Can Introduction of Collateral Registries for Movable Assets Spur Firms' Access to Credit in Nigeria?

Danjuma Ahmad

Lecturer, Department of Economics, Faculty of Social and Management Sciences, Adamawa State University, Mubi-Nigeria

***Abstract*:-Access to credit remained one of the topmost obstacles to micro small and medium enterprises doing business in Nigeria. Due to the fact that financial institutions basically prefer lending against fixed collateral, most studies in the past look try to look at the impact of fixed collateral assets on access to finance. However, recent studies found that majority of MSMEs keep their assets in movable assets, and as a result there has been a gradual reform on movable assets across many countries of the world based on the advice of World Bank and International Financial Corporation. This study therefore, investigates the prospects and challenges associated with the introduction of collateral reforms on movable asset on firms' access to finance in Nigeria. The result should assist regulators and policy makers to focus on addressing these challenges so as to make the reform a successful one. The study found that lack of physical access to financial institutions, regulatory arbitrage, lack of sound financial education and technical problems are among the factors that constraints the smooth operation of the reform. It therefore recommends that attention should be given to these identified problems in order to make the reform a successful one**

***Keywords:* Movable collateral, Credit constraints, information asymmetry, MSMEs.**

I. INTRODUCTION

Lack of sound financial infrastructure is one of the major problems in the credit market for small and medium enterprises in many countries of the world including Nigeria. Therefore, sound financial infrastructure will help countries to reduce the information asymmetries and uncertainties that increase risk to lenders and constraints the supply of finance to enterprises. Firms in Nigeria, like in many other countries, experiences such problems too. It has been estimated that Nigeria has over 37 million Micro, Small and Medium Enterprises (MSMEs) and their contribution to economic growth and job creation is significant. However, majority of these enterprises could not grow and prosper due to lack of collateral like land and building that they can place to secure credit for investment (World Bank, 2016). Similarly, the World Bank Enterprise Survey conducted in 2014 estimated that, in over 89 percent of the loan application by the firms in Nigeria, banks required a collateral. Empirical evidences also suggest that insufficient collateral is one of the main reason firms are rejected when they apply for bank credit (Fleisig, Safavian, & De La Pena, 2006).

During the last quarter of 2017, the volume of loans to small and medium sized enterprises accounted for only 0.1% of total credit advanced by commercial banks in Nigeria to the private sector (CBN, 2017). This low access to credit was primarily due to the fact that the firms lack credit history, coupled with their inability to provide acceptable collateral, which usually sees them falling short of the underwriting conditions of the banks. It is common knowledge that prior to the enactment of the Secured Transaction in Movable Assets Act in Nigeria, there was no legal framework for the registration and social control of interest in movable assets (such as vehicles, plants and machinery, account receivables, commodities, amongst others). As a result of this, banks over the years emphasized on accepting collateral such as real estate than any other forms of credit guarantee.

Unlike fixed assets, such as land and buildings, moveable assets account for most of capital stock of private firms and comprise significantly large share assets of micro, small and medium-size enterprises. For example, within the developing world seventy-eight percent of the capital stock of companies is often in movable assets, Only twenty-two percent is in immovable assets (Maw, 2018), (de lA CAmpA, Downes, & Hennig, 2012). Hence, movable assets are the main type of collateral that majority of the MSMEs in Nigeria can pledge to obtain bank financing. If banks will be willing not to accept movable assets as collateral due to the inadequate legal and regulatory environment in which banks and firms operates, It then follows that movable assets become "dead capital" (Fleisig et al., 2006).

Basically, collateral registries for movable assets accomplish two key functions. Firstly, it notifies parties about the existence of an interest in movable property (of existing liens), secondly, it establish the priority of creditors vis-a-vis third parties (de lA CAmpA et al., 2012). Therefore, without a well-functioning written record for movable assets, even the simplest secured transactions laws can be ineffective or may be useless (Love, Peria, & Singh, 2016)

In May 2016, the Central Bank of Nigeria in collaboration with the World Bank Group launched a modern online collateral registry. The registry is expected to assist the low-income people and small and medium size entrepreneurs to secure loans against movable assets such as machinery, livestock, and inventory. This is a major achievement and it is expected to improve access to finance for MSMEs and more broadly the financial inclusion agenda of Nigeria. However, the question is; can introduction of collateral registries for movable assets spur credit access by firms in Nigeria? Of course, poor infrastructure, poor legal right and dwindling macroeconomic environment has been earlier identified as major obstacles to financing investment in most of the developing countries and Nigeria in particular. Against this background, this research will investigate the extent to which collateral registry will facilitate access to credit in Nigeria. Therefore, the main objective of this research is to provide a review rather than establishing empirical evidence on the problems and prospect of movable assets as collateral for MSMEs in Nigeria.

