CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Smalland Medium Enterprises (SMEs) play a vital role in the development of nationaleconomy. Due to their importance and the crucial role they play in economicdevelopment and growth of the nation, much attention has been placed onfinancing of small and medium enterprises, since they are major contributors tothe economy of Nigeria. These enterprises are drivers of the economy; thereforepolicy attention has to be given to them especially in developing economies becauseof their impact on many sectors of the economy. Their impact is felt in thefollowing ways: Greater utilization of local raw materials, employmentgeneration, encouragement of rural development, development of entrepreneurship,mobilization of local savings, linkages with bigger industries, provision ofregional balance by spreading investments more evenly, provision of avenue forself employment and provision of opportunity for training managers and semiskilled workers.

In Nigeria, credit has been recognized as anessential tool for promoting small and Micro Enterprises (SMEs), hence the needfor recapitalization of commercial banks in Nigeria. Bank recapitalizationwhich was effective from 2006 is aimed at making Nigerian banks stronger andbetter in-order to finance all sectors of the economy including the majordrivers of the economy-Small and Medium Scale Enterprises. About 70 percent ofthe population is engaged in the informal sector or in agricultural production.The Federal and State governments have recognized that for sustainable growthand development, the financial empowerment of the people is vital. If thisgrowth strategy is adopted and the latent entrepreneurial capabilities of thislarge segment of the people is sufficiently stimulated and sustained, thenpositive multipliers will be felt throughout the economy. To give effect tothese aspirations various policies have been instituted over time by theFederal Government to improve rural and urban enterprise productioncapabilities (Olaitan 2006)

Thecentral Bank of Nigeria on July 6th 2004, announced the recapitalization ofbanking sector from N2 billion to N25 billion with effect from 1st January2006. This was with a view to make the sector internationally competitive,sound and improves its ability to provide credit to

all the productive sectorsof the economy. In order to meet this obligation, banks embarked on strategiesof merger and acquisition, floating of new shares and so on. At the end of the exercise,25 new banks emerged.

Itwas hoped that the consolidation will make the banks stronger to be able toprovide large amount of funds to productive sectors of the economy which islargely dominated by Small and Medium Enterprises, thereby making them growinto large firms with enough resources to contribute to the economicdevelopment.

Also,in December 2005, the CBN introduced new Micro-finance Policy (MFP) which wasdesigned to be public and private sector driven.

Thepurpose of the policy was to strengthen community banks in order for them to beable to grant collateral and non collateral loans to finance microeconomicactivities in the economy. The policy also aims at providing many people withaccess to financial services who otherwise will have no access to theseservices.

Smalland Medium Enterprises as said earlier have a crucial role to play in thedevelopment of an economy, they are training grounds for local entrepreneurs,they encourage local savings and ensure equitable distribution of wealththereby reducing rural- urban migration of human resources.

Tothis end, government should collaborate with private sector in order to createan enabling and conducive environment for SME'S in order to contributepositively towards the development of the economy.

1.2 STATEMENT OF PROBLEM

Bank fraud, poorlending and credit management practices in the Nigerian banking sector forcedthe Central bank of Nigeria to revisit the capital structure of commercialbanks in Nigeria. These among other things led the CentralBank of Nigeria (CBN) to give a directive that all banks should recapitalizefrom N2 billion to N25 billion with effect from 1st January 2006.

This development led to various financialactivities in the Nigerian financial sector with most banks initially optingfor additional source of fund from the capital market via floating of shares.Most banks at this stage started inviting members of the public to acquire newshares in-order to meet up with the new minimum capital directed by the centralbank of Nigeria.

Notwithstanding, some banks were not capable of raising thenew minimum capital by themselves, hence the need for mergers and consolidationof banks, reducing the total number of banks in Nigeria to twenty five (25).

However,the consolidation of the banking sector presented new challenges to the bankswhich require more efforts to control cost and increase their efficiency; thisin turn has effect the volume of credit facilities granted to small and mediumscale enterprises in Nigeria. A study conducted by Iloh et al (2012) revealsthe gap between deposit money bank deposits (DMBD) and commercial bank lendingto SMEs from year 2000 upward (the year that saw the end of merchant banks).There is a wide margin between the two variables and while deposit money bankdeposits rose very high, commercial bank lending to SMEs declined from 2004 to2010. The gap between commercial bank deposits and its lending to SMEs revealsthe shift in focus from lending to SMEs to lending to major investors (customers).One is made to ask, while the banking sector is said to drive any economy, hasNigerian commercial banks neglected SMEs, which is vital for the growth and developmentof the Nigerian economy? Notwithstanding, it is interesting to note that community/Microfinance bank (CMFB) lending to SMEs moved in the same trend with its bankdeposit. This implies that as community/microfinance bank deposits increased,it's lending to SMEs increased. Regardless of the direct impact ofcommunity/microfinance bank on SMEs, SMEs still cry for lack of funding andlending to SMEs in Nigeria is still poor. This is so because their capital,reserve and deposit are very small and insufficient to meet the needs of smalland medium entrepreneurs.

