b) Carries out instructions from the lenders to protect lenders interests in accordance with the terms of the loan agreement.

c) Appoint lawyers, accountants and other exports whose services may be required during the course of the loan with the consent of the lenders.

d) Takes actions specifically required in accordance with

the terms of the loan agreement.

e) Ascertains that the convenants are complied with.

The functions of the agent bank end when the loan is fully repaid.

THE LENDING INSTITUTIONS:- The lending institutions are the members of the syndicate. They become participants in the syndication arrangement by giving their commitments to the lead-manager. This is formalized through the execution of the loan agreement. The rights and obligations of the lending institutions are confined to those laid down in the loan agreement. The lending institutions may be banks or other financial institutions such as insurance companies and pension funds.

RELATIONSHIP AMONG THE PARTIES:- The lead-manager is appointed by the borrowed and is responsible to the borrower. It tries as much as possible to protect the interest of the borrower especially while negotiating the terms and conditions of the credit with the participants.

The agent bank is the agent of the lenders but is paid by the borrower. It obtains its powers from the inter-lenders agreement and tries as much as possible to protect the interest of the lenders throughout the duration of the loan. The participating banks relate to the borrower through the agent bank and vice versa. This helps to forestall any of the lenders being given preferential treatment by the borrower.

5.5 ORGANISATION OF A BANK FOR A SYNDICATION ASSIGNMENT

The following arrangement is recommended when a bank is handling a syndicate assignment:

1) SYNDICATION TEAM:- It is often recommended that a syndication team under the control of a syndication manager may be formed at the beginning of the syndication to handle the assignment. Each member will be responsible for a specific task and report to the syndication manager. The duties could be assigned as follows:-

TEAM MEMBER 'A' will

- Handle preparation of the confidential information memorandum.
- Make market calls and follow-up with the banks for their commitment.
- Run the books.

TEAM MEMBER 'B' will

- Follow-up with the solicitors on the loan documentation.
- Handle the signing ceremony.

2) HOLDING OF DAILY MEETING: It is advisable for the syndication team to meet daily under the syndication manager to review the progress of the syndication effort. Each team member where appropriate will give a report showing latest development and specific problems which require special attention.

3) SYNDICATION TIME TABLE:- At the beginning of the

assignment, the syndication manager will prepare a time table and this will be up-dated and amended to reflect progress made.

In some banks syndicated loans are handled by the corporate finance department, while in others, they are handled by the advances department or credit department.

FEES AND COSTS:

The syndication exercise is not carried out for the borrower free of costs and expenses. For their services in the exercise, the lead-manager and the agent bank are paid for.

The normal fees and costs incurred in a loan syndication arrangements are as follows:-

a) Management Fee:- This is usually upfront on the total amount of the loan, upon or shortly after, signing of the loan agreement. The central bank of Nigeria bankers tariff for now stipulates the maximum amount payable by a client as management fee. It is at present ½% of total funds raised.

b) Agency Fee:- The agent bank is paid an annual fee for the administration of the loan until it is fully repaid. The bankers tariff also stipulates the maximum amount payable and it is at present ₦5,000 per annum.

c) Reimbursable Expense:- The borrower will usually have to agree with the lead-manager to reimbuse it for all expenses and costs incurred on its behalf in handling the syndication. This will include the printing, legal, travel, advertising

expenses and other out of pocket expenses incurred by the lead-manager. It will also reimburse the agent bank all expenses it incurs in the administration of the loan. The above fees and expenses are payable in addition to interest payment and commitment fees on the loan.

5.5.1 SYNDICATION BY MERCHANT BANKS IN NIGERIA

For the purpose of this study, the writer is going to concentrate on syndications lead by ICON Merchant Bank as it was the only merchant bank that was able to give details of syndications lead by it to the writer. The syndicated loan consisted of term loans and overdrafts to meet the requirements of their various clients.

The first recorded term loan syndication in Nigeria was arranged by ICON Merchant Bank in November 1976 totalling ₦4 million on behalf of Pan Ocean. As at July 1984 the total member of consortiums arranged by the bank has risen to about 20 and total amount put in the region of ₦239.718 million.

