

CBN MPC Decisions: What it means for SMEs in Accessing Finance

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Outline

- The Access to Finance Landscape for Nano, Micro, Small and Medium Enterprises (NMSMEs)
- Trend of Interest Rates in Nigeria
- CBN MPC raised rates in February 2024: The Rationale
- Impact of High Interest Rates on NMSMEs
- Conclusion

The Access to Finance Landscape for NMSMEs

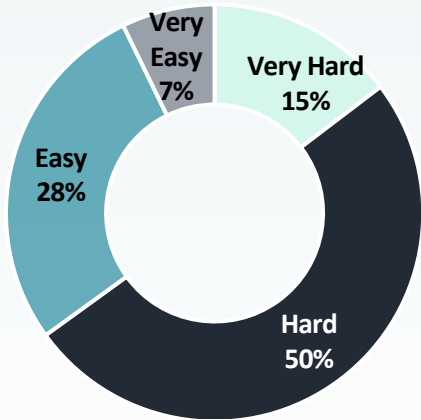
Access to finance is still a major challenge for small businesses. It was ranked as the topmost problematic factor in doing business in Nigeria

Which of the following factors have negatively impacted your business in the last one year?

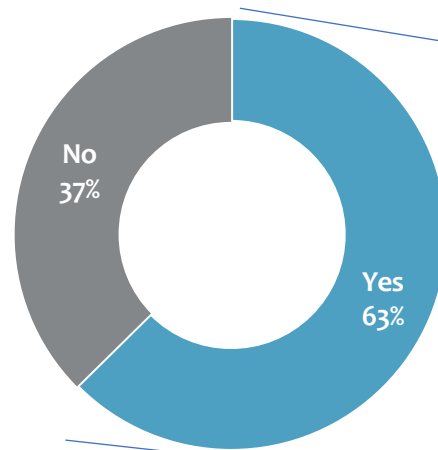
Rank	2021	2022	2023
1	Inadequate infrastructure	Limited access to finance	Limited access to finance
2	Insecurity	Poor power supply	Poor Power Supply
3	Multiple Taxation	Multiple taxation	Unstable government policies and regulations
4	Poor business support from the government	Poor access to markets	Multiple taxation
5	Limited access to affordable finance	Insecurity	Poor access to markets
6	Unstable Government policies and regulation	Foreign exchange challenges	Poor capacity building and limited business support
7	Bribery and corruption	Poor capacity building and limited business support	Insecurity
8	Complex certification processes	Unstable Government policies and regulation	Foreign exchange challenges
9	Foreign exchange problems	Infrastructure challenges	Lack of skilled workforce
10		Poor access to input materials	Poor access to input materials
11		Lack of skilled workforce	Infrastructure challenges

Personal savings is the major source of financing for small businesses in Nigeria

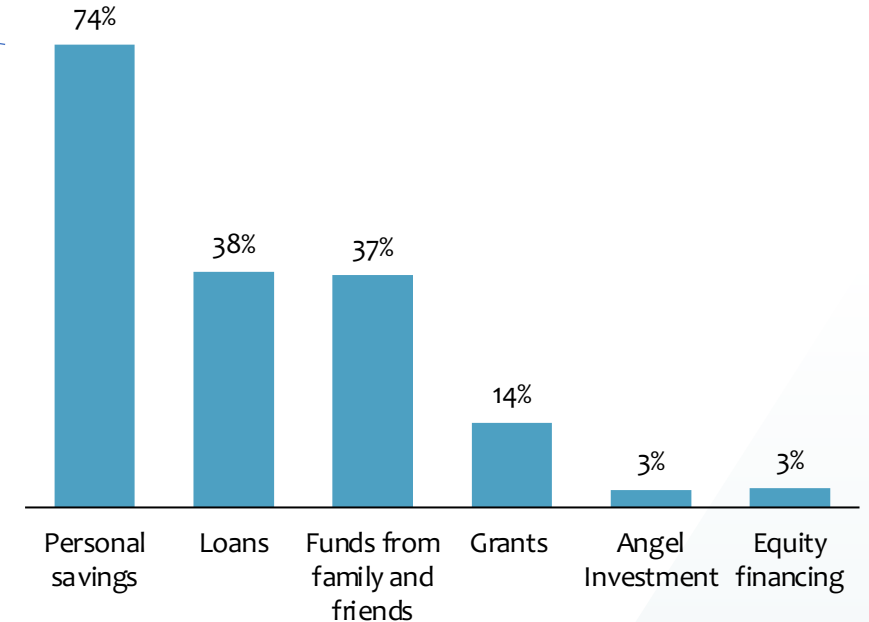
How would you describe accessing finance for your business?



Have you been able to raise finance for your business over the past one year?



