Managing Construction Risk in Nigeria through Capitalization of Construction Firms

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***Abstract*—**The Nigerian construction industry is faced with challenges ranging from poor project delivery, lack of expansion, job dissatisfaction, and poor project delivery and finally lean firms' profit. The low capital base of Nigeria construction firms exerts negative influence on the participation of the sector in the nation's building.

The prevailing issue in the industry includes abandoning of projects, collapse of structures, poor welfare workers package and stunted growth of the firms. This has a general effect on the overall performance of the nation's economy. This paper aims at study the industry and the effect capitalization would have on it in comparison with the banking sector. Data collected from the key players of the industry and the economists and review works aid in this work.

The study further revealed capitalization as a tool to development of the industry. It was therefore recommended that the operators of the Nigeria capital market and policy makers should raise the level of awareness so that investors and government will be abreast with the happenings in the industry and make it more vibrant.

***Keywords*—**Construction Risk, Capitalization, Construction Firms.

I. Introduction

THE relevance of construction firms in the economy of any nation cannot be overemphasized. They are the cornerstones and serves as the linchpin to the economy growth of a country. The economy of all market-oriented nations depends on the efficient operation of complex and delicately balanced systems of money and credit. Construction industries are an indispensable element in this system. It could be said that the economic well being of a nation is a function of an advancement and development of her Construction Industry.

The financial deregulation in Nigeria that started in 1987 and the associated financial innovations have generated an unprecedented degree of competition in the industry. Construction Industry has also faced problems associated with a persistent slowdown in economic activities, severe political instability, virulent inflation, worsening economic financial conditions of their corporate lenders and increasing incidence of fraud and embezzlement which are all regarded as risks.

Risk is a multi-facet concept. In the context of construction industry, it could be the likelihood of the occurrence of a definite event/factor or combination of events/factors which occur during the whole process of construction to the detriment of the project (Faber, 1979), a lack of predictability about structure outcome or consequences in a decision or planning situation (Hertz and Thomas, 1983). In addition to the different definitions of risk, there are various ways for categorizing risk for different purposes too. For example, some categorize risks in construction projects broadly into external risks and internal risks while others classify risk in more detailed categories of political risk, financial risk, market risk, intellectual property risk, social risk, safety risk, etc (Songer et al.,1997).

Factors such as capitalization, government policy tax rate charged on organization amongst others exert some impact on the developmental and growth of the economy. Bakare (2000:58) defines capitalization rate as the discount rate used to determine the present value of future earnings. The size of capitalization and its growth rate pose a major influence on the growth and development of the economy. In Nigeria capitalization and solidification processes are directly managed by the monetary authorities-the Central Bank of Nigeria. This control the activities of focused sector of the nation based on the expert advice from financial gurus who perceived that the economy, as at that period lack a well developed financial market.

Another major problem the industry faces is the inconsistency in monetary, importation, manufacturing and regulatory polices. The surveillance and regulatory measures of the Central Bank of Nigeria (CBN) have unfortunately been unable to keep the pace with the rapidity of the changes in the financial system which would have assisted in making Nigeria institutions the pride of nations, Sanusi (1995). All these factors: deregulation, competition, innovation, economic recession, political instability, inflation, and frequent reversal in monetary policy have combined to create a challenging and financial risk to Nigeria construction firm. The continuing deterioration in the financial state of firms and increasing incidence of construction failure and folding of many indigenous construction companies have raised questions about the nature and state of the Nigerian construction sector. It is a known fact that the investment that promotes economic growth and development requires long term funding, far longer than the duration for which most savers are willing to commit their funds (Akingbola, 2011).

Capitalization is an important risk management tool to any economy because; it encourages savings and real investment in any healthy economic environment. Through the market,

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aggregate savings are channeled into real investment that increases the capital stock and therefore economic growth of the country.

By far the greatest achievement of the Central Bank of Nigeria since it was established on July 1st 1959 has been the gradual development of the Nigerian financial system (Soludo 2004). Its major significance is that it is the machinery for the mobilization of the countries resources for economic growth and development.