Although, research in support of the establishment of credit registries for movable collateral has flourished in recent decades, little or none attempt has been done for Nigeria perhaps, due to unavailability of data. As such, this paper only reviews the prospect of introducing collateral registry for moveable assets on firms' access to finance in Nigeria using firm-level survey retrieved from World bank Enterprise Survey and Central Bank of Nigeria's Credit Survey Reports. And to our knowledge, this is the first paper to investigate the prospect of introducing collateral registries for movable assets on firms' access to finance in Nigeria. The paper is organized as follows; section one covers introduction, followed by literature survey in section two. Section three evaluate on the various legal, regulatory and institutional challenges to MSMEs finance in Nigeria and movable collateral, as well as provides information regarding the effectiveness of the reforms. Section four concludes and makes recommendation.

II. LITERATURE REVIEW: COLLATERAL REQUIREMENT FOR CREDITS AND INFORMATION ASYMMETRY

There are ample number of theoretical literatures that examine the advantages and disadvantages of using collateral to secure loans. Those that favours the use of collateral argued that it enhances the ability of firms to access credit in the capital market, by resolving the agency problems arising from asymmetric information. Asymmetric information is a situation where agents in a market possess information that others do not have. Some of the problems associated with asymmetric information are adverse selection and moral hazards. By adverse selection it means a situation in which at a point of consummating a contract say credit, one party is having information that the other contract party does not have. As a result of this, financial institutions normally demand for collateral when consummating a credit contract with firms, because they have little or no information about the profitability and viability of their clients' businesses.

Stiglitz and Weiss (1981) are among the early scholars that paved way in the theoretical literature favouring collateral as a screening device to reduce adverse selection (Bester, 1985), (Besanko & Thakor, 1987), and as a way of reducing various frictions such as moral hazard (Boot & Thakor, 1994), costly state verification (Gale & Hellwig, 1985), and imperfect contract enforcement (Albuquerque & Hopenhayn, 2004). However, aside these benefits, the use of collateral to secure loan is often blamed for amplifying the business cycle, through the so called "collateral channel" (B. Bernanke & Gertler, 1990), (Kiyotaki & Moore, 1997). If for instance, the values of collateral are appreciating during the expansion phase of the business cycle, credit also boom. On the other hand, if there is depreciation in the value, it weakens both the demand and supply of credit, leading to a deeper recession. The collateral channel is viewed as one of main drivers of the Great Depression (B. S. Bernanke, 1983), and as an important factor behind the 2007-2009 financial crisis in the United States (Mian & Sufi, 2011), (Mian & Sufi, 2014).

Empirical literatures provide important micro-evidence on the impact of collateral on the demand and supply of credit, analysing each individually by holding the other constant. Some research show that increase in the exogenous collateral values enable firms to get access to more and cheaper credit with fairly longer maturities (Benmelech, Garmaise, & Moskowitz, 2005), (Benmelech & Bergman, 2009), while a fall in the value of the collaterals due to exogenous shocks lead to a higher loan rates, tighter credit limits and lower monitoring intensity (Cerqueiro, Ongena, & Roszbach, 2016). Therefore, changes in credit supply are found to have a significant impact on firm decisions, such as investment (Chaney, Sraer, & Thesmar, 2012), (Gan, Ma, & Wu, 2007) and entrepreneurship (Schmalz, Sraer, & Thesmar, 2017). Changes in collateral values are also shown to induce similar and contemporaneous changes in households' consumer demand, which further weakens firms' demand and access to credit (Mian and Sufi 2011), (Mian and Sufi 2014)

However, due to the fact that most firms lack immovable assets like land and buildings to pledge as collateral, many countries through the influence of World Bank and International Finance Corporation, advocate the use of movable collateral as a compliment to immovable collateral for securing credits (Alvarez de la Campa, Wohlers, Barnes, & Simavi, 2010).