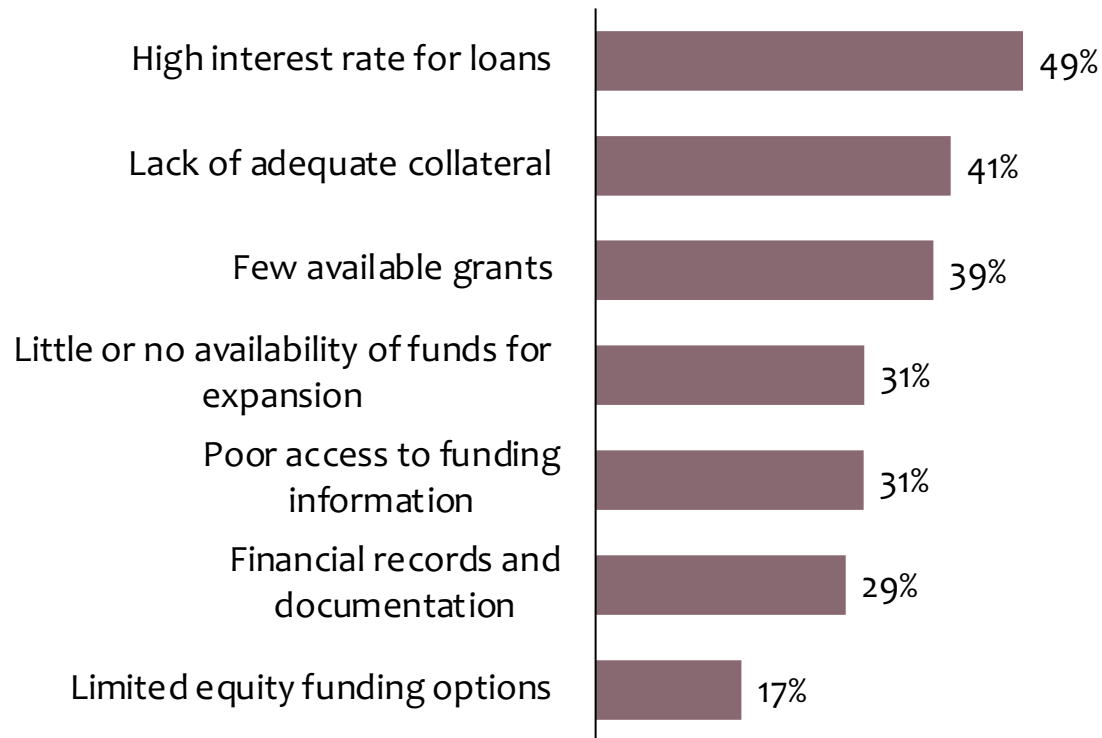
If yes, what type of financing were you able to access for your business over the past one year?



Institutional sources: 47% raised finance from cooperatives, 37% from microfinance banks and only 32% from commercial banks.

High interest rate and inadequate collateral are major constraints in accessing finance

Factors limiting access to finance for businesses (% of respondents that did not access finance)

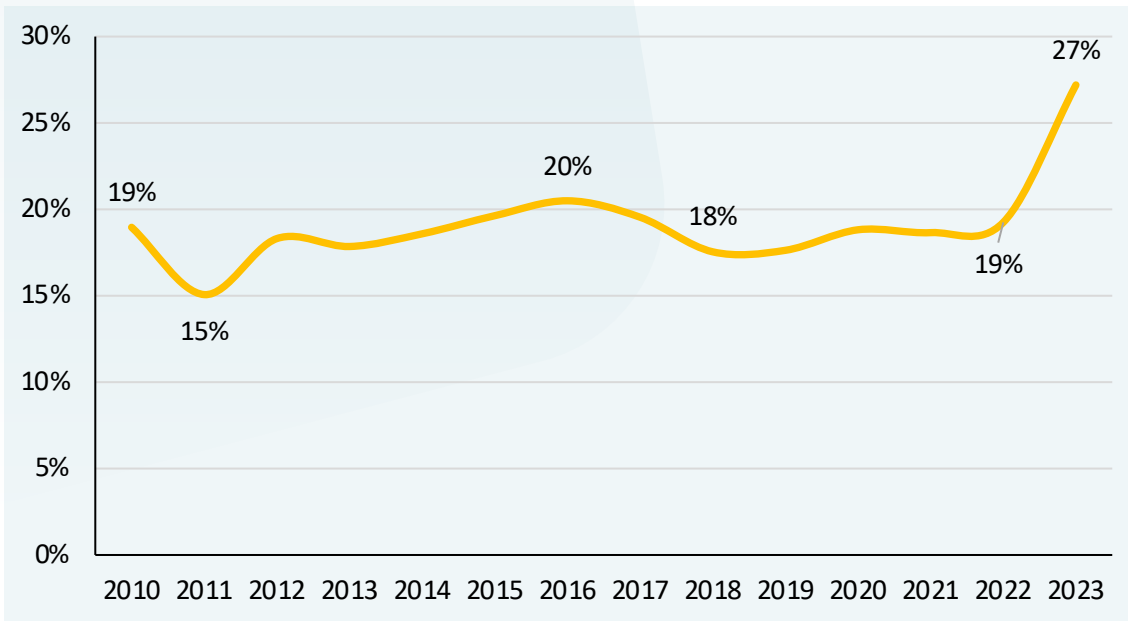


Are you aware of the National Collateral Registry Initiative by the Government?