II. Paper Review

The Construction Industry is essentially an assembly Industry, assembling on site the products of other industries. The Industry embraces a wide range of loose integrations that collectively construct, alter and repair a wide range of different Building and Civil Engineering structures. The industry can be sub-divided into major areas of activity namely Building, Civil and Heavy Engineering. Examples are the road works, building structures, power plants etc. The integral part of the system includes manpower involved, materials use, method applied, financial outlay and the structure of the society. Moreover, the future of any country depends considerably on the performance of her Construction Industry.

Duncan (2002) asserts Construction Industry as the biggest employer of labour in the economy. This assertion can be confirmed if one relates this to the numbers of Nigerian working directly within the industry and related sectors like manufacturing and the distributors of the manufactured products like cement that is produced. There is need to agree that when the industry sneezes, the economy catches cold. This is because Construction Industry is used as an economic regulator because of; its size, it provides investment goods and government as the major client.

The essential needs of the public are to have basic roads, water, shelter and some other projects of civil engineering nature. The Construction Industry gulps a substantial portion of the state's resources and it is vital that these scarce and limited resources are protected and well administered in order to avoid waste. There is need for government to pay special attention to the industry.

Through financial intermediation, construction industries are supposed to promote economic growth by operating in a safe and sound manner. This is because the industry is vital to every form of national development. It has been seen as a paradox that despite the size of the economy, the country construction firms are still backward and couldn't execute bigger construction works like roads, railway, airport and large civil and heavy engineering projects due to her low capacity. The sector has been highly concentrated structurally as the receiving end meanwhile they are not empowered and clinically looked into considered the importance; this has rendered the system very marginal relative to its potentials and in comparison to other countries. There has therefore been the need to be proactive and to strategically place Nigerian Construction Industry to be active players and not spectators in the emerging world economy.

III. The Nigeria Construction firms

The Nigeria Construction Industry is characterized by large numbers of small contracting firms and relatively fewer numbers of large contracting firms that carry out cost of industry's workload. The Construction Industry in Nigeria as a matter of fact has quite different characteristics in that they are typified by; A proliferation of small firms forming temporary alliances upon a project basis for the duration of that project; the separation of the design and construction activity; uncertainty due to variable demand, on site construction hampered by inclement weather and the lack of a standard project; fierce competition for work that creates low levels of commercial profitability; hundreds of stakeholders in any one project, many of whom may have conflicting business objectives; and displaying considerable resistance to any change in working practices.

Construction firms in Nigeria could be classified using the following base: The organization structure; the number of employee in the firm's payroll and the volume of work executed in financial terms/turnover. See table 1.1 below.

Table I
Categorization of Firms base on number of employee

S/N	CATEGORY	TOTAL NO IN EMPLOYMENT	NO OF FIRMS	TOTAL NO OF FIRMS
1	Small firms	1	94,452	
		2-3	68,486	
		4-7	30,395	
		8-13	5,240	
		14-24	3,574	202,147
2	Medium firms	25-34	1,146	
		35-59	1,148	
		60-79	361	
		80-114	317	
		115-299	387	3,359
3	Large firms	300-599	103	
		600-1199	59	162
4	Big firms	1200 and over	36	36
	Total			**205,704**

Source: Awodele .O. (2004)

Few months after the assumption of office by former Governor of the Central Bank of Nigeria (CBN), Professor Charles C. Soludo, he made pronouncements on banking sector reforms. The first phase of the reforms was designed to ensure a diversified, strong and reliable banking sector, which will ensure the safety of depositors money, play active developmental roles in the Nigerian Economy and become competent and competitive players both in the African and global financial systems, while the second phase will involve encouraging the emergence of regional and specialized bank.

In Nigeria, there are many construction firms that are registered with Corporate Affairs Commission (CAC). In all,

most of these firms have low or weak capital base. Inadequate access to short or long term funding to finance projects has often been cited as a major problem facing contracting organizations in developing countries. This often leads to the stoppage of work on project sites until sufficient finance is available to resume project activities, (Faniran, 1994). Hence their weak financial strength makes it almost impossible for them to be awarded huge contract. Weak capital base encourages under-performance because such firms use the mobilization to start equipping their firms and so on which has negative impact on the project. This is also another cause of abandon projects in Nigeria. Many companies in Nigeria cry foul that most government contracts are given to the foreign companies.

