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Lending in Nigeria – the building blocks

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The disparity between Nigeria's GDP and the size of its banking sector clearly indicates significant growth opportunities for banks in the country. The gap between the two is particularly striking when compared with South Africa.

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Nigeria's Deposit Money Banks, of which there are 21, serve a population of 180 million people, in a country that boasts a GDP of over half a trillion US dollars. The combined market capitalisation of Nigeria's banks is approximately US$17bn, with net assets of $18.5bn. South Africa's listed banks serve a population of 50 million people. South Africa's GDP is around $370bn, however its banks have a combined market capitalization of $83.5bn with net assets of $42bn.

A central component of the growth in the banking sector will come from corporate lending which, in turn, should be supported by economic growth. But economic growth alone does not necessarily stimulate private sector lending. In order for a loan to take place, one needs a willing buyer of capital (the borrower) and a willing seller of capital (the lender). At the most basic level, the borrower generally focuses on price (the interest rate), whilst the lender, although sensitive to price, focuses on loss minimization (the legal framework regarding property rights and contract enforceability).

So what stimulates growth in lending is an environment with high demand for capital from the borrower due to favourable interest rates, and where the lender can, with a high level of certainty, assess both the probability of the borrower being unable to repay the capital lent and how much of the capital the lender stands to lose should non-payment occur. But what are the factors that create such an environment, and in Nigeria why do banks lend less than in South Africa?

Hernando De Soto's discerning book *"The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else"* demonstrates how the institution of formal property rights unlocks capital and fosters an environment where capitalism can thrive and where wealth can be created.

A fundamental concept that De Soto articulates is that capital is not a physical thing of value, like gold, but rather it is a form of information. Capital is in essence a form of relationship, where the value is derived out of transactions enabled by a set of defined and enforceable relations (a contract) with respect to the handling of gold.

However, defined relations or legal title alone cannot enable the enforcement of contracts. To have value, contracts depend deeply upon the wider legal, economic and social environment to convey their full potential in stimulating lending and true capital formation.

The laws that govern commercial transactions in Nigeria are to a large extent inherited from English law. Nigeria's legal system was designed with the English legal system as reference. Therefore, on a standalone basis, with formal property rights and highly skilled lawyers to ensure enforcement of contracts, Nigeria's legal system cannot explain deficiencies in lending practices. The courts may be inefficient and backlogged and jurisprudence can be found lacking when it comes to financial transactions, but you will get your day of fair representation in court.