Historical Research Letter
ISSN 2224-3178 (Paper) ISSN 2225-0964 (Online)
Vol.21, 2015

Banking Reforms and the Nigerian Economy, 1990 – 2007.

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ABSTRACT

The resultant effect of financial liberalization opened up the Nigerian economy to global financial markets, which has generated increasing apprehension in the economy and has exposed the fragility and vulnerability of her financial system. It is therefore imperative for the Central Bank of Nigeria to introduce measures that will reduce the exposure and enhance the stability of the nation's financial system. A defensive measure that will strengthen the existing banks and put the new ones on a firm base is needed. This led to the introduction of a new capital base of ₦25 billion. The study employed secondary data obtained from bank journals, CBN annual reports, NDIC annual reports and magazines. Also thermatic method was adopted in writing this essay. In conclusion, the study notes the need to bolster reforms through the deliberate adoption of policies that would ensure convergence of domestic and international rates of return on financial market investments.

1.1 BACKGROUND TO THE STUDY

The landscape of the Nigerian banking industry from the 1980s has been characterized by the need to strengthen the banking institutions and thereby enhance their performance and developmental role in the economy. As key institutions in the financial intermediation process, the banks are supposed to play a critical role in the mobilization of funds and the creation of wealth. However, banking in Nigeria, as in other parts of the world has been characterized by upheavals, such as unfair competitions from foreign owned banks, inadequate capital, mismanagement, over trading and lack of regulations.

Modern banking commenced in Nigeria in 1892, although ownership was dominated by foreigners.[1] This contributed significantly to the inability of indigenous Nigerian entrepreneurs to secure bank credits. In a bid to redress this situation and meet the financial requirements of Nigerian businesses, many indigenous entrepreneurs became involved in banking from the late 1920s to the mid 1950s.[2] Some of these early indigenous banks included; African Banking Corporation (1892), Bank of British West Africa (1894), Anglo-African Bank (1899), Colonial Bank (1916), to mention but a few.[3]

However, due to problems such as inadequate capital, mismanagement, over-trading, lack of regulation and unfair competition from the foreign-owned banks, 21 out of 24 of the indigenous banks established during that period up to 1954, failed.[4] This was mainly by self-liquidation, a condition that created untold hardship for depositors and a considerable loss of confidence in the ability of Nigerians to manage banking concerns.

The banking system in Nigeria started to stabilize with the regulation of banking, via the Banking Ordinance of 1952, the establishment of the Central Bank in 1959, and the Banking Decree of 1969.[5] The situation was aided by the oil boom which commenced in the early 1970s and brought along with it economic growth thereby making banking a thriving and lucrative business. In this era, there were less than 20 banks, significant ownership and control of banks by government, and highly regulated interest rates. With relaxed competition, the profit margin of banks was more or less guaranteed, notwithstanding their bloated overhead costs.

Also, ownership and management of banks by both government and the private sector increased in the 1980s. This was as a result of the restructuring of the Nigerian economy as a result of the introduction of the International Monetary Fund (IMF) backed Structural Adjustment Programme. Despite this, a major factor that impacted negatively on the banking sector in the mid-1980s was the lack of experience and adequate personnel to cope with the burgeoning industry. With the number of banks increasing to 120,[6] and with the few experienced hands moving to the highest paid jobs, opportunities were created for inexperienced personnel and even misfits to be appointed or promoted into sensitive positions in the banking industry. This led to diminished professionalism, which relegated honesty and integrity to the background, elevating materialism and inordinate ambition.

The situation was not helped by state ownership of many banks. In this scenario, staffing and running of the banks were largely subjected to political considerations. It was therefore, not surprising that most of the seven banks that were insolvent by 1989 were owned by state governments. This proved to be a tip of the iceberg as between 1989 and 1993 the number of distressed banks leapt to 28, a 300 percent increase. [7] Similarly, 1995 also witnessed the peak of bank distress, as the number increased to 60; 31 of the 60 banks were not only distressed, but terminally insolvent and depositors lost billions of naira in the crisis.

A greater percentage of the problem could be attributed to a decline in standards and breach of banking ethics. All this brought about a loss of confidence in the banking system, so much so that, according to an estimate by the Nigeria Deposit Insurance Corporation (NDIC) 50 percent of money supply in the country was outside the banking system in 1988.

1.2 STATEMENT OF THE PROBLEM

Substantial changes were introduced in the banking sector from 1993 to tackle inadequacies in the sector. Among these changes were deregulation of financial activities, especially interest rate determination, treasury securities trading, credit administration, monetary management, review and update of banking laws, introduction of prudential guidelines and the relaxation in the rules for the licensing of banks.

Against this backdrop, unearthing the basic undermining factors to reforms in the Nigerian banking sector is the major problem of this study. We desire to investigate the key elements responsible for this. Poor governance and economic instability has exposed the weaknesses of indigenous banks. These weaknesses include poor supervisory role of the Central Bank of Nigeria (CBN), mismanagement and unprofessional practices in banks and lack of well-qualified professionals.

1.3 AIM OF THE STUDY

The aim of this study is to highlight the reforms in the banking industry from 1990 to 2007. In order to know whether banks are playing their role as key institutions in the financial intermediation process, the banks are supposed to play a critical role in the mobilization of funds and the creation of wealth. Nigerian citizens are concerned about the banking industry, where it is heading to; and what benefits they have from this trend.

Furthermore, the study seeks to highlight whether banks had become stronger players in a manner that will ensure longevity hence offer higher returns to their shareholders and also promote greater impact on the Nigerian economy. The beneficiaries of this policy shift would be the ordinary men and women who can put their deposits in the banks and have a restful sleep; the entrepreneurial Nigerians who can now rely on a stronger financial system to finance their businesses and the economy, which will benefit from internationally connected and competitive banks that would also mobilize international capital for development of the country.[8]

2.0 AN OVERVIEW OF THE NIGERIAN BANKING INDUSTRY BEFORE 1990

The banking industry is the heart of any nation’s financial system. This is because banks do not only accept deposits, but also make these funds available, through their primary activities of lending and investment, to both private and public institutions. It is therefore not surprising that banks have always played a major role in influencing social and economic development; and, it is this unique role of banks that informed the development of Nigerian banking system.