TABLE 5.1

LIST OF SYNDICATED LOANS LED BY ICON MERCHANT BANK FROM 1974-84

	COMPANY	YEAR	₦'m TERM LOAN	₦'m OVER-DRAFT	₦'m TOTAL	PURPOSE
1.	Pan Ocean, Lagos	1976	4.0	-	4.0	To meeting working capital requirements
2.	Mainline Tans-Transport, Kano	1977	3.578	-	3.578	To finance purchase of trade fleet
3.	Anambra Motor Company Anamco	1978	12	41.0	53.0	Construction of fixed assets e.g. Assembly Plant
4.	Leyland, Ibadan	1979	4.3	-	4.3	Construction of a plant.
5.	Agbara estate, Lagos	1980	7.0	-	7.0	Development of infrastructures for Agbara estate
6.	Drinco Industires Limited, Kaduna	1980	3.675	-	3.675	Construction of Factory
7.	Norjuice, Kano	1980	0.8	0.4	1.2	Construction of factory & working capital
8.	Benro Packaging Lagos	1980	1.9	1.2	3.1	Finance fixed assets etc.
9.	Berva Cement	1980	20	-	20	Fixed assets construction
10.	National Travels Kano	1981	12.0	31.0	43.0	Asset construction
11.	Diamond Breweries Anambra	1981	12.0	3.5	15.5	Finance plant and machinery for brewery product
12.	Pabod Breweries Rivers State	1981	5.0	2.5	7.5	Finance plant and machinery for brewery project

	COMPANY	YEAR	N'm TERM LOAN	N'm OVER-DRAFT	N'm TOTAL	PURPOSE
13.	Unitex Ltd., Kaduna	1981	10.0	2.4	12.4	Acquisition of fixed assets
14.	Lagos Chamger of Commerce	1982	2.5	-	2.5	Construction of Commerce house
15.	Nigerhin: Lagos	1982	3.7	2.14	5.8	Financing Capital expenditure
16.	Premier Metals Ondo	1982	1.5	0.5	2.0	Finance capital expenditure
17.	Soboyejo Farms, Lagos	1983	3.6	-	3.6	Acquisition of fixed assets and working capital
18.	Nigerian Newsprint Cross Rivers	1983	11.5	-	11.5	Construction of infrastructural facilities
19.	Cross Rivers Breweries	1984	16.55	-	16.55	Expansion purpose
20.	Tempo mills Anambra State	1984	83	5.20	13.50	Expansion purpose
			149.878	89.84	239.718	

SOURCE: ICON Merchant Bank publication.

SYNDICATED LOANS

PAN OCEAN (NIG.) LTD. — ₦10 million

BANKS	PERCENTAGE	TERM LOANS (₦)
ICON	25.0	2,500,000
IBWA	16.7	1,670,000
NBN	16.7	1,670,000
CMB	16.7	1,670,000
CBN	16.7	1,670,00
WEMA	8.3	829,000

AWAMMCO (NIG.) LITD. — ₦53.0 Million

BANKS	PERCENTAGE	₦'m TERM LOAN	₦'m OVERDRAFT	₦'m TOTAL
ICON	9.4	0.6	4.4	5.0
UBN	18.8	2.7	7.3	10.0
FBN	24.5	2.7	10.3	13.0
NAMB	2.4	0.3	1	1.3
IBWA	14.7	1.6	6.2	7.8
NBN	3.7	0.6	1.4	2.0
UBA	18.8	2.7	7.3	10.0
IMB	7.3	0.8	3.1	3.9

MAINLINE TRANSPORT (1977) — ₦3,578,509

BANKS	PERCENTAGE	TERM LOAN
ICON	19.6	416,896
IBWA	40.0	1,433,193
CMB	25.0	894,628
NAL	11.6	416,896
IMB	11.6	416,896

LEYLAND (1979) ₦4.3 Million

BANKS	PERCENTAGE	TERM LOAN
ICON		1,200,000
SGBN	34.88	1,499,840
FBN	23.26	1,000,100
CMB	13.95	549,850

AGBARA ESTATE (1980) ₦7 million

BANKS	PERCENTAGE	TERM LOAN
ICON	12.86	900,000
UBA	14.28	1,000,000
UBN	28.57	2,000,000
BCCI	14.28	1,000,000
FBN	30.0	2,100,000