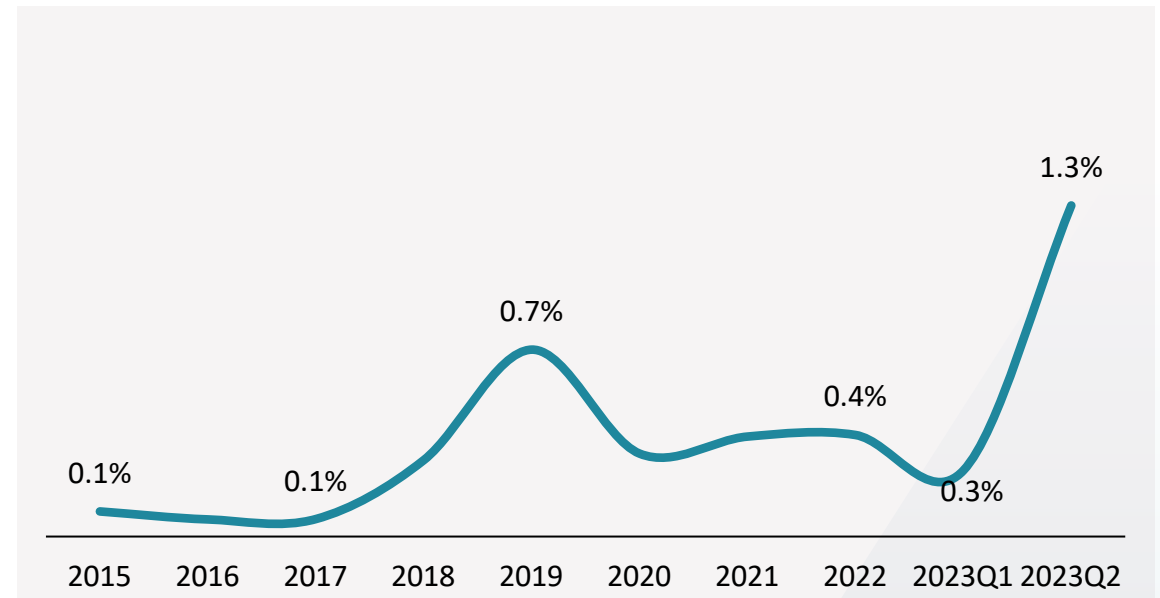
	All	South East	South West	South South	North East	North West	North Central
Yes	20%	30%	26%	13%	11%	11%	9%
No	80%						

While Credit to the Private Sector (CPS) as a percentage of GDP has grown, total loan to small-scale businesses is under 2% of CPS

Credit to the Private Sector as a percentage of GDP



Share of small-scale loans in total Commercial Bank Credit to the Private Sector



Data Source: Central Bank of Nigeria (CBN)

Demand and Supply-Side Issues in Accessing Finance

Demand –Side Issues

- Lack of financial and business management skills among entrepreneurs
- Lack of proper documentation (on the part of small business owners)
- Lack of awareness of funding opportunities and limited understanding of financial products.
- Low level of trust in financial service providers and government programmes.

Supply-side Issues

- High interest rates
- Crowding-out effect of government borrowing
- Limited innovative products, processes and services tailored for small businesses.
- Poor coverage of government funding programmes.
- Inadequate knowledge of the NMSMEs space.
- Demand for huge collateral and strenuous loan application process.

