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The Impact of Loan Syndication in the Growth of Nigerian Economy

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Abstract
Loan syndication is potent source of funding for business organizations and also an important revenue earner for banks. However its arrangement and consummation is forth with series of problems such as, lengthy time in appraisal of the credit risk, delays in packaging of loans, dilatory behaviour of the borrowers, high rates and other charges as well as the loan duration. These problems could be addressed by creating special loan syndication units, sound credit appraisal, out sourcing, intensification on-site and off-site inspections, and the banks helping a prospective loan request in an acceptable form.

BACKGROUND

Loan syndication is an arrangement between two or more lending institutions to provide a borrower or borrowers with credit facility, utilizing common loan documentation. There is need to look at the two operational words; loan and syndication in other to gain a closer insight into the subject matter. A loan may be regarded as something lent usually money on the condition that it is returned at a future date with or without interest. A syndicate can be regarded as a combination of commercial firms associated to forward a common interest. This association is usually on adhoc basis, in which case, once the immediate object of interest is fully exploited, the relationship will cease.

Against this backdrop loan syndication can be regarded as an arrangement by which different banks or financial institutions team up to grant a large loan to large scale borrowers. Such financial institutions come together as a consortium to provide the required facility because the amount required may be too large and risky for a single bank to provide. By coming together to provide the required facility, the risk is spread out and experience is shared. The major bank that initiates the proposition and invites others to participate is the lead bank, while other banks that come together to provide the facility are the participating banks.

Usually when a proposition is brought before a bank to finance a project, the bank studies the financial statement and cash flow projections presented to it. The bank after studying the documents presented to it may be favourably disposed towards the application. A decision is the taken as to whether the facility should be extended solely in-house or through a consortium of banks depending on the magnitude of the loan request.

The first syndicated loan is traced to banks of the middle ages who often distribute financial risks among several houses to support trade flows. However, this traditional form was mostly on participating basis unlike formalized syndication in use these days, as lenders did not adopt common loan documentation. Modern loan syndication had its roots in the United States of America, before the Second World War. The practice was for banks to lend money to their clients on short term basis (i.e. within one year), with specific interest attached to the loans. After the Second World War the government introduced attractive tax incentives in order to encourage institutional investors and various corporations to undertake large capital investment programmes designed to match the high growth rate of the economy. However, since banks were controlled by the government through monetary policy guidelines, it became difficult for a single bank to lend all the money required by an investor to meet projected investment programmes. In the United Kingdom, loan syndication started with the formation of consortium banks. These consortium banks are banks that are registered in the United Kingdom but were:

a. No one bank owns more than 5 percent of the share capital and
b. At least one share holder is a foreign bank. Invariably, they tend to be more than two banks each having a minority share holding, e.g. the European banking company's share capital is owned in equal proportion by seven banks, one of which is the Midland Bank Plc. These institutions head a syndicate of loans whereby they ask other consortium banks to provide part of the fund. An example that readily comes to mind is the attempted arrangement to save Lakers Airways.

In Nigeria, the first syndication was consummated in 1960 when a consortium of commercial banks and acceptance houses discounted trade bills for marketing boards, under the produce bill finance scheme. Loan syndication was officially formalized in the 1970's when the need arose more than ever before for adequate capital to finance industrialization programmes and development plans adopted by the federal government.

In this paper, we shall investigate the Impact of Loan Syndication in the Growth of Nigerian Economy. The paper is divided into six parts. The first part will look at the operational aspects of the issues involved. Part two will investigate the syndication process. In part three, we shall review the impact of loan syndication in the growth of Nigerian economy/highlights on notable loan syndications carried out by current operating banks. The pros and cons of syndicated loan as a variable financing tool are presented in part four, while part five will x-ray the factors militating against efficient loan syndication. Part six contains the summary, conclusion and recommendations.

OPERATIONAL ASPECTS OF THE ISSUES INVOLVED

Ezeanyagu (2000:95) is of the view that bank loans are made by syndicates of commercial and merchant banks as a result of the restrictions imposed on the banks through the banking act and monetary policy guidelines. Egbui (1998: 55) emphasized that formal syndication has been diversified by financial institution in the form of syndicated credit, syndicated lease, underwriting syndicates etc. Writing on this, Osamede (2005:43) explained that presently a loan syndication law has been promulgated in this country specifying the corporations eligible to finance their projects with syndicated loans. He pointed out that it is large or medium sized corporate bodies, government or parastatals with reasonable technological and managerial expertise, that are allowed to seek for such facility.