BENRO PACKAGING (1980) ₦3 million

BANKS	PERCENTATE	TERM LOAN	OVERDRAFT	TOTAL
ICON	38.71	800,000	400,000	1,200,000
UBA	61.29	1,100,000	800,000	1,900,000

BENVE CEMENT (1980) ₦20 million

BANKS	PERCENTAGE	TERM LOAN
ICON	7.5	1,500,000
UBN	35.43	7,086,000
FBN	26.035	5,207,000
CMB	5.0	1,000,000
UBA	26.035	5,207,000

NATIONALTRUCKS (1981) ₦43 million

BANKS	PERCENTAGE	TERM LOAN	OVERDRAFT	TOTAL
ICON	6.06	727,200	1,879,000	2,606,200
SCBN	6.06	727,200	1,879,000	2,606,200
UBA	24.24	2,908,500	7,516,000	10,422,800
FBN	15.15	1,818,000	4,697,000	6,515,000
UBN	12.12	1,454,400	3,757,000	5,211,400
BON	12.12	1,454,400	3,757,000	5,211,400
SBN	9.09	1,090,800	2,818,000	3,908,800
IBWA	9.09	1,090,800	2,818,000	3,908, 00
NBN	6.06	727,200	1,879,000	2,606,200

DIAMOND BREWERIES (1981) ₦15.5 million

BANKS	PERCENTAGE	TERM LOAN	OVERDRAFT	TOTAL
ICON	7.10	851,610	248,390	1,100,000
FBN	29.35	3,522,580	1,027,420	4,550,000
UBN	29.35	3,522,580	1,027,420	4,550,000
UBA	24.52	2,941,940	858,060	3,800,000
NBN	9.67	1,161,290	338,710	1,500,000

PABOD BREWERIES (1981) ₦7.5 million

BANKS	PERCENTAGE	TERM LOAN	OVERDRAFT	TOTAL
ICON	20.0	1,000,000	500,000	1,500,000
UBN	33.3	1,666,666	833,334	2,500,000
NBN	20.0	1,000,000	500,000	1,520,000
IMB	13.3	666,667	333,333	1,000,000
ACB	13.3	666,667	333,333	1,000,000

SOBOYEJO FARMS (1983 ₦3.6 million

BANKS	PERCENTAGE	TERM LOAN
ICON	58.33	2,100,000
UBA	41.67	1,500,000

DRINCO INDUSTRIES LIMITED (1980) ₦3.65 million

BANKS	PERCENTAGE	TERM LOAN
ICON	28.96	1,057,200
NAMB	32.30	1,178,800
UBA	38.74	1,414,000

NORJUICE AND MILK INDUSTRIES LTD. (1980) ₦1.2 million

BANKS	PERCENTAGE	TERM LOAN	OVERDRAFT	TOTAL
ICON	41.67	400,000	100,000	500,000
BCCI	58.33	400,000	300,000	700,000

NIGERIAN NEWSPRINT MANUFACTURING CO. LTD. (1983) ₦11.5 million

BANKS	PERCENTAGE	TERM LOAN
ACB	46.09	5,300,000
ALLIED	26.09	3,000,000
NBN	10.43	1,200,000
ICON	17.39	2,000,000

In all 21 banks have been involved in about 20 consortiums. Of the total of ₦239.718 million syndicate loans organised by ICON 1976 - 1984 on behalf of various companies, the sum of ₦41.46 million or 17.29% came from ICON Limited. Overall of the total amount UBA ranked first with ₦44.543 million or 18.58% in terms of financial commitment. This was closely followed by INCON (2nd), FBN (3rd), UBN (4th) with commitments of ₦42.46 million (17.71%), ₦36.072 million (15.04%), ₦35.047 million (14.62%) respectively. The last being NMB with ₦0.5 million or 0.21%.