The genesis of banking industry in Nigeria dates back to 1892 with the establishment of the first commercial bank, the African Banking Corporation (ABC). From then onward, the growth in the banking sector has been profound. Nigeria’s banking sector is presently a virile and booming one, but the march to these robust banking activities has not been entirely smooth. Be that as it may, we shall in this chapter reflect on the Nigerian banking system, Commercial banks, Merchant banks, Development banks and the role of the Central Bank of Nigeria as overseer of the Nigerian banking sector.

2.1 THE NIGERIAN BANKING SYSTEM

Nigeria, the largest country in Africa in terms of population (about 120 million people in 1991), also has the largest financial system in terms of the number of financial institutions, the range of services provided and the level of sophistication of customer requirements.[1] On the eve of independence in 1960, the financial system was under-developed and most of the complex ramifications which were integral to it today were not there. The

Central Bank of Nigeria (CBN) began operation on July 1, 1959[2], a year before independence, and until that date, there was little significant regulation of the banking industry. At the time, too, fiscal policy was rudimentary. Most of the banks were foreign-owned and foreign-managed, and their orientation was essentially foreign. Rural banking was unheard of as most of the foreign banks had their branches located either at the local towns or at urban centres,[3] that is to say that their branches were situated at a more populated centres.

Before the advent of colonial rule in Nigeria, the traditional barter system was widely practiced.[4] Towards the end of the 19th century, British silver coins were imported into the West African colonies to monetize the economies. Indeed, it was the need, among other factors, for the importation and distribution of these silver coins that led to the establishment of the African Banking Corporation (ABC) in 1892.[5] The bank began operation in Lagos that same year, but as a result of the trade recession which hit Lagos at that time, the bank was taken over by Elder Dempster and Company (a shipping firm) as a private bank in 1893.[6] Similarly, other banks came up in their succession and these included; Bank of British West Africa (BBWA) 1894, Anglo-African Bank (AAB) 1899 and Colonial Bank (CB) 1916.[7]

It is believed that it was in an effort to counter the apparent discrimination by the existing expatriate banks in extension of credit facilities to Nigerians that strenuous efforts were made by many Nigerians to set up banks in the country, in the first half of the 20th century.

Thus, the first indigenous bank to be established in the country, was formed in 1929; the Nigerian industrial and Commercial bank.[8] This was followed by Nigerian Mercantile Bank in 1931. These banks folded up in 1930 and 1936 respectively[9], as a result of incompetent management, accounting ineptitude and the unsound policies and practices of their officers.

The National Bank of Nigeria limited which was set up in 1933 was the first indigenous bank to be successfully established. The Post Office Savings Bank was opened in 1923 by the Post Office Savings Bank Ordinance of the same year, but was ill-equipped from its inception and thus could not operate as a conventional bank.[10] At best, the Post Office Savings Bank was viewed as a thrift institution until it was restructured into the Federal Savings Bank in 1972 and subsequently licensed as a Commercial bank in 1991 with the name Federal Savings Bank International Limited. The second successful indigenous bank, the African Continental Bank started as a private company known as Tinubu Properties Limited in 1937. It changed its name to Tinubu Bank Limited in 1947, and subsequently adopted the current name, African Continental Bank Limited, that same year.[11] Other indigenous banks established during the same period include, among others, the Nigerian farmers and Commerce Bank 1947, the Agbonmagbe Bank Incorporated 1952 which folded up in 1960.[12] Indeed a total of 185 banking companies were claimed to have been registered in Nigeria between 1947 and 1952. Unfortunately, most of the indigenous banks established between 1928 and 1952 did not survive for long, as the table below shows:

Table 1.1: List of some Recorded Bank Failures in Nigeria 1892 – 1994

Date Registered	Name of Bank	Remarks
1892	Afri. Banking Corporation	Absorbed by BBWA 1894
1899	Anglo-African Bank	Absorbed by BBWA 1912
1916	Colonial Bank	Absorbed by Barclays 1925
1929	The Industrial & Commercial Bank	Failed in 1930
1931	The Nigerian Mercantile Bank	Failed in 1976
7/1/47	Nigeria Farmer and Commercial Bank	Failed in 1953
24/2/47	Pan Nigerian Bank	Failed in 1954
21/6/51	Standard Bank of Nigeria	- do -
1990	Reliance Merchant Bank	Licence Revoked in 1992

1990	Financial Merchant Bank	Licence Revoked in 1994
1990	Capital Merchant Bank	Licence Revoked in 1994

Source: CBN Economic and Financial Review June, 1998.

Note: These failed banks bear no relationship with surviving namesakes.

Another major development in the banking scene during the independence era was the introduction of Merchant banking services into Nigeria. The Nigerian Acceptances Limited (NAL), formerly a wholly owned subsidiary of John Holt (Liverpool) limited which was set up to perform the function of a discount house, became the pioneer Merchant bank in Nigeria in November 1960.[13] In July 1969, NAL merged with Financial Holding (Nigeria) Limited, then trading under the name Phillip Hill (Nigeria) limited and by November, 1969, NAL became the first Nigerian financial house to be granted a merchant banking licence.[14] (But later, changed its name to NAL Merchant Bank Limited in 1981). In August 1973, Union Dominion Trust (UK) which had hitherto operated a hire purchase business in Nigeria was granted a Merchant banking license. Perhaps because of political uncertainty which led to the outbreak of a Civil War in 1966, and which lasted until January 1970, no new banks were licensed in the country between 1962 and 1970.