In loan syndication there are mainly two parties, the lender and the borrower. The lender is comprised of the lead bank, the participating banks and the agents. Usually the bank of the borrower's choice which agrees to raise the required amount is the lead bank and the staff of the bank charged with the responsibility of seeing that relationship to its logical end is the lead manager. On this issue Gerrard and Dole (2003:120) hinted that the lead bank makes a substantial commitment to drive the transaction through the market place. It is the duty of the lead manager to ensure security perfection, repayment of the loan, consortium of meetings, visitation of the company's premises, maintenance of proper record procedures to control maturity and interest payment. Nwankwo (1996:70) however added that a lead bank may appear as a participant or as a deal underwriter.

THE SYNDICATION PROCESS

The process of loan syndication can be split in three, namely the contract/mandate stage, the contractual/documentation stage, the post signing/credit administration stage.

i. **The Contract/Mandate Stage:** Macdonald (1995:60) regards the contract/mandate stage as the green field stage where the basic ground work and infrastructure for the successful prosecution of the syndication are initiated and laid. Usually a prospective loan applicant draws up its credit requirement and the most suitable package that would maximize its expected utility. These catalogues of requirements are presented to a bank or banks that can help in procuring the desired credit. If the loan request is in excess of the bank's lending limits, rather than commit itself to the total amount demanded or reject the loan application due to portfolio constraints, the bank may suggest to the loan applicant that the desired credit be raised through a syndicate. Having satisfied itself that the project is feasible and viable, the bank will state the terms and conditions for syndication. An acceptance of this by the loan applicant confirms mandate to syndicate the facility. Nervitt (1999:90) was quick to add that in case of a limited liability company the mandate in the form of a board resolution must show among other things the acceptance of the proposed interest rate, the repayment terms, the security and the consortium lending charges. Having given the mandate, the lead bank then initiates a programme for actualizing the syndication.

In order to sell this project to other financial institutions the lead bank must prepare the "placement/confidential information memorandum". This document will state among other things the terms, and conditions under which the lead bank has been mandated by the bank's customer to raise the credit, a brief description of the borrower, the main shareholders/promoters of the company, the directors and the management team. Other relevant information that must be shown are technical, financial and market information about the products and prospects of the company.

The memorandum may contain a disclaimer cause which urges the participating banks to carry out their own independent credit appraisal. It must be emphasized that this disclaimer clause does not excuse the lead bank from any act of gross negligence during the time that the loan is on call. The placement memorandum also contains fees paid to the lead bank and covenant governing the credit facility. Still on this, Milchel and Wall (1997:50) hinted that the next important stage is the meeting of all the participating lenders to review the mandate obtained by the lead bank. Egbui (1998:67) emphasized that the importance of this meeting is to reach an understanding on all the issues involved and to present a joint offer to the borrower in order to obtain a firm mandate to raise the credit if the borrower gives his consent.

ii. **The Contract Documentation State:** when this consent is given the entire arrangement then enters the most important aspect, which is the contract/documentation stage. Amani (2004:130) insists that this stage gives legal effect to the syndication of the loan and the various agreements reached. The lead bank arranges the drafting of all the legal documents to bind all the parties. All the parties involved must then vet the document before they are executed. The legal instrument specifies the details of the contractual agreement between the lenders and the borrowers. The legal instruments are the loan agreement, the agreement between the lender and the security requirement for the loan.

The loan agreement is the document that binds the borrowers and the lenders. This document provides for the disbursement of the funds, the principal, interest and fees as well as the basis for monitoring the financial health of the borrower until the loan is liquidated. Usually onsite and off-site tactics are employed. On this issue Humphrey (2004:74) said that the amount of the loan, the purpose, the interest and other charges, terms of disbursement of the funds, repayment schedule, termination procedure and security provisions are integral part of this document. To give legal expression to this, the loan agreement must be signed by all the parties involved and stamped. Making his contributions, Onwuaghara (1997:101) emphasized that the agreement between the lenders is the document that specifies the relationship between the lenders, the duties and obligations of the lead bank. The arrangement relating to sharing of interest income and other fess are clearly stated. The participating banks must sign this document. The borrower is not a party to this document; hence he is not required to sign the document. This document is usually annexed to the loan agreement; hence the borrower cannot claim ignorance of its existence or in the interest of the various stakeholders during the tenure of the credit.