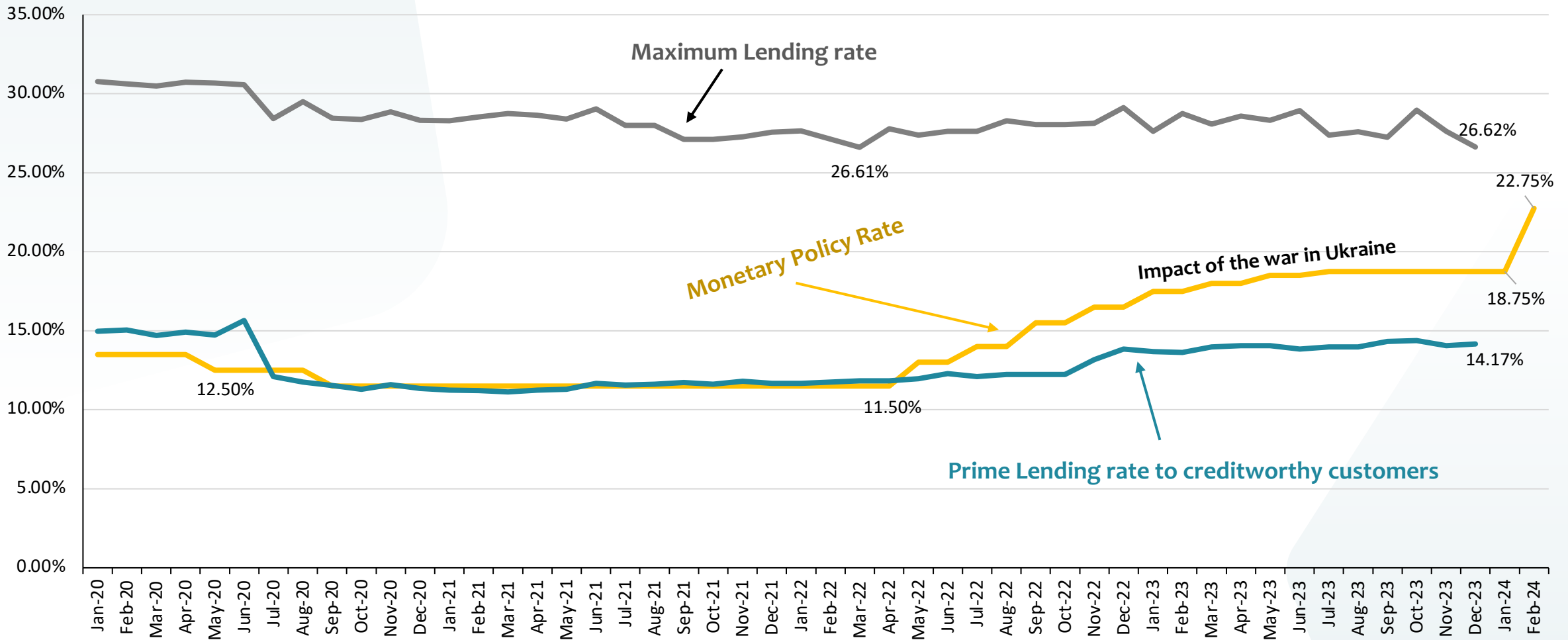
Trend of Interest Rates in Nigeria

Key Interest Rates in Nigeria

Key Interest rates	Description
Monetary Policy Rates	Benchmark interest rates set by the Central Bank to influence lending rates.
Lending Rates (Prime vs Maximum)	Interest rates charged by financial institutions on loans, including prime rates (preferred rates offered to creditworthy borrowers) and maximum rates
Savings Rate	Interest rates offered to depositors on savings accounts.
Treasure Bills Rate	Yields on short-term debt securities issued by governments to finance their operations.
Government Bonds Rate	Yields on long-term debt securities issued by governments to raise capital.
Rates on Commercial Papers	Interest rates on short-term debt instruments issued by corporations to meet short-term funding needs.

Key Interest Rates in Nigeria: MPR has been on the rise since May 2022

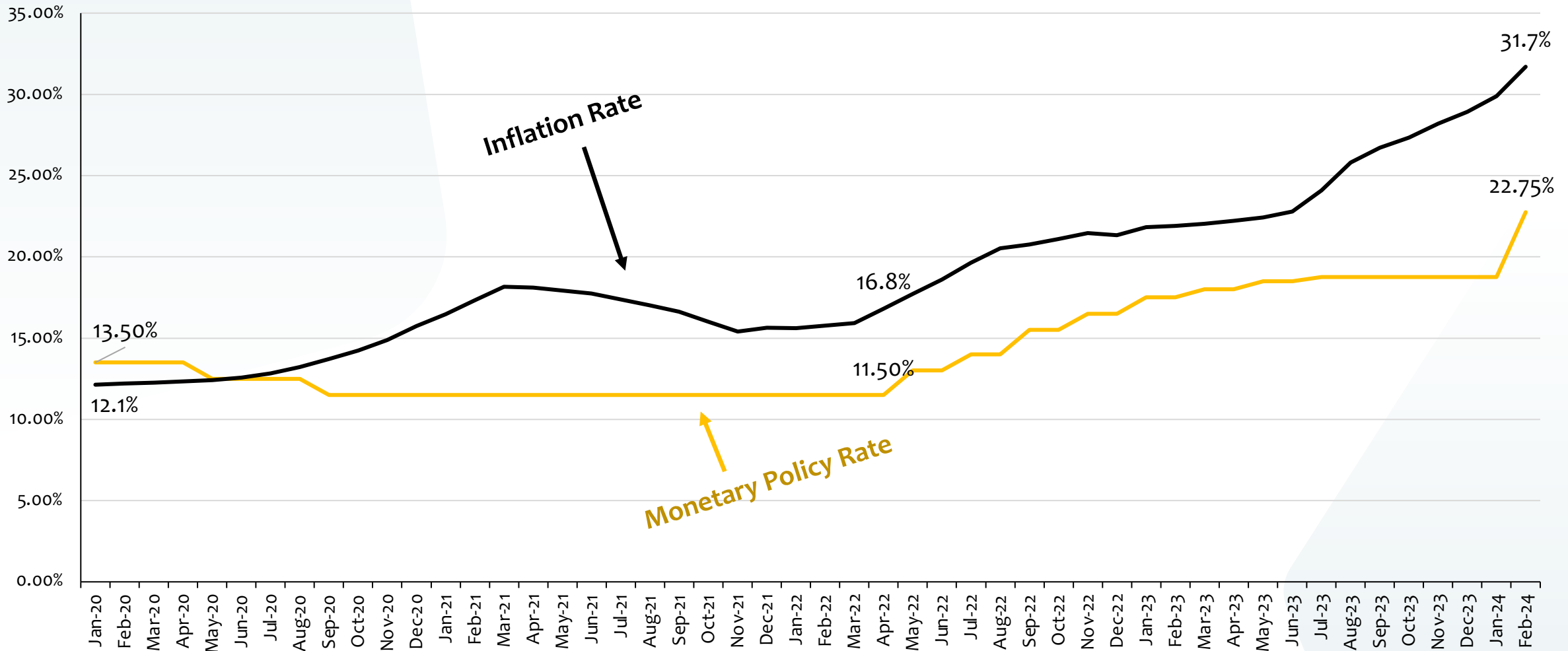
Monetary Policy Rate (MPR), Prime Lending Rate and Maximum Lending Rate