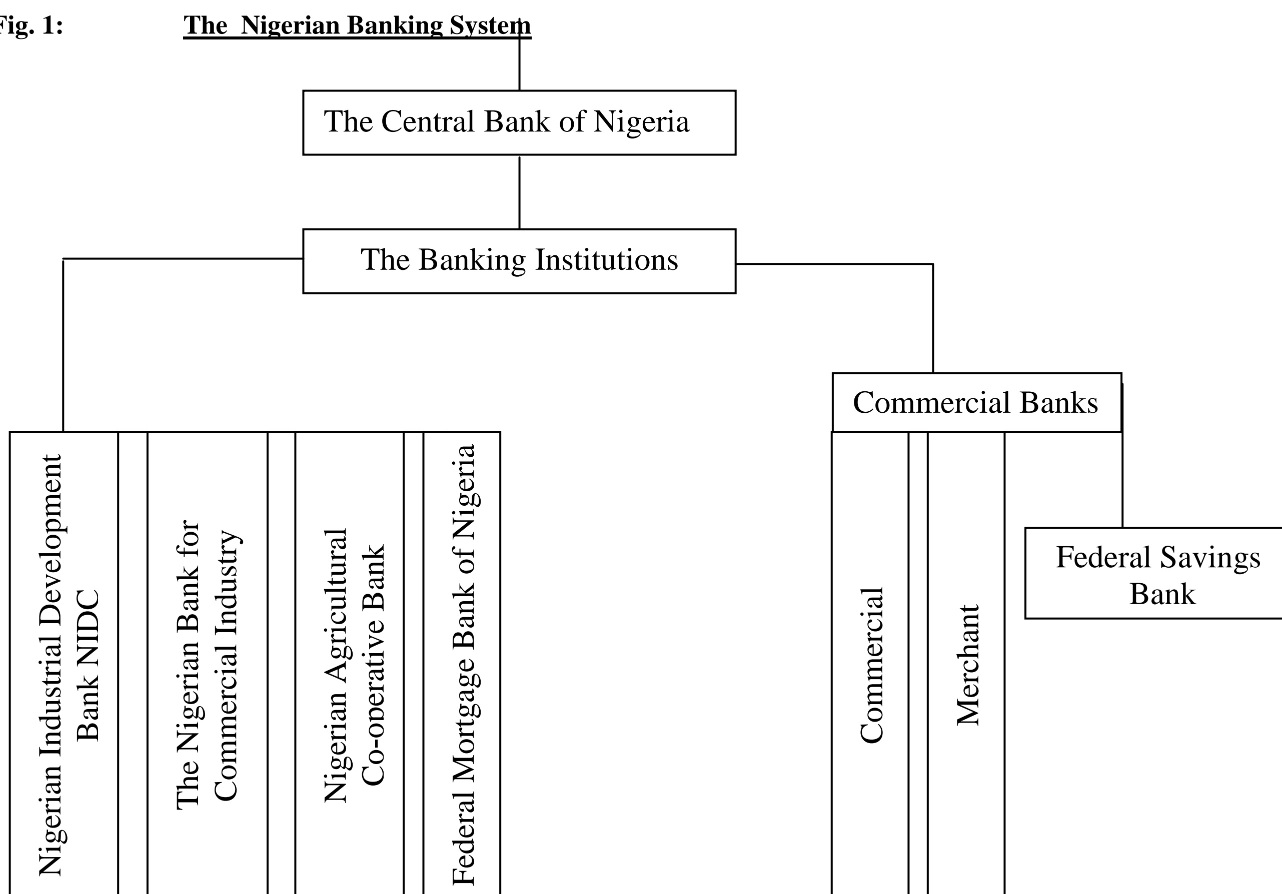
After the war, the nation embarked on post war reconstruction and development, setting the stage for indigenization of the country's financial system, particularly the banking sector which occupies the commanding heights of the nation's economy. Indigenization has been broadly defined as an evolutionary process by which the natives of a country are enabled and are seen to acquire ownership, control and management of their economy.[15] The first major step towards indigenization started with the rush to establish state banks. This was complemented by the formation of more development banks by the federal government. With the creation of the 12 – state structure in 1967 during Gowon's administration, the case was made for a bank for each state government. Hence the ownership of some banks by state governments is an important programme which affected the structure of banking in the country during the period under review was the rural banking scheme. The scheme was established following government's acceptance of the recommendations of the Okigbo Financial System Review Committee (1976).[16]

Under the first phase of the scheme which ran from July 1977 to June 1980, 188 new branch offices of commercial banks were opened. The second phase that lasted from June 1980 to December 1983 witnessed a further growth of commercial banks branches to 266 and 300 branch offices respectively, under the third phase.[17] The rapid rise in the number of banks was attributed to many factors, especially high returns on investment and conferment of automatic foreign exchange dealership status on newly established banks. Specifically, the upsurge in the number of Merchant banks vis- à-vis commercial banks has been attributed to the lower minimum equity capital requirement, lower operating costs and exemption from the rural banking programme.

The table below shows the structure of the Nigerian Banking System.

ISSN 2224-3178 (Paper) ISSN 2225-0964 (Online)
Vol.21, 2015

Fig. 1: The Nigerian Banking System



Source: CBN Annual Report June, 1987.

Commercial Banks

Commercial banks represent one of the main vehicle for the implementation of the Central Bank of Nigeria's monetary policies encapsulated in the credit guidelines. The traditional role of commercial banks embraces, among others, acceptance of deposits through the operation of current and savings accounts for individuals and corporate customers, provision of short-term and overdraft facilities and money creation.[18]

Commercial banks contribution to the socio-economic development of Nigeria is sub-sumed in the implementation of the national development plans and credit facilities made available to the priority sectors of t he economy[19] such as agriculture, industrial and manufacturing sectors, agro-allied industries, transport and communication as well as credit to federal and state governments.

The pulse of the commercial banking sector is dominated to a large extent by three big banks now dubbed the "big three" namely First Bank, Union Bank and United Bank for Africa (UBA). The "big three" contribution to the alleviation of unemployment in the country is manifested by the like in the number of employee. Staff strength of Union Bank rose from 10,736 in 1986 to 11,226 in 1987; First Bank, from 9,810 in 1986 to 10,865 in 1987; and UBA from 7,222 in 1986 to 7,644 in 1987.[19] Other commercial banks have also contributed their quotas in like manner.

