

Housing Crises: A Theoretical Study of the Home Building Industry in Nigeria

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Abstract

The paper examines the housing problems in Nigeria and the home building market on an international viability landscape with special references to the Nigerian housing sector. The paper creates a platform for a global building industry company that is well capitalized through a series of mergers and acquisitions (M&A). Furthermore, the emphasis on the establishment of a global building company is imperative because of its role in developing and emerging housing markets where home ownership has just commenced and mortgage financing is rare.

Keywords: Mergers & Acquisition (M&A), Housing Market, Mortgages, Developing & Emerging Markets.

Introduction/Overview

With the recent downturn of the housing market, most companies within the home building industry in the United States of America have either downsized, filed for bankruptcy merged/acquired (M&A) or a combination of all of the aforementioned. In developing countries like Nigeria, home ownership through mortgage financing is in its infancy. The global performance of the housing industry is mixed. North American markets have been hit hard with subprime lending and other practices that have led to the current debacle. The European market has been affected as well but unlike the North American market, the housing sector in Europe has maintained a sense of stability in terms of cost valuation.

In Nigeria and most developing and emerging countries there has historically been housing shortage. The federal government of Nigeria set out to build 121,000 units to curb the shortage (Ajanlekoko, J.S. 2001). In addition, the number of Licensed Primary Mortgage Finance Institutions (LPMFI) rose from 251 in 1993 to 276 in 1994. However, by the end of 1998, it declined to 115. In concert with the decline, the Federal Government capital expenditure on housing increased by over 500 per cent (CBN 1994 and 1998). Despite the push by the federal government for the construction of 121,000 units, it was reported that a little over 1000 units were completed. Without the formation of private home building companies the housing shortage will remain a major socio economic and financial constraint for these economies.

In terms of population, there are 3 major urban centers of Nigeria. Cities like Lagos, Port Harcourt and the federal capital Abuja are the most populated areas of the country. Lagos has an estimated population of 15 million residences of which about half make rent payments due to the staggering prices of homes. Since Lagos is Nigeria's most prosperous city, and much of the nation's wealth and economic activity are concentrated there, most residence endure the living conditions to seek job opportunities and economic stability. According to the 2006 census, Abuja has an estimated population of 1 million. In recent years more people migrate to the capital territory in search for housing and economic opportunities to no avail. As a result, these individuals manage to live with 3 to 6 other individuals per room. With no running water or steady electricity supply, the living conditions these individual face are bleak. Port Harcourt holds a population of roughly 8 million, of which 2 million reside in the urban center. Like the other cities, Port Harcourt faces the same harsh realities of inadequate housing.

The opportunity for a well capitalized home building company is present. In the major cities mentioned, an estimated supply gap of 6000 – 10000 thousand units is needed per annum in the near term to curb the housing shortage.

Furthermore, home ownership in Nigeria is dependent on ones liquidity. Commercial banks as well as its banking activities have been present since the country was under colonial governance. These institutions at the time primarily served the needs of commerce, prompting some growth in the commercial banking sector while the growth in savings and domestic financing of investments continued to remain dormant (Nubi, 2003). Arguably, some of the mitigating factors that have prevented developing nations like Nigeria to extend credit to potential home buyers can be linked to the ability of debt repayment by borrowers, and high interest rates extended to potential home buyers by the banking institutions to name a few.

Recently in the American Housing market Pulte merged with Centex. While Pulte executives dominate the roster of the newly merged Pulte, the company is adopting some of Centex's operating principles, including a push toward selling homes that are built to order, rather than speculative homes, because they tend to yield greater margins. The new Pulte is also moving toward Centex's cadence model of construction. This approach, which is essentially even-flow production, applies manufacturing techniques to home building, calling for a steady number of homes to be in various stages of construction at all times, smoothing the process, and creating savings through efficiencies (Burney, 2009). The merger of the two companies has created a stronger force that will be able to survive the downturn.