Data Source: Central Bank of Nigeria (CBN)

Inflation Rate has been trending upwards with the MPR is playing catch-up

Monetary Policy Rate vs Inflation Rate



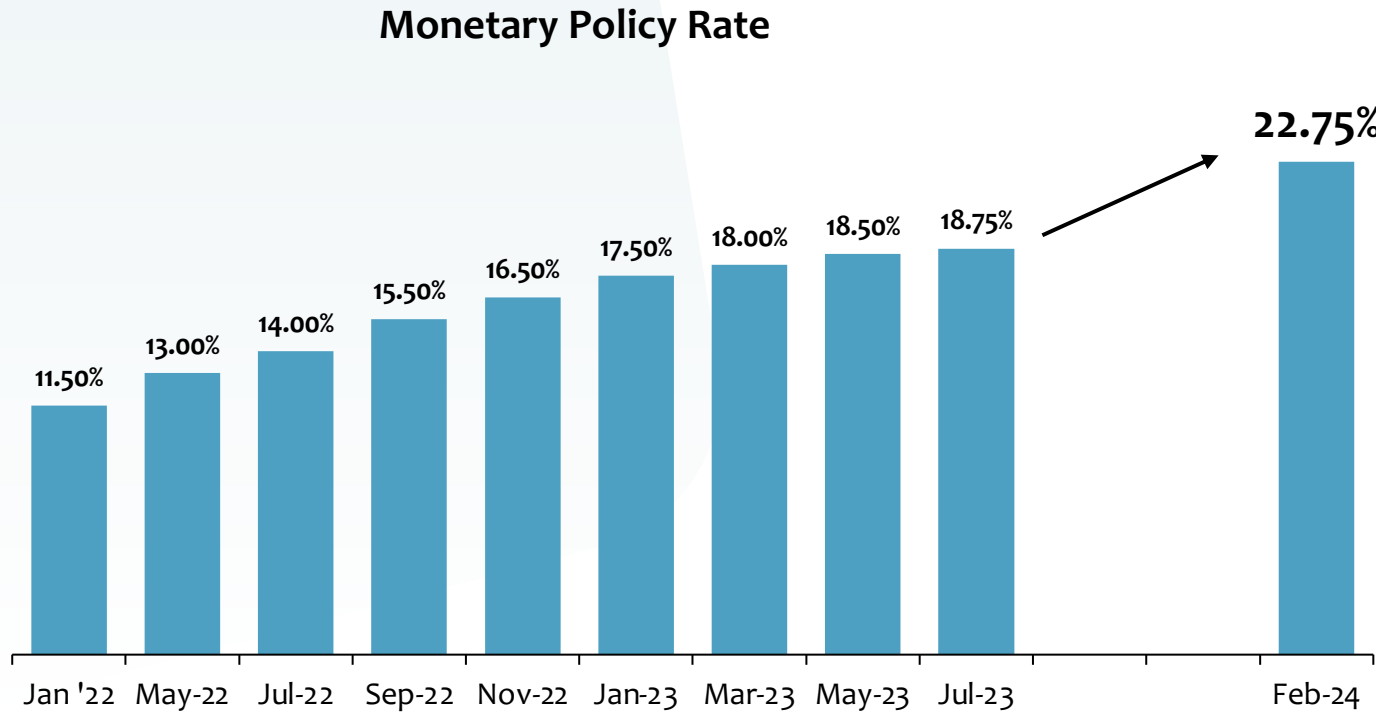
Data Source: CBN, National Bureau of Statistics

Why are Interest Rates High in Nigeria?