Union bank has also blazed the trail in the funding of higher education. In 1987, three federal universities became the first beneficiaries. The fund aimed at making the universities centres of excellence in Agricultural Technology (Akure), Computer Technology (Minna) and Banking and Finance (Owerri). This is what social responsibility is all about – contribution to the social development of the society/community in which the organization operates.[20]

IBWA/Afribank funded a university post graduate studies programme at the University of Ibadan (UI). The UBA donated some Peugeot Patrol cars to the Nigerian Police in 1987. First bank also made a cash donation of 5 million naira to the Nigeria Police. Apart from that, first bank's annual undergraduate essay competition helps to stimulate students thought on national issues. In the field of sports, most Nigerian banks have sponsored sporting activities in the past from polo to Golf, soccer to athletics and tennis. African Continental Bank (ACB), First Bank, New Nigerian Banks, among others, had football teams that featured in national league competitions. In the field of entertainment and enlightenment, some commercial banks have made their impact through the sponsorship of radio and television programmes. United Bank for Africa used to sponsor "Cock Crow at Dawn", a serialized national programme whose thrust was to generate mass interest in agricultural production. The Cooperative and Commerce Bank (CCB) sponsored "New Masquerade", then favorite TV programme aimed at redressing the ills of the Nigerian Society IBWA/ Afribank's Road Safety Campaign on TV screens add to the enlightment programmes to build a safer society.[21]

Since development permeates all facets of human life, commercial bank's contribution in these regards are noteworthy. Yet, much is still expected from the banks. "The banks", says Uchenna A. Nwaodu, an economic writer, "need to do more in their social responsibilities to our society to justify the huge profits they derive annually from their operation".[22]

Merchant Banks

There is considerable ambiguity in the use of the term Merchant bank. It is a term that has been passed on from British banking practice and adopted in Nigeria without a clear idea in the minds of the authorities, until late 1970s. As to the role and function of such institutions little wonder that judgements as to their relevance and their contributions were often interwoven with judgements concerning commercial banks.[23]

In British, whence merchant banking has come to Nigeria, its origin goes back to merchandise trade in goods. Large and established traders would, in time, provide financial facilities and services to their customers by 'accepting' bills of exchange drawn by, or on, their customers.[24] With the growing sophistication of the Nigerian financial system, the services rendered by specialized banks to fill the gap created by commercial bank and further accelerate the pace of economic development became a desideration. In consequence, merchant and development banks in the country rose to the challenge dating back to 1969 when the Nigerian Acceptance limited merged its operations with Phillip Hills to form the NAL merchant bank, the contributions of merchant banks to t he economic development of Nigeria has not been in doubt.

As a result of their specialized services and wholesale banking practice, minimum amount depositable in any merchant bank is 50,000 naira. Merchant banks have been identified as dual intermediaries in the domestic and international spheres. Kayoed Akin-Ajayi, a merchant banker, observed that merchant banks are "prime innovators in the promotion of industrialization and economic development filling in the process the gap created by the commercial and development banks in their respective short and long term end of the financial market".[25] True to type, merchant bank's impact on the Nigerian economy can be gauged in part, in the realms of loans and advances for new projects, plant expansion, general commerce, service, leasing and industrial re-equipment.[26]

In the seventies, total merchant banks' loans and advances to investment units in the economy amounted to less than 250 million naira. By 1980s however, the situation dramatically changed for the better. The total loans and advances made available to the domestic economy stood at 493.2 million naira.[27] Also according to CBN reports, merchant banks' aggregate loans and advances to state governments rose from 6.1 million in 1983 to 20 and 21 million naira respectively in 1985 and 1986.[28] One other emerging role of the merchant banks in Nigeria is that they are increasingly being mandated to serve as "financial intermediaries between the state government" and the World Bank on the Infrastructural Development Finance (IDF) projects which embraces water supply, primary drainage, road network and refuse disposal among others.

Furthermore merchant banks in Nigeria have played a significant role in underwriting, placing and management of public issues of debts and equity. IMB securities limited, NAL stock brokers, NMB's merchant securities limited, among others are worthy of mention here.[29]

Development Banks

The rationale for development banking in Nigeria according to financial market watchers ranged from filling the "Gaps" created in the financial system by the commercial banks to serving as catalyst to stimulate fast rate of economic development. The Nigerian Bank for Commerce and Industry (NBCI), Nigeria Industrial

Development Bank (NIDB), Nigeria Agricultural and Co-operative Bank (NACB), Federal Mortgage Bank (FMB) and Federal Savings Bank (FSB) were borne out of this development. Established in October 1973, six months after the establishment of the Nigerian Agricultural and Co-operative Bank (NACB), the paid up capital of NBCI was 50 million naira and this was increased to 170 million naira over the years. The bank was established by the federal government with the Central Bank of Nigeria (CBN) controlling 40 percent.[30]

The Act establishing NBCI recognized the prime motive of setting it up to aid the financing of indigenization of the Nigerian economy. Thus NBCI was set up primarily to "act as a catalyst for development".[31] Its activities cover merchant or wholesale banking as well as the provision of equity and loan capital for medium and long term investment to Nigerian citizens, institution and organizations in the field of commerce and industry. In the first three years of operation (1976), NBCI invested (both equity and loans) in such government projects as Ashaka Cement Company Limited (17 million naira); Benue Cement Company Limited (17.52 million naira); and Maiduguri Brick Project (2.15 million naira). It also invested in South Eastern Brewery (now Cross River Breweries) (1.605 million naira) and Kainji Textiles Company Limited (1.35 million naira).[32] Within the same period, the bank also invested in non-government project such as food and beverages, tourism, petrochemical products among many others, which became lapsed or inactive. A total of 12.968 million went down the drain.[32]

In Nigeria, as in other African States, one of the key functions of development banks is that they act as catalysts for development, making available to the country funds from international institutions that should otherwise be channeled elsewhere. Notably in this role function are the Nigerian Industrial Development Bank (NIDB) and the Nigerian Bank for Commerce and Industry (NBCI).

Furthermore, NIDB has embarked on diversification of its operations. The new services provided as from the third quarter of 1985 includes opening of letter of credits (LCs) and acceptance of deposits from industrial clients as well as provision of working capital loans and trading in the foreign exchange market (FEM).