ROCAD Construction Limited, Julius Berger, Arabs Contractors, RCC (Reynolds Construction Company) are few among foreign based companies operating in Nigeria. These companies distinguished themselves from the local ones due to the volume of work they can conveniently execute, the type of equipment at their disposal to carry out project execution. To mention also is their strength in terms of human resources and quality of materials usage. A reference is a foreign firm that is working in Enugu State, Nigeria that handles projects that the value exceeds Seven Billion Naira. It would be out of place to sign such a contract with local companies with poor or no facilities to meet up with the client's expectation in terms of time and quality. The low capital base of Nigeria construction firms exerts negative influence on the participation of the sector in the nation's building. This has made the industry to be risky.

All over the world and given the internationalization of finance, size has become an important ingredient for success in the globalizing world. In the world of finance, no country can afford to operate in isolation (Anyanwu, 1993).

The last few years have witnessed the creation of the world's banking group through mergers and acquisitions which can as well work effectively in Construction Industry. The Nigerian construction firms system today is fragile and marginal. The focus and purpose should be system that is part of the global change, and which is strong, competitive and reliable. Everyone has a role to play.

On the part of firms, the challenges are quite enormous as the owners are primarily in business to make profit, and need to be conscious of the need not to jeopardize this key driving motivation for innovation and entrepreneurship. However, it is widely known that Construction Industry occupies a unique position in every economy and that is why it often attracts more than a casual regulatory attention.

Nigeria construction industry in the 21st century must have a moral face and live up to some modicum of social responsibility. Capitalism must have a social face and a human soul to be sustainable. This is the lesson of world history. It is in this context that the spate of frauds, ethical misconduct, falsification of tax clearance pay slip, unregistered firm, abandonment of project, poor construction, poor materials installation and abuse of workers in the name of 'casual workers' would be viewed so that collective effort be made to stop the ills and given the system a new face.

Construction firms are also expected to imbibe best-practice corporate governance, improve on self-regulation, enhance reasonable capital base, institute IT-driven culture, and seek to be competitive in today's globalizing world. The regulatory authorities, like the Federal Maintenance Agencies, ministries in Connection with works and other construction activities including the consultants on their part, should further streamline the regulatory framework and strengthen the supervisory capacity to ensure a sound and efficient system.

IV. Consolidation

Consolidation has been internationally recognized all over the world to encourage solid financial base and to reduce financial risk. Meanwhile sizes of the bodies coming together in the consolidation are essential for the success to be recorded. The last few years have witnessed the creation of the world of banking group through mergers and acquisitions. Flowing from this, the stipulated fact is that the only legal modes of consolidation allowed are mergers and outright acquisition/takeovers. A mere group arrangement is not acceptable for the purpose of meeting the minimum capital base, (Akingbola 2011; Adesola 2001).

The Construction firms just like its banking sector counterpart should also look into this direction with the view to achieving the minimum capital base that would ensure more competency, reliability, performance and efficiency.

This means that all construction firms that have other firms as subsidiaries or have common ownership or same mission could merge and thereby have the required financial strength. Consolidation is simply another way of saying survival of the fittest that would give birth to a bigger, more efficient, more reliable, more organized and more skilled industry. Consolidation is part of the natural evaluation of industries; it is primarily driven by; a) Business motives b) Regulatory interventions

Generally, capital is required to support business. But the importance of adequate capital in construction sector cannot be overemphasized. It is an essential element which enhances confidence and permits a construction firm to engage in construction of complex projects and with huge financial outlay. As Phillips (1997, 12) has correctly observed, "the more capital a company has, the more losses it can sustain without going bankrupt. Capital thus provides the measure for the time it has to correct for lapses, internal weakness or negative developments. The large sized and capital, the longer the time a firm has before losses completely erode its capital."