- **To limit foreign investment outflows.** Nigeria is not an island. What happens elsewhere (outside Nigeria) affects the economy. When major economies like the US and UK raise rates, developing economies suffer capital outflows. Hence, they raise rates to retain investments.
- **To attract Foreign Portfolio Investment inflows into the country.**
- **To control inflation.** Inflation rate in Nigeria is high. Latest inflation figures – 31.7% in February 2024, the highest in over 27 years. A high interest rate is one measure to control money supply and by extension inflation. However, this transmission can be weak in developing countries with huge informal economy.
- **High risk element factored into the maximum lending rate.** Limited credit database, high cost of doing business, limited financial inclusion, etc.

CBN MPC raised rates in February 2024: The Rationale

The Central Bank Monetary Policy Committee recently raised the MPR...



Rationale

- To constrict money supply and tame the rising inflation rate.
- Inflation expectation: Prices are expected to trend upwards in the short term – CBN staff forecast.
- Maintain exchange rate stability.

Other rationale

- To attract portfolio investments into the country and limit outflows of investment.
- To grow external reserves

Cash Reserve Ratio was also raised from 32.5% to 45%

Since the CBN MPC Decision, key interest rates have increased...

182-Day NTB Rate (Mar 13, 2024)

17%

364-Day NTB Rate (Mar 13, 2024)

21.124%

OMO Auction 361-day (Mar 1, 2024)

21.5%



High borrowing cost for the government

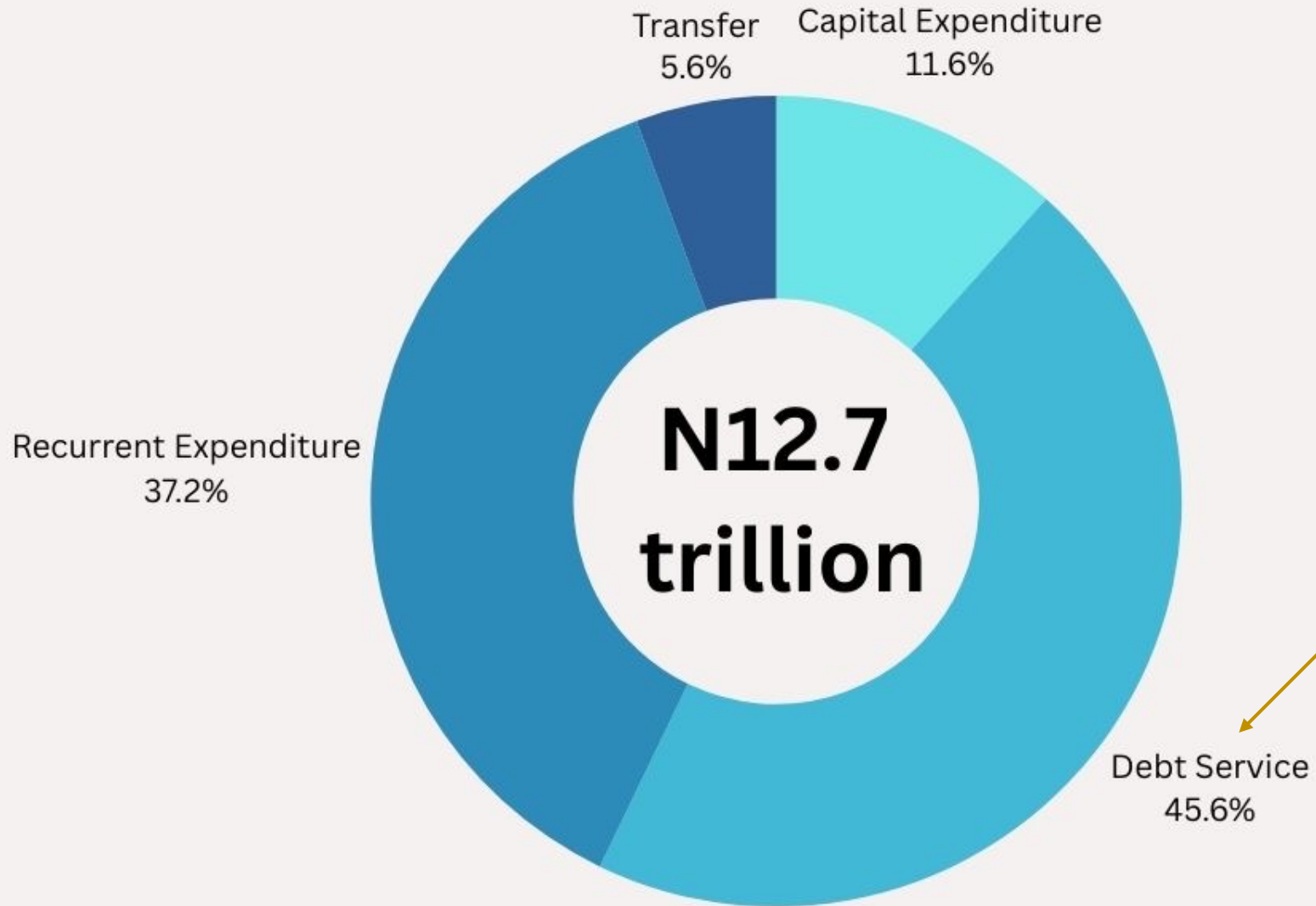
(Debt Service/revenue ratio and CBN Balance sheet)