For the commercial and merchant banks, banking in a recessed economy means more than a single challenge. Innovative packages, aggressive marketing, competitive edge, strategic initiatives and for the first time, serious efforts at rendering efficient services are all poised to change the Nigerian banking climate for the better. The magic behind this was the deregulation of interest rates on July 31, 1987 as well as the "survival of the fittest syndrome", which banking in a recessed and charging economy conjures.[33] There is a gradual change from armchair banking to innovative and aggressive banking.

2.2 THE ROLE OF THE CBN AS OVERSEER OF THE NIGERIAN BANKING SECTOR

The organization of a Central Bank may differ from one country to another but in general the functions are basically the same. The Central Bank, by whatever name it is called (Bank of England in Britain, Federal Reserve Board in the USA, etc) is the banker's bank, a bank of last resort; it is the banker to the government and adviser on financial and monetary policy. It is the only authority for the issuance of the legal tender or currency in the country. These functions are enumerated and defined as powers given to the Central Bank in the basic law which established it, in this case the Central Bank Act 1958, as amended by subsequent legislations and decrees. It is because they have been prescribed in those laws, the duties become statutory; they cannot be withdrawn except by means of legislative amendment, similarly failure to carry them out becomes a breach of a statutory duty, or a duty imposed by law. We take these duties one by one.

Bank of last resort and banker to the government, the Central Bank maintains the account of the federal government. Until its establishment, the commercial banks competed for these accounts even though government accounts inject a certain measure of instability. In its role as banker to the government, the Central Bank does for the government to a large extent what the commercial bank do for its private customers: it provides advances, by ways and means, of up to 25% of the revenues estimated to accrue in the year.[34] The government, like any other economic unit, needs loans and long term funds for its investment programme. As banker to the government, it is the Central Bank that manages the public debt of the federation.

Issues of currency: The Central Bank is the bank of issue. It issues its notes which by law are legal tender and are accepted throughout the federation. Before the establishment of the Central Bank, the notes in circulation were the West African currency notes issued by the West African Currency Board. The Central Bank took over this function effectively in 1962 thereby terminating one of the few major vestiges of colonial rule that lingered into post-independence Nigeria.[35]

Managing the Reserves: The capacity of a country to pay for its imports depends on its export earnings; or earrings from its overseas investments, on loans and gifts from abroad and investment in the country by residents overseas. The first problem of management of the external reserves of a country is to document and monitor the movement of the reserves. The Central Bank Research Department keeps a constant watch on the movements in the balance of payments and records the transactions on the external account – both current and capital. It is therefore able to identify when policy measures are required to protect the external reserves, and long run measures are to be introduced in anticipation of pressures on external reserves.

Promotion of Monetary Stability: In this function, the Central Bank exercises its main regulatory and supervisory role over the banking system. It is the core of the Central Bank's strength and authority for it enables the bank to influence the movements in money supply and in credit by the banking system and constitutes the bank into an effective apex institution. The role is exercised through the use of several powers and instruments. The commercial banks are required by the Central Bank to maintain a prescribed ratio of cash to deposits and a ratio of liquid assets to deposits. It is the Central Bank that defines for the banking system what assets can count for liquid assets for the purpose of determining the liquidity ratio.[36] In a bid to control credit, the Central Bank issues monetary circulars every year in which it prescribes the credit ceilings within which the commercial banks can operate.

The Central Bank does engage in open market operations: buying and selling of government securities, bills, stocks etc to the banking system. If the credit expansion by the banking system is excessive, according to Mr. Ikechi Amaefula during an interview with him, the Central Bank cannot only raise the liquidity ratio but can also sell securities and thereby reduce the level of the capacity of the banks to create credit. It can embark on the reverse course if there is too little liquidity and the banks need to be encouraged to expand credit.[37]

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3.0 REFORMS IN THE NIGERIAN BANKING SECTOR IN THE 1990s

There is a consensus in the literature that at the heart of economic reforms is the need to address a two-fold task: restructure or get policy incentives right as well as restructure key implementation institutions. Financial sector reforms is that aspect of economic reforms which focus mainly on restructuring financial sector institutions (regulators and operators) via institutional and policy reforms. As part of the financial sector, banking sector reforms is that aspect which focuses mainly on getting incentives right for the banking sector to take the lead role in empowering the private sector to contribute more to economic growth.[1]

In Nigeria, we recognize four phases of banking sector reforms since the commencement of Structural Adjustment Programme (SAP). The first is the financial systems reforms of 1986 to 1993 which led to deregulation of the banking industry that hitherto was dominated by indigenized banks that had over 60 percent federal and state governments' stakes, in addition to credit, interest rate and foreign exchange policy reforms.[2] The second phase began in the late 1993 – 1998, with the re-introduction of regulations. During this period, the banking sector suffered deep financial distress which necessitated another round of reforms, designed to manage distress.[3] The third phase began with the advent of civilian democracy in 1999 which saw the return to liberalization of the financial sector, accompanied with the adoption of distress resolution programmes. This era also saw the introduction of universal banking which empowered the banks to operate in all aspect of retail banking and non-bank financial markets.[4] The fourth phase began in 2004 to 2007 which shall be discussed in subsequent chapters.

3.1 GENESIS AND REASONS FOR REFORMS IN THE 1990S

Banking reforms have been an on-going phenomenon around the world right from the 1980s, but it is more intensified in recent time because of the impact of globalization which is precipitated by continuous integration of the world market and economies. Banking reforms involve several elements that are unique to each country based on historical, economic and institutional imperatives. In Nigeria, the reforms in the banking sector was necessary against the backdrop of banking crisis due to highly undercapitalization, deposit taking banks; weakness in the regulatory and supervisory framework; weak management practices; and the tolerance of deficiencies in the corporate governance behaviour of banks.[5] Banking sector reforms and recapitalization have resulted from deliberate policy response to correct perceived or impending banking sector crises and subsequent failures. A banking crisis can be triggered by weakness in banking system characterized by persistent illiquidity, insolvency, undercapitalization, high level of non-performing loans and weak corporate governance, among others.