The researcher firmly believes that with the emergence of mortgage financing in Nigeria, various building companies should undergo (M&A) in order to have adequate capital and leverage to break into the developing and emerging markets. To that effect, it is important to note that in every business and financial crises, a niche market can be formed in order to sustain growth and profitability. Furthermore, the historic problems that have prevented developing and emerging countries from extending credit to home buyers will be explained. The researcher intends on accomplishing this by explaining the key factors such as: Debt repayment by borrowers, lack of home building companies, and the high interest rates by the banking institution. Lastly, a case is made for a global building company through (M&A).

Literature Review

Debt repayment by Borrowers:

The major issues that arise from the ability of one to pay back a home loan can be traced to the staggering cost of land in relation to wages and salaries, and transaction or origination cost associated with the loan agreement. Buckley (1989) opines in developing countries there is seldom mortgage credit extended to potential home buyers because of the high transaction cost associated with enforcing the contract. Where the reverse is the case for developed countries that is, mortgage credit is restrained by the cost of the post contract governance. Acquiring mortgage debt is an insidious problem in developing countries because of the imbalance of cost of building to an individual's earning power. Since the majority of the materials required in constructing a house are monopolized, these companies can fix the prices for the bricks, blocks and cement needed for construction. Furthermore unlike developing countries, securing financing for a home is facile. In the United States for instance, a thorough background check is conducted. During this time the banks or mortgage companies run the personal information obtained from the applicant verifying income, place of employment, and place of residence to name a few. Once these items can be verified, the next step is computing the affordability factor. Some applicants are denied because they are over leveraged. That is to say the debt to income ratio is unfavorable. In the case of developing countries these steps can be replicated but should be strongly enforced if one defaults on a loan agreement.

Since there is an estimated 15 million residence in the aforementioned cities renting homes and apartments on a monthly basis, one begs to question why a home building company cannot build an affordable home for these individuals and in turn collect their monthly payments? After all, once you are done paying your mortgage you become the owner of the property to which you reside. While on the other hand there is no financial gain from making rental payments from the view point of the renter.

Lack of Home Building Companies:

According to Nubi (2003), and Zubairu (2000), the absence of large real estate development companies with access to the relevant technology and financial muscle to develop cheap houses on a mass scale for the urban poor is a major setback in the housing delivery system. The lack of major developers has discouraged the development and local production of low cost building materials on a commercial basis. Nubi (2003) asserts that Cappa and Dalberto, solely own Oregon Clay Industry. Since the formation of these companies, a monopolistic market was created and the two companies have enjoyed profits since its inception. Consequently, the market created has not helped to reduce the prices which are supposed to be an alternative to cinder blocks. Currently in Nigeria, bricks are more expensive than blocks. The reliance of more builders on imported conventional building materials has led to high cost of construction, thereby compounding the problem of affordability (Nubi, 2003).

In lieu of major home building companies, the emergence of low skilled contractors has created a major problem for home owners during the process of construction. Researchers like Windapo (2000), Iyagba, & Asumo, (1997), and Odusami (1998) stated that the reliance on low skilled contractors and laborers alike is one of the major problems stifling progress in the home building industry in developing countries. For instance, if one decides to build a house in Nigeria, the probability of these individuals spending more money than budgeted is higher because of errors on the part of the construction workers. In some cases the errors may be from the design or foundation issues. In scenarios like this, the home builder would stop construction of the home and sue the

contractor hoping to recover the losses. On the other hand, if there were home building companies who have the resources to build the home, the burden would rest upon the company and not fall on the individual. After all, ownership does not transfer until the home is 100 per cent complete.

High Interest Rates:

Recently, Nubi (2003) enumerated the new structure for housing finance, in that framework came about the National Housing Fund (NHF) in 1992 which is a governmental agency established to provide loan financing to individuals. This institution can be directly compared to Fannie Mae of the United States. The NHF role is essentially to ensure a continuous flow of long term funding for housing development and to provide affordable loans for low income housing. Once this institution was formed, there came about the emergence of private mortgage companies. Despite the good intentions, Nubi (2003) asserts the technicalities and difficulties of releasing the loan to the mortgage institutions to lend to the public have not been properly implemented and as such most potential home buyers have been frustrated by the high interest rate and cost of funding. Without the steady stream of funds, most mortgage companies began raising the funds on their own by the way of deposits and savings and then pushing the burden on the potential home buyer.