ISSUER	Coleman Technical Industries Limited	
PROGRAM SIZE	₦30 billion	
TARGET SIZE	Up to ₦10 billion	
SERIES	13	14
TENOR	182 days	270 days
DISCOUNT RATE	19.83052%	21.10730%
IMPLIED YIELD	22.00000%	25.00000%
OFFER OPEN	Monday, 18th March 2024	
OFFER CLOSE	Friday, 22nd March 2024	
FUNDING DATE	Monday, 25th March 2024	



High borrowing cost for companies

What the Federal Government of Nigeria spent money on, from Jan to Sept 2023



With high interest rate, this share is likely to increase in 2024

Impact of High Interest Rates on NMSMEs

How will this decision affect businesses?

Economic growth could be constrained via weakened aggregate demand

- The CBN MPC needs to be cautious of AGGRESSIVE rate hikes in subsequent meetings. Economic growth of 2.7% in 2023 is low.
- Fiscal authorities will need to intensify efforts to support industries. The role of fiscal policies in addressing inflation is also crucial.

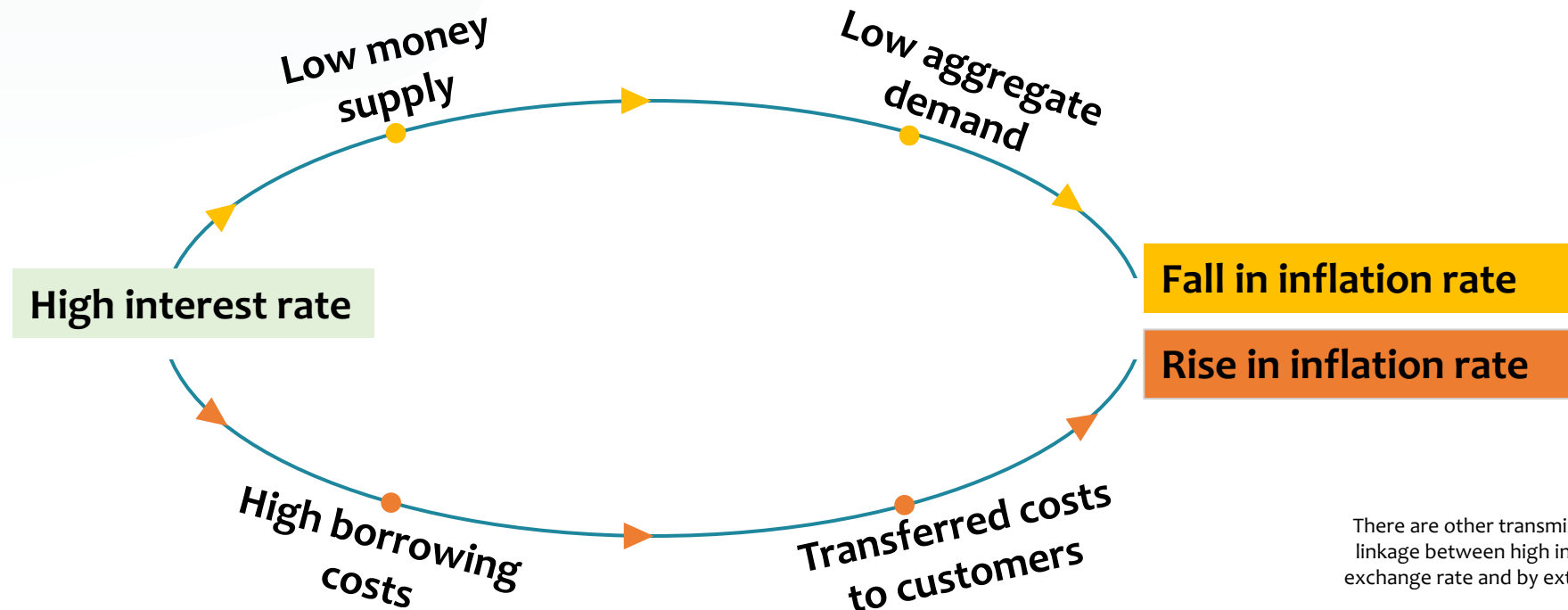
“The Committee, however, acknowledged the trade-off between the pursuit of output growth and taming inflation but was convinced that an enduring output expansion is possible only in an environment of low and stable inflation”.