Banking crisis usually starts with inability of the bank to meet its financial obligations to its stakeholders. This, in most cases, precipitates runs on banks, the banks and their customers engage in massive credit recalls and withdrawals which sometimes necessitate Central Bank liquidity support to the affected banks. Some terminal intervention mechanism may occur in the form of consolidation (mergers and acquisitions), recapitalization, use of bridge banks,

establishment of asset management companies to assume control and recovery of bank assets, and outright liquidation of non redeemable banks. Bank consolidation, which is at the core of most banking system reform programmes, occurs, some of the time, independent of any banking crisis.[6]

Irrespective of the cause, however, bank consolidation is implemented to strengthen the banking system, embrace globalization, improve healthy competition, exploit economies of scale, adopt advanced technologies, raise efficiency and improve profitability. Ultimately, the goal is to strengthen the intermediation role of banks and to ensure that they are able to perform their developmental role of enhancing economic growth, which subsequently leads to improved overall economic performance and societal welfare. The proponents of bank consolidation believe that increased size could potentially increase bank returns, through revenue and cost efficiency. It may also, reduce industry risks through the elimination of weak banks and create better diversification opportunities.[7] On the other hand, the opponents argue that consolidation could increase banks' propensity towards risk taking through increase in leverage and off balance sheet operations. In addition, scale economies are not limited as larger entities are usually more complex and costly to manage.[8]

Banking sector reforms in Nigeria are driven by the need to deepen the financial sector and reposition the Nigerian economy for growth; to become integrated into the global financial structural design and evolve a banking sector that is consistent with regional integration requirements and international best practices. It also aimed at addressing issues such as governance, risk management and operational inefficiencies, the centre of the reforms is around firming up capitalization said Mrs Ogechi Asua.[9]

Capitalization is an important component of reforms in the Nigeria banking industry, owing to the fact that a bank with a strong capital base has the ability to absolve losses arising from non performing liabilities. Attaining capitalization requirements may be achieved through consolidation of existing banks or raising additional funds through the capital market.

It must be mentioned here, that, recapitalization of banks is not a new phenomenon. Right from 1958, after the first banking ordinance in 1952,k the colonial government then raised the capital requirement for banks especially the foreign commercial banks from 200,000 pounds to 400,000 pounds. Ever since, the issue of banks recapitalization has been a continuous occurrence not only in Nigeria but generally around the world especially as the world continues to witness increasing interdependence among national economies.[10]

Recapitalization in Nigeria comes with every amendment to the existing banking laws. In 1969, capitalization for banks was ₦1.5m for foreign banks and ₦600, 000 for indigenous commercial banks.[11] In 1979, when merchant banks came on board the Nigerian banking scene, the capital base was ₦2m.[12] As from 1988, there had been further increase in the capital base, particularly coupled with the liberalization of the financial system and the introduction of Structural Adjustment Programme (SAP) in 1986. In February 1988, the capital base for commercial bank was increased to ₦5m while that of the merchant bank was pegged at ₦3m.[13] In October the same year, it was increased to ₦10m for commercial bank and ₦6m for merchant banks. In 1989, there was a further increase to ₦20m for commercial bank and ₦12m for merchant bank.[14]

In recognition of the fact that well capitalized banks would strengthen the banking system, the minimum paid-up capital for commercial banks was increased to ₦50m as against ₦20m in 1990. While that of merchant banks was increased to ₦40m as against ₦12m the year before.[15] Distressed banks whose capital fell short of the new increased paid-up capital, was given upto 31st of March,k 1997 to comply or face liquidation. Twenty-six of such banks were liquidated by January, 1998 (13 merchant and 13 commercial banks). Then by December 1998, a uniform minimum paid-up capital for commercial and merchant banks were raised to ₦500 million.

3.2 CHARACTERISTIC OF THE 1990S REFORM

Banking reforms have been an on going phenomenon around the world right from the 1980s, but it is more intensified in recent time because of the impact of globalization which is precipitated by continuous integration of the world market and economies. Also in the words of Mr. E.C. Nwogu banking reforms involve several elements that are unique to each country based on historical, economic and institutional imperatives.[16]

In Nigeria, the banking system was highly oligopolistic with remarkable features of market concentration and leadership. The system was characterized by generally small-sized fringe banks with very high overhead costs; low capital base averaging less than $10million or ₦1.4billion; heavy reliance on government patronage (with 20% of industry deposits from government sources).[17]

Furthermore, fifty-five out of the one hundred and twenty deposit-money banks that existed in 1993 exhibited one form of weakness or the other. Prominent among such weaknesses are under-capitalization and/or insolvency, illiquidity, poor asset quality, weak corporate governance, boardroom squabbles, dwindling earnings and, in some cases, loss making.[18]

Furthermore, Mr. S.U. Ejeh was of the opinion that the unhealthy competition that existed in the market, which was engendered by the relative ease of entry into the market as a result of the low capital base, necessitated some banks going into rent-seeking and non-banking businesses, which are not related to core banking functions. Some of the banks were preoccupied with trading in foreign exchange, government treasury bills and sometimes, indirect importation of goods through surrogate companies.[19] As a result of these, some of the banks became distressed and were liquidated, reducing their number to 89 and 2220 branch networks in 1998.[20]

Also, wide-spread incidence of non-performing loans have been considered as one of the characteristics of the 1990s reforms in the banking sector. They are usually exacerbated by negligence on the part of the lending officers. Some of the loans are granted without regards to the basic tenets and conditions of lending. In 1994, insider lending which is the major cause of bad debts, accounted for 65% of the total loan defaults of the four local banks liquidated.[21] This situation made it extremely difficult to recover a substantial part of the loans, while the resulting inability of lenders (banks) to solve adverse selection problem, made them less willing to lend. This development further led to a decline in lending, investment and aggregate economic activity.