In developed countries interest rates range from 4.75% to 7% on fixed term 30 year home loans, in contrast developing countries like Nigeria, interest rates are staggering. In most cases, the range is from 15% to 20% payable on a 5 year mortgage loan. Without proper systematic overhaul, the housing problems will continue without end in sight.

Definition

Mergers & Acquisition:

To enable home affordability in developing countries the researcher asserts a (M&A) is in order. A (M&A) can be explained as an aspect of corporate strategy, corporate finance and management dealing with the buying, selling and combining of different companies that can aid, finance, or help a growing company in a given industry grow rapidly without having to create another business entity (Depamphils, 2008). In the case of the home building industry, there has not been any multi - National home building Company formed. Although there have been numerous (M&A) transactions in the banking and investment sector as well as the manufacturing sector. To name a few, Heidelberg Cement group a building materials company based in Germany has been successful in the acquisition of several building company across continents. Lehigh cement and Hanson Aggregates is a couple of the North American acquisitions. Since every market is not the same, Heidelberg has been able to synergize and remain profitable in its separate entities around the world. With the global financial crises impact on the housing industry of many developed countries, many home building companies are finding it difficult to avoid bankruptcy. The merger of Pulte and Centex has created one of the biggest home building companies in the world. In the United States there are several home building companies who have been reporting staggering losses since 2007.

In the event of a merger Porter (2005) asserts that the determinant of a company's profitability is the attractiveness of the industry in which it operates. It is quite obvious that in Nigeria the demand for affordable homes are present, the major issues are financing and affordability. Some of the generic strategies highlighted by Porter are: cost leadership, differentiation strategy and focus strategy. As this pertains to the home building industry one may conclude that not anyone of these strategies will succeed in the long term alone. A combination of cost leadership and differentiation will aid in capturing majority of the profits in the global housing sector. According to Marcus (2005), the cost leadership strategy emphasizes efficiency. By producing high volumes of standardized products, the mergers of these companies may take advantage of economies of scale and experience curve effects. The product is often a basic no-frills product that is produced at a relatively low cost and made available to a very large customer base. Maintaining this strategy requires a continuous search for cost reductions in all aspects of the business. While on the other hand the differentiation strategy is aimed at the broad market that involves the creation of a product or services that is perceived throughout its industry as unique. Combining the two strategies can sustain growth in the long term for the global company.

Lastly, numerous articles have been published by researchers such as (Marcus, 2005; Porter, 1980; Porter 2005) to name a few in the management and financial literature on strategy and planning. The researcher believes that the market shares that can be captured by the global company through (M&A) are the low as well as middle class because these classes of people make up a greater number of the population of all African countries. In the interim, decision makers within the company should continuously monitor changes in the market in order to maximize the resources as well as new prospective home buyers.

The data on the figures below represents the economic pricing per square feet in Nigeria and the United States from 2000-2008. The Nigerian currency the "Naira" has been converted to present a concise comparison.

Based on the cost analysis, it is important to note that given the purchasing power of the American dollar and the increasing inflation issues affecting Nigeria and most developing countries, a well capitalized company will benefit vastly from the opportunity presented. Furthermore, the business model that will aid in the success of this endeavor is the loyalty business model which companies employ to generate loyalty to customers and other stakeholders. Focusing on the quality of product and service leads to customer satisfaction, which generally translates to customer loyalty and sustainable profitability. Dawkins & Reicheld (1990) elucidates that a 5% improvement in customer retention can cause an increase in profitability between 25% and 85% (in terms of net present value) depending upon the industry. The exponential increase in profitability can be linked to the following criteria;

1. Long term customers tend to be less inclined to switch and also tend to be less price sensitive. This can result in stable unit sales volume and increases in dollar-sales volume.
2. Long term customers may initiate free word of mouth promotions and referrals.
3. Long term customers tend to be satisfied with their relationship with the company and are less likely to switch to competitors, making market entry or competitors' market share gains difficult.