~ CBN Governor - Monetary Policy Committee Communique Feb 2024

How will this decision affect businesses?

Further worsen access to credit for NMSMEs as borrowing costs will increase

- High interest rates on govt securities incentivize financial sector players to purchase fixed income assets rather than lend to businesses
- With lending rate at ~30%, businesses will struggle to pay back
- High cost of raising capital via commercial papers (medium to large-sized firms)
- The role of development banks in limiting this negative impact is crucial.



There are other transmission channels - linkage between high interest rate and exchange rate and by extension inflation.

How will this decision affect businesses?

It could attract foreign investment inflows in the short term, which is good for exchange rate stability.

- Exchange rate volatility has lessened – also partly due to rising oil production and other FX reforms.
- For instance, average crude oil production was 1.55 million barrels per day in 2023Q4 from 1.22mbpd in Q2. Note that the exchange rate depreciation is an important driver of inflation because we import things that can be easily produced locally.

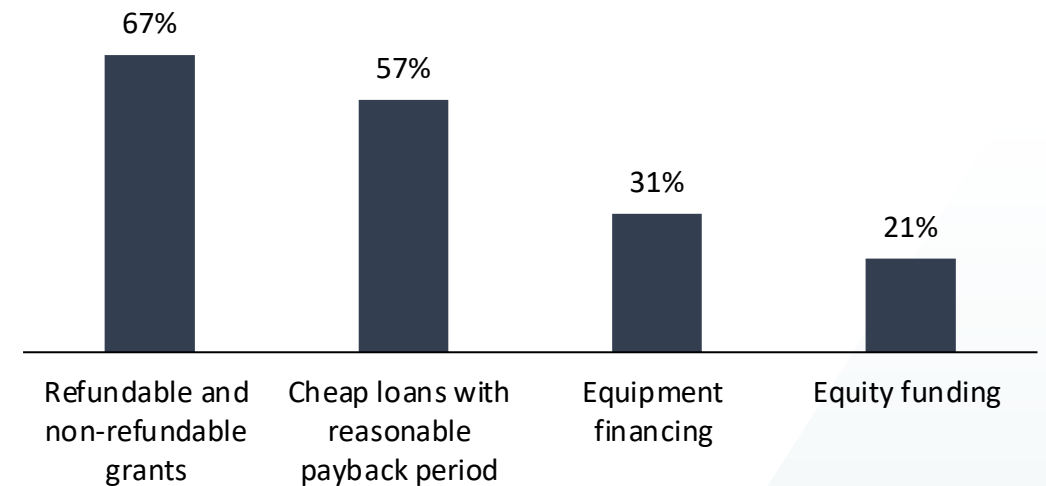
Possible rise in non-performing loans in the banking industry

- CBN's regulatory oversight becomes important

Is there hope for NMSMEs?

- Interest rates are likely to remain high in the medium term.
- Businesses will need to explore alternative sources of funding: grants, equity, government support schemes, and Venture Capital.
- Family and Friends and Personal Savings will continue to be an important source of finance.
- Restructure the business to maximise opportunities – export-led to capitalize a weaker exchange rate.
- Invest in knowledge acquisition and record-keeping.

What type of funding model would work for you as an entrepreneur? (% of total respondents)



Source: Fate Foundation's State of Entrepreneurship (SoE) Report 2023.

Conclusion

- The CBN has made it clear that it is prioritising inflation targeting over economic growth. But the apex Bank needs to be aware of its limitations in addressing inflation. Growth is also important and high borrowing costs could limit growth. The CBN MPC needs to consider this in subsequent decisions.

“More troubling, if growth continues at around the current 3 per cent a year, the number in absolute poverty would likely double by 2050”.

~ Dr ALOYSIUS UCHE ORDU, Member of the CBN Monetary Policy Committee

- Other crucial non-monetary factors such as insecurity, unproductive fiscal spending, low agricultural productivity and low oil production affect inflation. **For how long will the Monetary Policy Rate keep chasing inflation rate to achieve a positive real interest rate?**

Conclusion

- **CBN must stop Ways and Means as this will be counter-intuitive in relation to raising rates.**
- Businesses need to adjust to a high interest rate environment in the short term.
- **These reforms are crucial:** adoption of an NMSMEs Credit Risk Database on a wider scale; more structured funding at the state level to support small businesses; recapitalisation of development finance institutions in Nigeria: BOI, DBN, BOA, etc and enhancing coverage of government intervention funds with proper M&E.

Thank You



The views in this report are those of the author and do not represent the views of the organizations he is affiliated to.

Contact Me!

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