Out of the total amount of ₦239.718 million, ₦149.878 million or 62.5% was for term loan and ₦89.84 million or 37.5% was for overdraft. Also of the total of ₦42.46 million from ICON, the sum of ₦31.78 million was term loan while ₦10.68 was overdraft.

It can be seen therefore that ICON Merchant Bank has contributed financially to projects which have a direct impact on the social upliftment and welfare of Nigerian citizens.

5.5.2 IMPACT OF STRUCTURAL ADJUSTMENT PROGRAMME (SAP) ON LOAN SYNDICATION IN NIGERIA

The devaluation of the naira vis-a-vis other currencies which followed the introduction of the foreign exchange market affected the amount of goods the naira can buy. The cost of

implementing projects is now far higher than what it used to be, consequently many of the requests coming to the banks can only be handled through syndication. The above notwithstanding, the scarcity of foreign exchange has affected the implementation of new projects. The country does not produce much of capital goods required as essential inputs in the implementation of new projects. This has dampened the rate at which new projects are introduced and has consequently affected the syndication market. Furthermore, the introduction of the foreign exchange market (FEM) has affected the liquidity position of most of the banks. This has affected the ability of the merchant banks to make substantial loans. This however has motivated the banks to cooperate with each other in meeting the demands of their clients.

Consortium lending as a modern banking practice has contributed to the economic development of this country. A lot of gigantic industrial and commercial projects have been financed through funds raised via syndication. It is one of the specialized merchant banking service that has helped to foster understanding and good relationship among banks in Nigeria.

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CHAPTER 6

CONCLUSION AND RECOMMENDATIONS

6.1 CONCLUSION

Merchant banks have been granted licences in Nigeria so that they may fill the gaps in the economy by adapting their operations to reflect the changing structure of the economy towards increased industrialization. A dynamic economy requires specialist institutions like merchant banks. From the available data presented in this study, we have shown how merchant banks have been unable to meet the central bank guidelines with regards to the sectoral allocation of their loans and advances. The merchant banks have over the years not been able to meet the target allocated to the preferred sector which is the productive sector while the maximum target for the less preferred sector has always been surpassed. Furthermore, the maturity pattern and the repayment patterns of their loans and advances does not augur well for this country which needs longer maturity dates for its industries which are mostly in their infancy. In view of this, the maturity pattern of their loans and advances must change if they are to contribute effectively to the economic development of the nation.

For merchant banks to perform their functions well, there must exist the right regulatory atmosphere as well as incentives to these institutions. Merchant banks must have a different legislative and regulatory laws from other financial institutions

if they are to perform as expected.

In spite of criticisms, merchant banks have made alot of contributions to the development of our financial and economic system. They have through consortium lending as a modern banking practice contributed to the economic development of this country. A lot of gigantic commercial projects have been financed through funds raised through syndication.[1] By performing their specialised functions they have introduced variety to the financial services available to businesses which neither the commercial banks nor the development banks can provide satisfactorily. For example, ICON in the mid 70s pioneered the conceptual evolution of liability management within the banking industry in Nigeria which lead to the introduction of of negotiable certificate of deposits (NCDS) as a money market instrument.[2] Also, the financial market has witnessed a number of companies approaching the stock market to raise finance for expansion or new operations through the specialised services offered by merchant banks. Furthermore, in 1982, International Merchant Banks was appointed financial adviser to the Federal government on the proposed liquified natural gas project

To aid our industrial and agricultural development efforts, merchant banks must increase their equipment leasing activities to meet CBN requirements since finance by leasing is not regarded by the regulatory authorities as loans or advances. By so doing they are also diversifying and increasing their sources of income.

The role of merchant banks change with the economic environment. One is therefore hopeful that as the Nigerian economy improves, more opportunities would arise which would enable these banks to play more effective their specialist role.