Recommendation/ Conclusion:

To recapitulate, in Nigeria and most developing countries, there is a stringent demand for home building companies who can build affordable homes for the individuals that seek them, and also provide financing for the loans. The home building company needed is not the typical builder whose role is merely building a house. In this case, the paper emphasizes the need for the formation of a multi – national company to carry out this project. The technologies and skilled labor shortage in these countries are limited and as such it is imperative that the formation of a global builder will aid in bridging the education and technological gap. Furthermore, since there is a problem with debt repayment by borrowers, reducing the cost of the home on the part of the new global company by using new materials and technologies will further curb the issue with affordability and debt repayment.

On that note the paper recommends the following actions must transpire.

1. A series of mergers of the home building industry in the United States, Asia, and Europe. Once the mergers have been accomplished, the new company that has emerged should move into the developing countries of Africa and acquire the smaller companies that are still operational. Doing so will create a sense of globalization. That is, being global but acting local. The overall objective by these (M&A) is specifically intended for capital building and synergizing resources within the companies' structure.
2. The acquisition of the smaller companies in the developing countries will be beneficial in maneuvering and understanding the politics, zoning rules, and laws within the host country. Having employees that are familiar with the language of the people will also reassure the prospective home buyer that all business dealings are legitimate.
3. The built up capital by the new global building company will be able to secure and streamline the building processes of the home because each project is self funded. The cost of construction of homes in developed countries is significantly cheaper than that of undeveloped countries because of the varying materials used in the building process. For example, in the United States, the average timeframe for constructing a new home range from 3-6 months. While in developing countries like Nigeria it is difficult to complete a house in 1 year.

Acknowledgements:

The author would like to thank O. Joseph Nnanna Ph.D., for the review of this paper. Also special thanks to the two anonymous reviewers of the paper. The views expressed are personal and do not represent those of the above individual.

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Median Cost of Building a Home in Nigeria:

Year	Nigeria	North	Region South	Southeast
2000	\$ 80.59	\$ 65.59	\$ 151.10	\$ 58.51
2001	\$ 78.21	\$ 67.21	\$ 158.08	\$ 60.43
2002	\$ 90.39	\$ 70.39	\$ 168.80	\$ 63.31
2003	\$ 91.07	\$ 73.07	\$ 181.02	\$ 64.80
2004	\$ 78.90	\$ 78.90	\$ 200.66	\$ 67.61
2005	\$ 105.45	\$ 83.61	\$ 220.98	\$ 72.03
2006	\$ 98.52	\$ 105.00	\$ 220.10	\$ 75.36
2007	\$ 114.22	\$ 118.00	\$ 216.72	\$ 77.36
2008	\$ 115.82	\$ 120.00	\$ 217.72	\$ 76.54

Median Cost of Building a Home in the United States:

Year	United States	North east	Region Midwest	South	West
2000	\$ 65.59	\$ 75.55	\$ 73.43	\$ 58.51	\$ 72.28
2001	\$ 67.21	\$ 79.04	\$ 74.89	\$ 60.43	\$ 75.38
2002	\$ 70.39	\$ 84.40	\$ 76.52	\$ 63.31	\$ 82.56
2003	\$ 73.07	\$ 90.51	\$ 80.71	\$ 64.80	\$ 85.95
2004	\$ 78.90	\$ 100.33	\$ 85.52	\$ 67.61	\$ 93.68
2005	\$ 83.61	\$ 110.49	\$ 87.32	\$ 72.03	\$ 106.29
2006	\$ 85.44	\$ 110.05	\$ 86.96	\$ 75.36	\$ 111.86
2007	\$ 84.71	\$ 108.36	\$ 84.95	\$ 77.36	\$ 108.30
2008	\$ 81.78	\$ 103.86	\$ 84.41	\$ 76.54	\$ 99.24

Source: National Association of Homebuilders.

Figure 1.