1.3 OBJECTIVES OF STUDY

The primary objective of the study is toexamine the effects of bank recapitalization on small and medium scaleenterprises in Nigeria. Specific objectives of the study are:

1.To determine the relationship between Commercial Banks and theperformance Small Business Entrepreneurs in Nigeria.

2.To determine whether bank recapitalization led to increase infunds for financing SMEs.

3.To examine the accessibility of Small and Medium Enterprise EquityInvestment Scheme (SMEEIS) funds to SMEs.

1.4 RESEARCH QUESTIONS

In-order to achieve the above statedobjectives, the researcher formulated the following research questions:

1.What is the relationship between commercial banks and theperformance small business entrepreneurs in Nigeria?

2.Does bank recapitalization increase funding for SMEs?

3.How accessible are Small and Medium Enterprise Equity InvestmentSchene Funds to SMEs?

1.5 HYPOTHESIS OF THESTUDY

The following hypotheses are formulated inline with the objectives and research questions of the study:

1.Ho: There is no significant relationship between Commercial bankand the performance of Small Business Owners in Nigeria.

Hi: There is asignificant relationship between Commercial banks and the performance of SmallBusiness Owners in Nigeria.

2.Ho: Bank Re-capitalization has not led to the increase of fundsto SMEs

Hi: Bankrecapitalization has led to the increase of Funds to SMEs

3.Ho: Small and Medium Enterprise Equity Investment Scheme fundsare not easily assessable to SMEs

Hi: Small and MediumEnterprise Equity Investment Scheme funds are easily assessable to SMEs

1.6 SIGINIFICANCE OFTHE STUDY

Robust economic growth cannot be achievedwithout putting in place well focused programmes to reduce poverty throughempowering the people by increasing their access to factors of production,especially credit. The latent capacity of the poor entrepreneurs would besignificantly enhanced through the provision of microfinance services to enablethem engage in economic activities and be more self-reliant; increaseemployment opportunities, enhance household income, and create wealth.

However, the lack of required financialsupport from the microfinance banks to Micro Business operators in Port Harcourtstate has become a major concern in Nigeria. Hence, this study shall berelevant to policy makers in the areas of finding out the impact of

microfinancing on the small scale investors. Also, this study shall enhance furtherresearch in the subject area.

1.7 SCOPE OF THE STUDY

Thescope of this research work is the recapitalized commercial banks and their SMEcustomers in Nigeria. However, due to the fact that there are many SME's inNigeria, the research is limited to SME owners in Port Harcourt.

1.8 LIMITATIONS OF THE STUDY

Timeand financial constraints were the major limitations of the study. Since theresearcher could not afford the cost of reaching out to more banks, moneybecame a challenge. The researcher was also engaged in other school activitieswhich also limited the time used for the project.

1.9 DEFINITION OF TERMS

·**Economy**:An economy is the total sum ofproduct and service transactions of value between two agents in a region, be itindividuals, organizations or states. An economy consists of the economic system,comprising the production, distribution or trade,and consumption of limited goodsand services between two agents,the agents can be individuals, businesses, organizations, or governments.

·**Mergersand Acquisitions**: Mergers and acquisitions (abbreviated M&A) is an aspect of corporate strategy, corporate finance andmanagementdealing with the buying, selling, dividing and combining of different companiesand similar entities that can help anenterprise grow rapidly in its sector or location of origin, or a new field ornew location, without creating a subsidiary, other child entity or using ajoint venture.

·**Recapitalization**:Recapitalization is a sort of acorporate reorganization involving substantial change in a company's capital structure.

·**SMEs:**Small and Medium Enterprises

·**SMEEIS:**Small and Medium Enterprise Equity Scheme

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THE EFFECT OF BANK RECAPITALIZATION ON THE PERFORMANCE OF SMALL AND MEDIUM SCALE ENTERPRISES IN NIGERIA