6.2 RECOMMENDATIONS

Merchant banks as a group are a recent addition to the Nigerian Financial System. The general expectation has been for merchant banks to play developmental or other specialised financing roles. Everyone believed he knew what merchant banks should do but no one, except perhaps the merchant bankers themselves understood the constraints militating aginst the effective fulfilment of their expected roles. In order to remove these constraints, the following recommendations are suggested:-

1) TERM LENDING REQUIREMENTS:

In the 1987 central bank credit policy guidelines, merchant banks are required to have at least 50% of total loans in maturities of three years or longer and no more than 20% of total loans in maturities of one year or less. These regulations present two problems - Funding and Adequate Return.

FUNDING OF TERM LOANS

Sound banking practice calls for close coordination between assets and liabilities. Therefore, a bank's loans - its major assets - must be supported by deposits - its main liabilities.

Commercial banks in Nigeria have been able through their exclusive branch networks, to develop a large volume of demand deposit and savings accounts, thus creating a large, stable deposit base with which to fund their loans. Merchant banks, on the other hand, have no such deposit base and must rely mainly on the narrow and potentially volatile inter-bank money markets for their deposits. The problem then lies with matching the maturities of such deposits with the maturities of loans. Unfortunately, funds over one year in maturity are difficult to obtain while funds of over two years maturity are virtually non-existnet. 50% of a merchant bank's loans however, are required to have maturities of over three years.

The risks inherent in the mismatch of assets and liabilities portfolios are rather glaring. By placing the majority of their loans in medium term maturities, the merchant banks are subjected to unacceptable liquidity risks inherent in making lont term loans funded by short-term money market deposits. These risks are particular high at present because bank liquidity has shrunk and the surplus funds of the commercial banks which the merchant banks have traditionally relied on to fund their loans may not be available especially in view of the current recession.

In order to be in a position to carry out the goverment's wishes in the term-lending area, merchant banks would need the support of the central bank in their medium term funding. This support is needed both in assuring the continuing availability of

funds and in stabilizing interest rates. It could take the form of a formal guarantee of funding, or preferably, the actual placing of 3 to 5 years deposits with merchant banks at reasonable interest rates say $\frac{1}{9}\%$ over the rate paid by the central bank for funds of such maturities.

2) It should be recognised that the ability to make term loans one a sound banking basis rests with the commercial banks rather than merchant banks, and that a requirement that commercial banks should have 5% of their loans in term loans of 3 years and over would result in greater volume of such loans than requiring merchant banks to have 50% of loans theirin such maturities. In the light of the above, the central bank should relax its guidelines concerning the maturities of merchant banks loan portfolios. As a compromise, the following suggestions is acceptable targets for merchant banks 25% of loans in maturities of three years or longer, 50% of loans in maturities of more than one year but less than three years, and 25% of loans in maturities of one year or less.[3]

3) ADEQUATE RETURN ON TERM LOANS

One of the basic tenets of lending is that term loans for the same class of customer carry higher interest rates than do short term loans. The cost of medium term funding is of course higher than the cost of short-term funding, but also the risk in term lending is greater than the risk in overdraft lending. For

a bank to commut its resources to a company for a number of years is a different more risky exercise from lending money at call. Central bank guidelines do not, however, permit higher interest rates to be charged on preferred sector term loans than as less preferred sector overdrafts. 15% per annum is the maximum in both cases. In order to encourage banks into making more term loans, the central bank should allow them to charge premium interest rates.

4) INTEREST RATE STRUCTURE

One year money formerly costs a minimum of 12 percent on time deposits while on deposits it costs 11%. Merchant banks can hardly fund. Funds beyond this 12 months tenure, yet they are expected to have 50% of their loan book with maturity of over 3 years. They are borrowing short and expected to lend long - a classic prescription for disaster.

On the other hand commercial banks have much lower average cost of funds. Banks with low cost money should be called upon to make longer term loans at low interest rate.

5) RELATING MONETARY POLICIES TO THE OBJECTIVES OF DEVELOPMENT

Promisory notes and other paper arising from loans to such specific preferred sub-sectors as agriculture and residential housing should be eligible for rediscounting. The availability of a rediscounting/discounting facility for the papers will

minimize it not eliminate the funding risks attendant to such credits. Such risks have tended to discourage merchant banks from being as active in these areas as they otherwise could have been. One major advantage of rediscounting preferred sub-sector notes will be to help meet credit allocation objectives of the fiscal and monetary authorities.