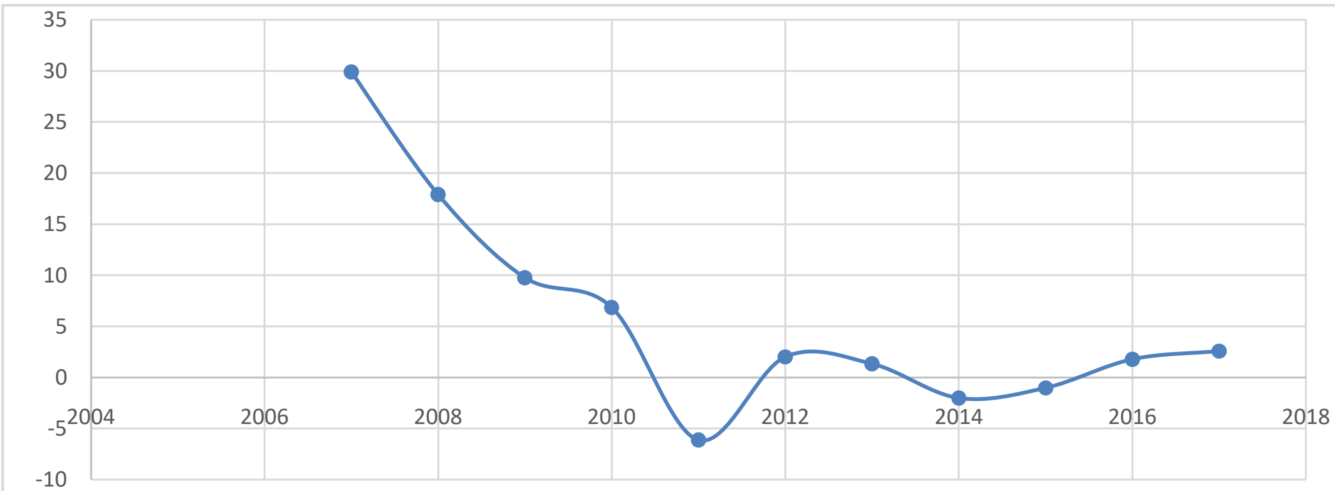
III. METHODOLOGY

The technique employed in this research is a systematic review of published articles including peer-reviewed articles, Working/Technical Papers and selected report from Central Bank of Nigeria as well as from international finance corporation. Relevant information and details from each article were extracted and synthesized. The data synthesis involved both qualitative and descriptive analysis relating and comparing findings from different sources, collating and summarizing the extracted information. The findings of the rest of the studies were organized according to the themes rather than reporting on results of individual studies. Although attempts were made to cover a wide-range of literature, however, only relevant literature pertaining to the study question were exhaustively identified and reviewed.

IV. EVALUATING THE PROSPECTS AND PROBLEMS OF MOVABLE COLLATERAL MARKETS IN NIGERIA

Access to affordable finance remains a critical constraint affecting the ability of many firms to invest efficiently in various production, trading, and marketing projects. Evidence suggests that a significant gap exist particularly in the areas where physical access to financial services is not readily available. Conning and Udry (2007) argued that limited financial services can makes household to forego valuable investment and income generating activities and the consequences of this may lead them to suffer from volatile consumption. This can equally be applicable to rural firms. Fig 1.1 displays the rate at which commercial banks are growing in branches across the various states in Nigeria.

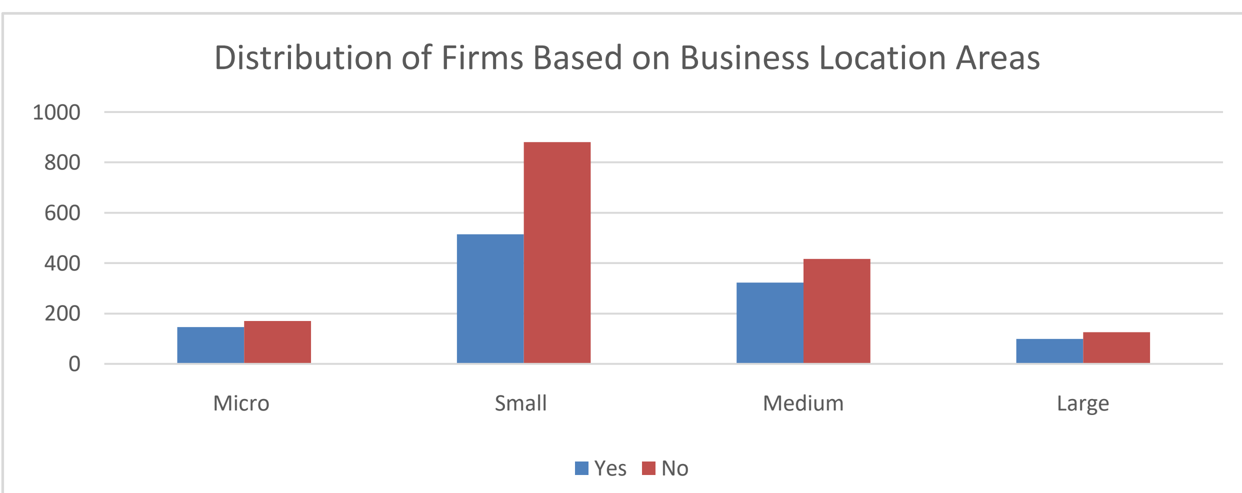
Fig 1.1: Percentage Growth of Commercial Banks Branches in Nigeria 2006-2017