The other instrument is the security requirement for the loan. On this issue Okeke (2005:30) hinted that this depends on the type of security required in respect of the loan. Security can take the form of stocks, mortgage, guaranteed standby letter of credit, insurance policies etc. on this issue Emekwue (1994:68-69) took time out to warn that, having agreed on the security to the lodged, let it be deposited with the bank before the funds are taken out. There should be no sentiments on whether the loan applicant is a good man, or whether he belongs to our congregation or club, those are separate arrangements. The arrangement on the table is that of loan demand and the deposition of an agreed security to back up the loan. Bitter experiences have shown that if sentiments are brought to play and the borrower is allowed to take out the fund before depositing the security, when it is time for payment he starts dodging and telling all sorts of stories. At this time the banker finds out that the attitude of a loan applicant when he is soliciting for loan is not maintained when it is time for payment. The lead bank has the duty of perfecting the security. On default, the lead bank after consultation with the participating banks and trustees would proceed to realize the security. If stocks were used as security, a receiving manager may be appointed to take over the management of the company with a view to restructuring the business and paying the debts.

iii. The post signing/credit administration: this essentially is the process of managing the loan amount. Teddy and Martins (2003:125) was quick to point out that all the participating banks are involved in the execution of the loan agreement. The draw down schedule will be supervised by all the participating banks. The lead bank assumes the role of an active player in the credit management vis-à-vis the borrower. Agreeing with this view Gerrard and Dole (2003:140) added that the lead bank sees to the proper utilization of disbursed funds and monitors the progress of the project, while keeping other participants duly informed. There are instances where special conditions may be imposed relating to charges on the organization and the financial status of the borrowing company, consequent to the first and second draw downs. Glyn (2004:16) emphasized that the lead bank has the responsibility to liaise closely with the borrower to ensure compliance.

THE IMPACT OF LOAN SYNDICATION IN THE GROWTH OF NIGERIAN ECONOMY

Through loan syndication, financial institutions have continued to support the industrialization policy of the government including economic growth and reduction in the level of unemployment. Syndicated facilities are often medium to long-term end.

Loan syndication is an economically beneficial method of transforming mobilized funds into real capital because without it, some viable investment opportunities might be lost for lack of preparation on the part of any one bank or financier to finance the investment alone.

Hence, loan syndication enhances the investment and the economy's productive capacity by promoting the flow of funds into the industry and other priority sectors of the economy. This has reduced the rate of project failures and mitigated the number of abandoned projects in Nigeria.

We have seen how the regulations in the Banking Act and Central Bank credit guidelines make it difficult for a single bank to grant loans of certain amounts to single borrower.

Loan syndication saves the borrower the pains of raising independently from different institutions having to prepare costly separate documentations for each little credit and negotiating one to one the different lender's terms and conditions. Thus, it helps in saving precious time and allocation of the scarce resources with a little waste.

The industrialization policy of the government demands large capital outlay and such funds can only be made available either government grants or syndicated loans from the financial institutions.

HIGHLIGHTS ON NOTABLE LOAN SYNDICATIONS CARRIED OUT BY CURRENT OPERATING BANKS.

Based on the fact that all merchant banks are presently involved in commercial banking activities, below are a few highlights on current bank operations in line with their syndication activities.

- **First City Monument Bank (FCMB)**: An identification of banks that have and still participate in loan syndication will be incomplete without special reference to this bank. This is due to the fact that it led the first public loan syndication of #70m ($75m) for the then National Fertilizer Company of Nigeria. This landmark achievement was in 1986 when the bank was First City Merchant Bank. Till date FCMB still participate in loan syndication for economic development.
- **Afri Bank Plc:** Within the years 2000 and 2005, Afri Bank Plc led a syndication involving seven (7) banks for a sum of #14b ($100m).The negotiation requires contribution of 20% of the money to fund 250,000 lines expansion for the general restructuring of NITEL (Nigerian Telecommunication Limited), with major emphasis on the Lagos region.
- **First Bank of Nigeria Plc:** First Bank of Nigeria is known for its consistent participation/leading of loan syndication in Nigeria. In 2001, the bank led a syndication of #15m to overall development of the marine and oil sector of the economy. Between 2004 and 2005, First Bank led a syndication of $185m for the acquisition of GSM license by NITEL $72m for NITEL expansion.

  In 2005, it led a syndication of #60b to Dangote Group. In addition to the bank's consistent role as a lead bank, it also acts as a participating bank in some syndication, a few of which referred to in consequent highlights.

OTHER BANK INTERVENTIONS IN LOAN SYNDICATIONS

In 2005, eight (8) Nigerian Banks teamed with twenty (20) other International Banks to provide $600m for NNPC/EXXON mobile satellite oil field programme, where the Nigerian Banks raised $160m (about 70% of the total).