6) AGRICULTURAL AND RESIDENTIAL CONSTRUCTION LOANS

Two specific central banks guidelines that are especially difficult for merchant banks to meet are those concerning loans to the Agricultural and Residential Construction sub-sectors. Unlike commercial banks, merchant banks do not have the large number of retail branches which would enable them to develop the knowledge, coverage and contacts essential for a successful appraisal and handling of residential and agricultural loans. These are therefore, sectors of the economy for which merchant banks do not have the expertise, training or capacity.

Agricultural and residential construction lending should therefore be recognised as remaining broadly outside the normal scope of merchant banking activity. Here, in percentage terms, the effect of merchant bank compliance or non-compliance with present guidelines is insignificant.

The best way for government to realise its objectives in accelerating development in these areas will be by providing proper safeguards and incentives to the banks. One of such

incentives is in the provision of rediscounting facilities.

7) LEASING

Leasing should be an area of considerable opportunity for the merchant banks and certain other financial institutions, if the present tax regulations were revised to make the leasing of capital equipment to industry more attractive. Leasing can flourish only in the presence of a tax environment which allows substantial tax benefits to accrue to the lesser by virtue of his ownership of the equipment in the early years of the lease.

Merchant banks do not meet the annual targets set by central bank with regards to leasing not only because of the negative cash flow effects of capital allowances but the combination of three inter-locking constraints which together make leasing much less attractive than it should be. First, the structure of capital allowances forces leasors to increase their business exponentially to try to escape the negative cash flow effects from the end of the first year to any individual leasing transaction until the equipment is sold (32½% in year one but thereafter only 12½% per annum on a declining balance basis).

Secondly, with few leases running beyond 5 years (because of the funding risk which is the same as for loans), at the end of the leasing period the equipment is only 60% depreciated. The tax authorities are apparently reluctant to allow leasors to seel long lasting equipment at a nominal price to recover the remaining 40% of depreciation at the end of the lease period. By

this refusal, the advantage to both lessor and leasee of leasing (as opposed to arranging a loan and having the owner of the equipment, the borrower, depreciate it at say 20% per annum) is totally annuled. Lastly, because leasors have to increase the value of new leases booked every year if they are to avoid setting up substantial deferred tax reserces on their accounts, they have to ensure that their portfolios grow at a carefully controlled pace, both to avoid over-stepping the central bank of Nigeria limited of 15% of assets and to make sure that they do not eventually face themselves with an unattainable annual leasing target.

It is therefore suggested that a relatively small change in the structure of capital allowances, so that the accumulated cash flow effects in the first three years are positive when compared to normal book depreciation, would undo this log-jam, since it would simultaneously reduce the residential value at the end of the leasing period thus removing the objection of the tax authorities to a sale at a nominal price and eliminate much of the tread-mill effect created by the struggle to keep the annual Post-tax cash flow of the leasing portfolio positive. It would then be possible for banks to hold their leasing portfolios steady at close to the maximum permitted level of 15% of total assets. At the moment they dare not approach it for fear that the other constraints could force them far over the top.

Accordingly, the following structure for capital allowances will be okey:

50% for the first year, 25% for the second year and another 25% for the third year. This will allow a three write-off.

8) Most of the government owned corporations such as Nigerian Airways, Nigerian Railway etc. are supported by government subventions. She do not go to the capital market to raise funds. This blocks merchant bank's avenue for increased corporate finance activities as these corporations will need the services of merchant banks if government will allow them to raise funds in the capital market. In view of this, government should stop the subvention and allow them to raise funds for themselves from wherever possible.

9) Nigerian industrialist and would-be clients of merchant banks should be enlightneed on the importance and benefits of syndicate lending which among other things the ability to raise larger amounts through a syndicate than through a series of individual loans or from one bank, once and for all explanation of financial condition and requirements, negotiating one agreement, pay one legal fees, availability of an export to market their loan and present their credit and ultimately puts their names into the market and so do not compromise their ability to borrow at future period.