Source: Author's computation from CBN Statistical Bulletin, 2017

Figure 1.1 shows the trend in the growth of commercial banks branches across the 36 states in Nigeria. From 2006 to 2011 there has been a constant decline in the number of commercial banks branches across the country from 29 percent growth rate to 1.3 percent growth rate in 2013. Although, the trend changed with a gradual increase averaging 0.36 percent from 2014 to 2017, however, in majority of the rural areas in the country where these MSMEs are prevalent, it is hard to account for even this insignificant growth. In other words, the expansion in the branches was mainly restricted in the urban centres. This might be enough to deterred the MSMEs with rural base from accessing any line of credit from the commercial banks even though the reform has allowed for the use of movable collateral. The World Bank Enterprise Survey reveal that most of the firms are not located in the business area. Perhaps could the reason why banks do not extend credit to such firms. Figure 1.2 shows the distribution of firms based on business location.

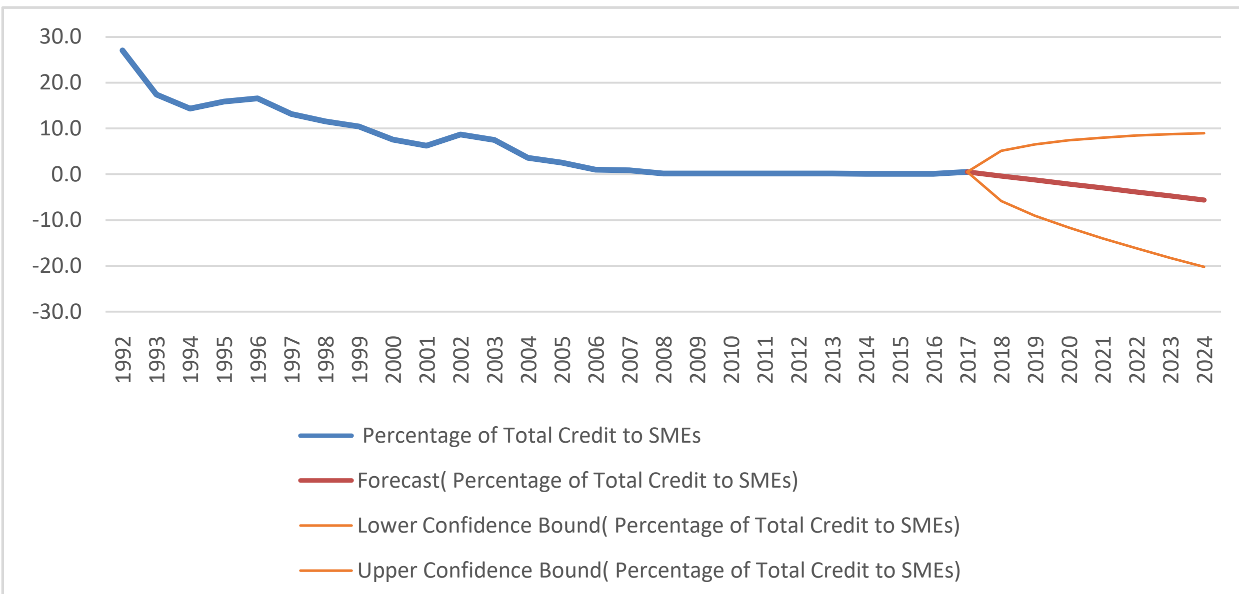
Fig 1.2



Source: World Bank Enterprise Survey, 2014

Another important aspect aside expansion in the physical branches is the rate at which the commercial banks extend credits to MSMEs as compared to large sized firms. Despite the fact that in 2017 the MSMEs contributes nearly 47 percent of the national GDP on average, yet in that same year only 0.1 percent of the total credit offered by formal financial institutions to private sector that goes to MSMEs, signifying that the movable collateral Act is yet to be operational in the country. While at the same time, the unsatisfied credit demand for Nigeria's firms continue to grow over the years (CBN, 2018), leading to a significant gap between demand for, and supply of MSMEs finance. Figure 1.2 shows the actual and projected trend of commercial banks' loan to SMEs in Nigeria. The trend shows that, over the years, the commercial bank loans to SMEs has been constantly declining. For example, in 1992 it was 27 percent, it gradually continued to decline to 10 percent during return to democracy and even with the 2005 banking consolidation the fortune did not changed whatsoever. Therefore, if the situation were to continue on the same pattern, the proportion of loans to SMEs by the year 2022 will fall to negative 4.8 % from 0.1 percent at commencement of the movable collateral Registry Act in 2017. However, the trend can be reverse if regulators provide a levelling playing field where the financial service can be provided to all customers without discrimination. This may, on the other hand, lead to a growth of the loan to 8.4 percent by the year 2022. However, under the presence of regulatory arbitrage, the trend will be worsened off to a further decline growth of about 18 percent.

Fig 1.3 Percentage of Commercial Banks Loan to SMEs in Nigeria



Source: Authors computation from CBN Statistical Bulletin, 2017

Profitability and sustainable growth are key to any business organisation. For banks to be profitable and achieve a sustained growth, revenues must exceed costs of capital and all associated risks of non-payment. However, without an efficient and effective secured transactions and legal framework in place, MSMEs finance will remain out of reach for higher-risk borrowers. The collateral registry reforms of course, allow for the use of movable assets, most banks in Nigeria are sceptical in accepting it for number of reasons. Titilayo (2018) noted that most banks and microfinances in Nigeria do not accept movable collateral mainly due to the risk involved. Therefore, any subsidized MSMEs credit that does not commensurate with long-term strategy for reducing risk of non-payment to lenders might only generate short-term gains but will not address the factors that drive up the cost of capital in the long run.