The eight (8) local banks that participated are:

- Investment Banking and Trust Company Plc
- Union Bank of Nigeria Plc
- United Bank of Africa Plc
- Access Bank Plc
- Zenith Bank Plc
- Guarantee Trust Bank Plc
- Standard Chartered Bank Nigeria Limited
- First Bank of Nigeria Plc

V Mobile completed a $1.1b medium term debt finance agreement with leading International Banks and a consortium of sixteen (16) top Nigerian Banks for a coverage expansion programme.

The foreign banks provided $650m while the local banks provided $450m.

It was the largest club lending by size and until then the maiden medium-term financing in the local market.

Furthermore, 50% of Nigerian banks intervened in 2007 by raising over $200m to aid VISAVONE's smooth rollout and operation.

Thirteen (13) banks participated and are listed below:

- First Bank of Nigeria Plc
- Guarantee Trust Bank
- Oceanic Bank Plc
- Zenith Bank Plc
- Intercontinental Bank Plc
- Eco Bank Plc
- Platinum Habib Bank Plc
- Fidelity Bank Plc
- First Inland Bank Plc
- Afri Bank Plc
- Sterling Bank Plc
- Access Bank Plc
- First City Monument Bank
- Afro Financial Corporation (the only non-banking institution involved).

The significance of this lies in the fact that this may well be the largest syndicated loan facility by Nigerian Banks for a wholly owned Nigerian Phone Mobile Company.

The above highlights go a long way to prove that loan syndication as a variable financing tool is an operational angle by current existing banks.

PROS AND CONS OF SYNDICATED LOAN AS A VARIABLE FINANCING TOOL

From the point of view of the borrower, this section examines the merits and demerits of syndicated loan financing as compared to other sources of medium and long-term financing.

ADVANTAGES

1. The principal advantage of loan syndication is FLEXIBILITY, the borrower deals directly with the lender and the loan can be tailored to the borrower's need through direct negotiation.
2. Syndicated loan is also beneficial to corporations that need jumbo loans to finance their project, and do not have access to the capital market, as well as not being able to readily float a public issue.
3. It lowers the cost of capital to the firm, because of tax deductibility of interest payments.
4. It saves the borrower the pains of raising equivalent loan independently from different financial institutions.
5. The repayment schedule is usually geared to the borrower's cash flow ability to service the debt, since syndicated loan is usually amortized.

DISADVANTAGES

Despite the numerous advantages of syndicated loan financing, it has the following disadvantages:

1. The expensive nature of syndicated loan is the principal disadvantage of this method of financing. The effective cost of capital exceeds the interest paid. This is as a result of other charges, such as management, agency and commitment fees.
2. Time wasting: Syndicating a loan is time consuming, documentation requirements often present problems as each party has to vet the documentation and where there are disagreements, the documents may have to be redrafted over and over again, resulting in unnecessary delays.
3. Repayment schedule also poses a problem to the using firm. Most syndicated loans are repayable in equal instalments, such that the firm does not make full use of the amount syndicated throughout the period of the loan. The borrower may also be facing liquidity problem during repayment period.
   Secondly, certain disbursement criteria and consideration do apply. The lead/agent bank may cease to disburse the loan to the borrower for non-compliance of any of the criteria.
4. Additional long-term debt: These are provisions against incurring additional long-term indebtedness except with the permission of the lender. The loan agreement also prohibits the borrower from assuming any contingent liabilities such as guaranteed indebtedness of the subsidiary firm.

FACTORS MILITATING AGAINST EFFICIENT LOAN SYNDICATION

Various reasons can be adduced as constraints against efficient loan syndication. These include but are not restricted to

- **Time:** time factor has often been cited as one of the variables that militate against efficient loan syndication. There are various requirements that must be put in place before the conclusion of the documentation process and it usually takes several months to satisfy those requirements. Consequent on this, by the time approval is given to the borrower, the projections made may have been over taken by other cost elements and this hinders the success of the loan facility.
- **Delays in packaging the loan:** there is also delay in packaging and putting the credit in place before disbursement of the funds to the borrower. As a result of the various interest groups that must be satisfied, too many stringent conditions and covenants are attached. Hence prospective borrowers prefer direct loans from a bank than syndicated loans. There are instances where the borrower is barred from restructuring the management even if glaring ineptitude is obvious. The borrower may even be prohibited from paying dividend during the duration of the loan and may not even be allowed to obtain further credit without prior approval form the syndication group.
- **Dilatory behaviour of the Borrower:** there are instances where the borrower is very unwilling or uncooperative as regards providing the necessary documents demanded after the loan has been approved and the draw down started. All sorts of delays and reasons for the delays are advanced. Also the borrower may be facing liquidity problems, low sales turnover, high carrying cost, industrial crisis etc. the cumulative effect of these is inability to meet the prior obligations or commitments entered into. These problems and indeed more if not addressed promptly and expeditiously may lead to, rescheduling restructuring, refinancing of the loan or outright failure of the loan.