Because of the present liquidity squeeze merchant banks should as a matter of policy be more involved in syndicate lending for by this, they will be able to spread their risk avoiding too much exposure to any single borrower or project and lending to a wider spectrum of different borrowers than they could fund single handedly.

10) MARKETING OF SERVICES

Little is known about the services that can be offered by merchant banks to enterprises and entrepreneurs. This could be due to the few number of branches these merchant banks have. In view of this merchant bank should as a matter of urgency engage in serious public relations of their services either through distribution of free copies of their brochure, advertisements on TVs, Radios, and newspapers. By so doing they would not only be exposed to more opportunities to serve clients but also broadening their revenue base. Above all, the public will better appreciate their role in the economic development of the country.

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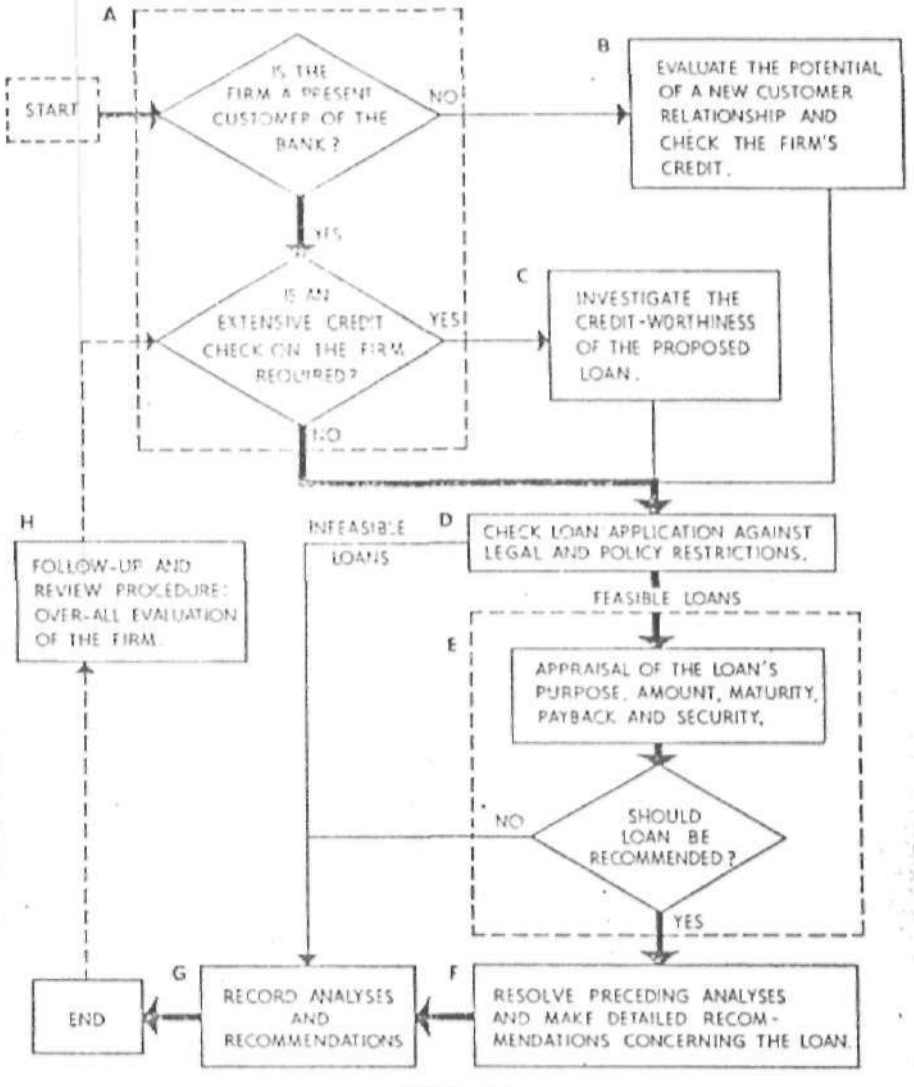


FIGURE 1

BANK PROCEDURES FOR ANALYZING BUSINESS LOAN APPLICATIONS

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