Another obstacle to MSMEs lending is that most of the firms have shabby financial records. Poor financial record is another key area that can affect successful operation of the collateral reforms. Small sized firms in particular pose a challenge for many financial institutions. It has been found that in most of the situations these MSMEs have only thin or non-existent credit history, insufficient proof of profitability, market fluctuation, and long production cycles which create unique risks for lenders. To mitigate these risks, financial institutions often require collateral which both serves as an incentive for repayment by the borrower, as well as a source of value to offset losses in the event of a default. Real property remains the favoured collateral among financial institutions, yet this practice posed a challenge for small-scale producers who have no formal title to their land, or who are unwilling to pledge their only productive asset. This situation particularly affects smaller firms, who in many countries have less access to clear title in their name. Small businesses are typically more likely to own movable property in their name than real property, making movable property a priority reform. Nigeria launched collateral registry reform in 2017, and over its first years, little has been done in terms of collateral requirements. The majority of loans given by commercial banks required much collateral particularly in fixed assets than on movable property

4.1 The Role Regulatory Bodies for Movable Collateral to Secure Finance

Across many developing countries, lack of policy implementation is one of the greatest challenges for growth. Similarly, lack of implementing the legal reforms on movable collateral may hinders securing finance for MSMEs in Nigeria. Properties that would be enforceable as movable collateral in developed country like US would be unenforceable in Country like Nigeria. In Kenya for example, lending institutions may accept movable property as collateral under the Chattels Transfer Act, however the terms do not allow this category to be truly transferable property. Legal limitations on what mobile property may function as collateral create barriers to finance. A legal framework that defines collateral in a broader sense as all sorts of movable property, both tangible and intangible, enables borrowers and lenders to determine the form of collateral that grants parties greater flexibility to agree on terms that are acceptable to all parties. In practice, banks routinely accept fewer forms of collateral than the law permits. In Nigeria for instance, the reform defined collateral as tangible and intangible movable property, where movable properties are assets (tangible or intangible) other than real property. However, in practice only on fewer cases this description is valid for collateral and where possible, only cars are accepted plus other fixed asset depending on the loan (Titilola, 2018). Although in Nigeria, unlike in some countries like Thailand that regulation permits lender to take the possession of the movable collateral, the regulatory framework permits the borrower to hold the collateral. This perhaps could increase the level of uncertainty with the lenders. Consequently, banks in Nigeria do not routinely accept movable property from MSMEs firms as collateral.