Similarly, the structure of ownership, as a matter of fact, warrants intervention in the inter-management of banks and very often contributes to the banks financial distress. A good example is the lack of independence of the Central Bank of Nigeria from the Federal Ministry of Finance (FMF), political consideration and lack of technical expertise in the FMF. All these hinders proper bank regulations and supervision, thereby leading to inefficient control and supervision of the banks portfolios by the apex bank. The result is that room is created for the banks to involve themselves in illicit and fraudulent act. This dependence syndrome has also made many cooperative banks to go insolvent. This is because their major shareholders influence the bank management with their poor knowledge of banking.[22]

Another characteristic of the 1990s reform is the assumption of control and management of some of the distressed banks by the monetary authorities. In line with this, interim management boards (IMBS) were appointed for the six distressed banks that were taken over by the CBN in 1993. As a result of their ineffectiveness, they were replaced with a single Transitional Supervisory Board (TSB).[23] The objective was not to acquire, but to restructure and subsequently sell them to the public. In 1995, the CBN obtained the approval of the federal government to assume the control and management of seventeen banks for restructuring and subsequent sale. The board of directors of the affected banks were dissolved and replaced with interim Management Boards.[24]

The federal government also promulgated decree No. 18 of 1994 on failed banks, recovery of debts and other financial problems in banks, particularly insider abuse in which key officials of most banks granted loans and advances to themselves and other staff without collaterals and little consideration for ability to repay.[25] All these characterized the 1990s reforms.

3.3 CONSEQUENCES OF THE 1990S REFORMS ON THE BANKING SECTOR AND THE ECONOMY

The review of the incentives structure and impact of reforms so far, show that the outcome fell short of expectation and that this was doomed to be so because of some pitfalls which militated against it. Among these are faulty premise for reforms, wrong sequencing of reforms, conflicts emanating from adopted theoretical models for reforms and above all, frequent reversals and/or non-sustainability of reforms.

The review of eras of reforms in Nigeria shows that the premise was to get price incentives right for the banking sector through the abolition of foreign exchange and credit rationing in favour of liberalized domestic money and foreign exchange markets.[26] The concern was more with reducing government intervention with the hope that there exists a virile private sector to fill the gap effectively. Unfortunately, the Nigerian financial market was far from being virile, as it was characterized by dualistic financial markets, whereby the commercial banks operated side by side with rural and parallel markets.[27] While the government succeeded, after a long period, of divesting her interests in the banking sector, market segmentations persisted and perhaps remained at the root of policy compromises which tended to thwart the reforms effort till date. Thus, one of the pitfalls of the reforms programme therefore is the premise that there exist virile private sectors that can successfully implement the reforms agenda.[28]

Related to the above is the poor sequencing and coordination between policy reforms initiatives, the timing of implementations and sustainability. This was particularly problematic in post-SAP era when the monetary authorities had to subject the banking sector to liquidity shocks via discretionary policy in order to tame the foreign exchange market. It has been argued that such shocks was detrimental to the performance of the banking sector and further exposed them to increased risks in the face of macroeconomic instability, arising from the weakening oil market, exchange rate and financial sector crisis.[29]

Furthermore, another such shock during this period occurred in 1990 when the monetary authority decided that the back-log of naira deposits for foreign exchange applications yet to be approved be moved from deposit money banks to the Central Bank of Nigeria. The second shock stemmed from the order that public sector funds in Deposit Money Bank (DMBs) be transferred to the CBN. These combined actions precipitated the liquidity crisis in the period and as such large scale withdrawal of deposits were made by customers. Although distress resolution measures were taken by the CBN through accommodating some of the banks as a lender of last resort, very few regained viability, while many of them had their licenses revoked and were subsequently liquidated.[30]

With regards to institutional reforms, the assumption is that banking sector liberalization accompanied by increased capital base requirements is a necessary condition for improved performance of the banking sector. This was echoed by the proponents of the initial banking sector reforms in SAP era and re-echoed by the pre-Soludo era.[31] The underlying argument draws its strength from the neo-classical supply-side economics, rooted in Say's law that "supply creates its own demand"[32] That is, increased capital base may imply increased availability of loanable funds. This should lead to a fall in interest rate and should be capable of stimulating or eliciting a demand following response as envisaged by Say's law of market. However, the major pitfalls of this assumption is reflected in the trade-offs costs which manifested in the various eras of reforms in Nigeria.[33]

Furthermore, another consequence revolves around the apparent inability of the monetary authority to monitor and supervise the conduct of the emerging few but strong "oligopolies" in the domestic money and foreign exchange markets. One argument often advanced by the monetary authorities is to keep a watch on monetary expansion; this on the other hand will be an instrument to stabilize the foreign exchange market. The operating procedure usually is to limit the capacity of banks to make outrageous bids for foreign exchange, through the control of their money reserves.[34]

The review so far shows that a major element of the banking sector reforms is the introduction of a foreign exchange market that metamorphosed from Stock Foreign Exchange Market (SFEM) to Foreign Exchange Market (FEM) and Inter-bank Foreign Exchange Market (IFEM).[35]

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4.0 BANK REFORMS FROM 2000 TO 2007

It is incontrovertible that the banking system is the engine of growth in any economy, given its function of financial intermediation. Through this function, banks facilitate capital formation, lubricate the production engine turbines and promote economic growth. However, banks' ability to engender economic growth and development depends on the health, soundness and stability of the system. The need for a strong, reliable and viable banking system is underscored by the fact that the industry is one of the few sectors in which the shareholders' fund is only a small proportion of the liabilities of the enterprise. It is therefore, not surprising that the banking industry is one of the most regulated sectors in any economy. It is against this background that the then Governor of Central Bank of Nigeria, Prof. Charles Soludo, in his maiden address, outlined the first phase of its banking sector reforms designed to ensure a diversified, strong and reliable banking industry.[1]

The primary objective of the reforms is to guarantee an efficient and sound financial system. The reforms are designed to enable the banking system develop the required resilience to support the economic development of the nation by efficiently performing its functions as the fulcrum of financial intermediation. Mr. Ikechukwu Onah was of the opinion that reforms were to ensure the safety of depositors' money, position banks to play active developmental roles in the Nigerian economy, and become major players in the sub-regional, regional and global financial markets.[2]

The key elements of the 13-point reform programme include: minimum capital base of ₦25 billion with a deadline of 31st December, 2005; consolidation of banking institutions through mergers and acquisitions; phased withdrawal of public sector funds from banks, beginning from July, 2005; adoption of a risk-focused and rule based regulatory framework; zero tolerance for weak corporate governance, misconduct and lack of transparency; accelerated completion of the Electronic Financial Analysis Surveillance System (e-FASS); The establishment of an Asset Management Company; promotion of the enforcement of dormant laws; closer collaboration with the Economic and Financial Crimes Commission (EFCC) and the establishment of the Financial Intelligence Unit (FIU);[3]

Two of the above reform elements which have since generated so much concern and reactions from various stakeholders are: requirement that the minimum capitalization of banks should be ₦25 billion with full compliance by 31st December, 2005 and consolidation of banking institutions through mergers and acquisitions.