- **Rates and other charges:** there is yet another problem with syndicated loans. This is the interest rate and other fees payable. Banks a times charge prohibitive interest rates on syndicated loans as a way of maximizing their returns. There are instances where they adopt floating interest rates thus quickening up the interest rate on the facility every year. In addition to this the borrower is compelled to pay the management fees, legal fees, penalty for default in draw down arrangements, commitment fees and out of pocket expenses of the managers of the loan facility. The cumulative effect of all these payments is that the facility may become very sticky.
- **Loan Duration:** there is the problem of duration of the loan. Banks due to the character of their liability prefer to lend short. Syndicated loans run into several years and this has severe implication on the liquidity of banks. Banks therefore undertake extensive self re-examination of their liquidity needs before venturing into the arena of syndicated lending.

SUMMARY, CONCLUSION AND RECOMMENDATIONS

SUMMARY

In this paper we have tried to look into the meaning of loan syndication, its origin and debut in the Nigerian financial arena. We are of the view that it is an arrangement between two or more lending institutions to provide a borrower with credit facility using common loan documentation. We traced its origin to the banks of the middle ages and the United States of America where after the Second World War generous tax incentives were allowed as a way of encouraging investors to undertake large capital investment programmes. We also said that loan syndication debuted in Nigeria in 1960. In part one, we explained the operational issues involved in loan syndication and the various stakeholders. This is comprised of the lead bank, the participating banks and the agents on one hand (the lender) and the borrower on the other. In part two, the syndication process was investigated. It was evident that it is an amalgam of the contract mandate stage, the documentation stage and the credit administration stage. In part three, we saw the impact of loan syndication in the growth of Nigerian economy and the various highlights on notable loan syndication carried out by current operating banks. Part four revealed the pros and cons of syndicated loan as a variable financing tool. In part five, the problems inherent in loan syndication were highlighted. These problems are encapsulated under lengthy time interval in the documentation stage, delay in packaging the facility, delays by borrowers in providing all the required information, very high and at times floating interest charges, multiplicity of other charges and duration of the loan contract.

CONCLUSION

In spite of the problems advanced about loan syndication as an instrument of finance, it has come to stay. This is because although it is a potent source of finance to big time industrialists, it is beneficial to banks. This is attributable to the high returns they make, the prestige inuring from being a lead bank, the generous commission charged and received, the fees and the enhanced status of the bank after a successful outing.

RECOMMENDATIONS

Banks should establish a special unit to take charge of loan syndication requests. The unit should be well staffed and operationally active.

Serious attempts must be made to reduce the time it takes o consummate a syndication facility so as not to render the borrowers projections obsolete and unrealistic.

Banks must search for avoidable dishonest borrowers. Emekwekwue (2005:443) believes that although credit depends on good faith, the amount of confidence that the parties have on each other, it does not reduce the importance of scrutiny of those occasions where good faith has been violated either deliberately or inadvertently. This is necessary to ensure that a borrower does not divert the fund to some other frivolous ventures such as taking fresh titles and/or increasing the numerical strength of his wives.

The banks and borrowers have a role to play in speeding up the pace of procedures involved in loan syndication. For instance, the borrower should perfect their documents before making a loan request. This will help the bank conclude its credit appraisal on time. Where the banks do not have competent staff they can outsource the credit appraisal to professional consultants.

Banks should intensify their after credit services. Kakeyere (2005:1-103) is of the view that, this they can do by making serious effort to institutionalize their business advisory services to the public. This is with a view to building up more enlightened clients, to professionally guide, direct and appreciate the problems and prospects of the borrower. The chartered institute of bankers (CIBN) is well positioned to perform this function. Funds could be centrally pooled by banks and made available to CIBN for this purpose.

The issue of onsite and offsite inspection of the borrower project must be taken seriously so as to ensure the success of the loan. The banks must lend a helping hand to the borrower to enable him present the loan request and the relevant documents in a manner that is acceptable to the bank. This is because the era of arm

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chair banking has long been consigned to the archives of history. Some prospective borrowers may not know what to do because of their background. The banks must therefore lend a helping hand in this direction.

Banks must address the issue of high interest charge and the floating rates which they adopt. A situation where a borrower pays over 25 per cent of the principal as interest on the facility may make syndicated loans unattractive to genuine industrialists. This then means that only those who seek for the loan for speculative purposes, distribution trade will come for the facility.

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