4.2 Creating an Efficient Collateral Registry

One of the main reasons behind establishing collateral registries is to serve as a means of notification to keep track of all security interests tied to an asset or to an individual borrower. A reliable collateral registry eliminates the risk that a borrower uses the same movable property as collateral to secure other loans without the knowledge of the lender. The importance of a functioning movable collateral registry cannot be overstated. Collateral law and movable collateral registry have assisted many countries to decrease their loan premium on lending. An efficient registry will facilitate in lowering the interest rate and spread between deposits and loans rates. A study by USAID shows that Albania is among the countries that experienced such improvement as interest rate spread fell by forty-three percent and five percent for both spread and on loan respectively (USAID, 2016).

Furthermore, in a study conducted by Love, Peria & Singh (2016) that consisted of different sized firms across seventy-three countries found that, introduction of collateral registries increases access to bank finance by eight percent and access to loans by seven percent. The impact tends to be higher among smaller firms in the countries surveyed. This means that movable collateral can be effective if well positioned in the capital market because it facilitates sharing of information across the industry. The introduction of electronic collateral systems offers significant advantages over paper-based systems, both in terms of cost and access. Electronic collateral registry systems have higher direct costs than paper-based systems, nonetheless, the advantages dramatically outweigh the expense of installation and maintenance.

Most important benefit of electronic collateral registries lies on the fact that it simplifies filing and lower likelihood of data entry errors. And in a situation where multiple registries exist within a country, such as between separate geographic regions, electronic collateral registries enable faster transmission of data between registries and effectively create a single unified registry. Electronic collateral registries also unlock the opportunity for improved access to the registry as well as improving access to financial lending in the rural areas by transmitting documents electronically. According to IFC (2016), the introduction of electronic movable collateral registry in Mexico enable smaller and medium firms to benefit from lager percentage of the financial institutions.

Electronic collateral registries have been found to have increased transparency within the system, because financial institutions and borrowers can search even from far location to ensure the accuracy of pledges filed in the name of any given borrower.

4.3 Improving enforcement to enable movable collateral

A strong system protecting enforcement of contract and protection of creditor’s rights is an important determinant of credit market growth and development. This is especially true with movable collateral, whose value often depreciates rapidly over time, requiring clear property rights and efficient enforcement mechanisms. Where banks are uncertain regarding the protection of property rights and the enforceability of contracts, banks adopt more conservative measures to limit exposure, leading to lower-risk lending and higher costs for borrowers.

This, of course, is the situation with the Nigerian credit market based on the review. If the business environment is highly unpredictable and contract enforcement weak, banks may shorten the maturity and amount of loans to borrowers. This on the other hand can lead to higher interest rates for borrowers. In the second quarter of 2017 according to Central Bank Credit Survey, loan application to medium and large firms decreased. The identifiable reason behind this can be attributed to the widening spread between bank rate on all firms' size business and Monetary Policy Rate, and at the same time, lenders demand more collateral from all firm size on all new approved loans. This raised questions regarding the short-term impact of movable collateral Act. As a result of that, financial institutions concentrated their capital in those customers with the greatest tangible assets and away from rural branches, resulting in a regressive outcome.

V. CONCLUSION AND RECOMMENDATION

From the valuation of the performance of Collateral Registries Act within its first year of operation in Nigeria, it can be concluded that operation ofnumber of observations can be outline here. Access to credit remains a major obstacle to many firms in Nigeria. The collateral reforms on movable assets can help to reduce the asymmetric information that lenders face if loans are extended to micro, small and medium enterprises in Nigeria. However, as identified in the study, certain obstacle hinders the successful operation of the policy. These are; regulatory arbitrage, poor policy implementation, limited access to financial institutions, lack of financial education and technical issues. Therefore, for the reform to be successful one, the following recommendation were made; Authorities responsible for enforcing laws like the Central Bank have to be up and doing else, many prospective firms will be deprived from accessing credits from financial institution due to high risk appetite of the financial institutions. Secondly, the reform should be accompanied with a sound financial education. Many of the MSMEs are not well educated on how to benefit from the reform, because the segment is the most financially excluded among the productive private enterprise in the economy. Campaign for orientation and creation of awareness should be designed and be given to them. This will help in reducing the problem. Thirdly, attention should be given to electronic platform of the collateral registry. Lack of reliability of the electronic registry system might affect the successful operation of the reforms. Technical issues related to the platforms should be address by the authorities concerned. Lastly, future research should make use of available data to test empirically.

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