In a view of its significance, the regulatory authorities consider capital adequacy a primary index to monitor the organization. Adequate capital, manpower, plant and machine help to promote confidence in the system. Many construction firms in Nigeria manage to pay workers' salary only after certificates must have been honoured by the client. This means that the sub-contractors, suppliers and workers are

therefore kept on hold till payments are made. The indigenous firms are worst affected; unlike their foreign counterparts who have better financial muscle. Local firms are characterized of lack of; workforce, governing policies, research and development, promotion system, welfare scheme and savings or retirements benefits for their workers (some workers are still kept as casual labours). Apart from the construction firms, the consultancies that ought to be overseeing professionally are also poorly organized.

Consolidation is not a new system to a growing economy. Similar consolidation has taken place in many parts of the world like known big construction nations like Egypt, India, America etc. there is a strong conviction that since it works well in the countries mentioned above that have similar economic history with Nigeria; it would also be a success if practiced here.

Consolidation would discourage the solely dependency on the project sponsored by the government who happens to be the biggest spender in the industry. Overdependence on government as the sole client is not helping the industry. Many firms appear to have abandoned their essential intermediation role of mobilizing the private sector to be part of the system. These private developers seek consolation in the services rendered by the quack and unregistered contractors which has brought nothing but challenge and slap upon professionalism in the countries. An example is the issue of collapse and abandoned structures at alarming rate in the country.

Capitalization in the industry apart from increasing the financial strength and offering protection against losses of the concerned companies, it would also: strengthen firms' ability to attract funds at lower cost, ability to acquire required expertise for project execution, prospect of firm's expansion and operation beyond the owners and enhances a firm's liquidity position. enhance participation in foreign construction works; Improve workers' welfares; ensure catalyst to innovation; Ensure job security; Increase employment rate; decrease rate of abandoned projects; Increases technical knowhow; encourage research activities and skill's improvement; Tax incentives in the areas of capital allowances; Reduction in transaction costs; enhance ability to purchase essential heavy and costly construction plants and equipments; It makes expansion easier and brings about improvement in turnover of the company.

Despite the positive effect of capitalization, it has some militating factors like: insincerity of purpose; Corruption and greed; weak corporate governance; poor planning; inaccurate research; professional conflict and lack of respect for individual's roles in the industry resulting in huge non-performing; poor risk management resulting into abandon project, cost overrun among others Influence of saboteurs; Political factors and Self-seeking purpose. It is the industry alone among the growth concerned sectors that lack the discipline and checkmate on their players.

The same pronouncement made by the CBN in case of banks should be made concerning construction firms as this would bring about active and positive steps towards increasing their capital base to or over the minimum capital base set.

This would give birth to positive competition within the system, expansion of business by way of employment and improvement in the information technology; reduce the risk in the industry and lots more.

Ojo (1979) discussed the activities of the government in the capitalization process. They said that there are possible dangers posed by the predominant role of government securities on the market, where the funds raised by the government is diverted to unproductive expenditure, the potential contribution by the institution to economic development is therefore reduced. We can therefore re-emphasize that government has a greater role to play if the construction industry would perform to optimal.

V. Conclusion

Hence, if the process of consolidation is properly implemented, then the consolidation of firms in the country will surely improve the construction sector in Nigeria and thus will translate to better services, product standardization and affordable involvement. More importantly, the public will not have fear of distress in any form, since the consolidated firms will have enough funds to take care of their lapses period even better than the retention fees that might not meet the expectation of the client(s).

The main objective of these changes is to move the Nigerian economy forward and to strengthen the Construction industry in order to facilitate development and reduction of risk. It is a global exercise and risk worth taking even as the nation is making effort to get her name among the list of country for maximum growth by year 2020. The country can get there, but wouldn't be possible without the proper positioning and overhauling of the Construction Industry which capitalization of the construction firms discussed above would enhanced.

VI. Recommendation

There is need for strength, good capital base and well-structured organization in order to meet up with the development challenges of the 21st and to also realize vision 2020. The following recommendations are therefore suggested: merging and acquisitions of firms should be taken seriously as an instrument for enhancing Nigeria Construction Industry's efficiency, size, and developmental roles; committee on implementation of capitalization should be set up to suggest best possible ways of its actualization.

It is at this joint that all are encouraged to look up to the future of the country where the Industry would accommodate new technology and start building massive projects at home and contesting or bidding for similar projects abroad.

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