4.1 BACKGROUND TO THE REFORMS

A review of the banking system as at June, 2004, revealed that marginal and unsound banks accounted for 19.2% of the total assets, 17.2% of total deposit liabilities, while industry non-performing assets was 19.5% of the total loans and advances.[5] The implication of this unsatisfactory statistics is that there existed threat of a systematic distress judging by the trigger points in the CBN contingency planning framework of December 2002, which stipulated a threshold of 20% of the industry assets, 15% of deposits being held by distressed banks and 35% of industry credits being classified as non-performing.[6] The aboved scenario required drastic action if the banking system was to properly play its role as a catalyst to development. Thus, in the words of the then Governor of the Central Bank of Nigeria (CBN), Professor Charles Soludo remarked that "it became necessary to take pre-emptive measures to avoid the cycle of boom and bust", adding that "it is now time to set up a structure that creates a strong base relative to the kind of economy we are operating where banks become channels to do proper intermediation."[7]

However, it has been contended that the political stalemate arising from the annulment of the June 12, 1993 national elections which caused fleeing customers of banks and finance companies to demand large amounts of cash withdrawals, and the collapse of the inter-bank market as a result of massive defaults among banks in honouring financial obligations may be viewed as the immediate causes of illiquidity and insolvency which led to the terminal ill-health of many banks.[8]

From the foregoing, it is not only clear that the root causes of the second banking crises were largely similar to those of the first banking crash of the 1950s, but it is also evident that our banking history has gone through a cycle similar to a life product cycle, that is growth, maturity and decline.

The latest assessment has shown that the overall health of the Nigerian banking system could be described as generally satisfactory; the state of some banks is less cheering. Specifically, as at the end of March, 2004, the CBN's ratings of all the banks, classified 62 as sound/satisfactory, 14 as marginal and 11 as unsound, while two of the banks did not render any returns during the period. The weaknesses of some of the ailing banks are manifested by their overdrawn positions with the CBN, high incidence of non-performing loans, capital deficiencies, weak management and poor corporate governance. These shortcomings have, in recent years, led to the revocation of the licenses of two banks and the suspension of three others from clearing house activities, prior to the commencement of the new settlement system.[9]

4.2 OBJECTIVES OF THE REFORMS

The then structure of the banking system, made up of 89 banks relatively small capitalization, cannot sufficiently mobilize international and domestic capital for the development of investments, especially in the oil and gas sector which is the backbone of the economy and are not resilient to shocks within the financial system. Thus the reforms aimed to strengthen and consolidate the banking system. The first phase of the reforms was designed to ensure a diversified, strong and reliable banking sector which would ensure the safety of the depositors' money, play active developmental roles in the economy, and to be competent and competitive players in the African regional and global financial system. It also aimed at ensuring longevity, hence higher returns to shareholders over time and greater impact on the economy.[10]

In the main, the policy aimed at developing a more resilient, competitive and dynamic banking system that supports and contributes positively to the growth of the economy with a core of strong and forward looking banking institutions that are technology driven and ready to face the challenges of liberalization and globalization. The reform essentially entails the build-up of capital, size and business scale of the banking institutions, at the end of which smaller number of, but much stronger, institutions will emerge.[11]

Furthermore, it also aimed at mergers and acquisition as an instrument for banking soundness. According to the then Governor of CBN, Charles Soludo, given the internationalization of finance, size had become an important ingredient for success in the globalizing world. In the world of finance, he added, no country can afford to operate in isolation. Mergers and acquisition especially in the banking industry have now become global phenomena. In the United States of America for instance, there have been over 7,000 cases of bank mergers since 1980, while the same trend occurred in the United Kingdom and other European countries.

All these reforms are driven by our medium and long-term objectives to ensure economic prosperity of Nigeria, and for Nigeria to become the Africa's financial hub by the year 2020. Only a sustained stable macroeconomic environment and a sound and vibrant financial system can propel the economy to achieve our national desire to become one of the 20 largest economies in the world by the year 2020.[13]

4.3 BANK RE-CAPITALIZATION AND CHALLENGES

The challenges confronting the consolidation process are examined under two headings, namely: pre-consolidation and post-consolidation. A number of issues were identified to be of critical importance in the pre-consolidation phase. Notable among these issues are: true line given for the consolidation programme; under normal condition, mergers and acquisitions take time to consummate because there are a number of processes which must be followed. For instance, from the Securities and Exchange Commission (SEC) angle, eight important steps must be followed before a successful merger or acquisition could be accomplished. The steps encompass; SEC's Approval in-principle; preparation of the scheme document; clearing of the scheme document with SEC and the Nigerian Stock Exchange (NSE); application to the Federal High Court, for the court to give orders that separate shareholders' meetings of the companies be convened; the scheme document and notice of respective court-ordered meetings are to be sent to the shareholders of the companies, and the shareholders need a minimum of three weeks notice to hold their meetings must be published in the Newspaper; Approval of the schemes of merger at the separate court-ordered meetings; the Resolutions of the Court-Ordered meetings of companies are to be referred to SEC for approval; the companies are required to file an application for a court order sanctioning the scheme of merger/ acquisition. In addition to the above, the banks had to satisfy the following CBN requirements; pre-merger consent; approval-in-principle; final approval.[14]

Given the processes involved in consolidation, it is obvious that 18 months was inadequate for these processes to be effectively undertaken. Thus, what we witnessed in the Nigerian banking landscape are the mergers and acquisition of banks that were hastily packaged in order to beat the CBN deadline. According to Mr. Godwin Udegbu, mergers and acquisitions are supposed to be voluntary strategies for consolidation. Therefore, the

policy-induced M and As of the concluded bank consolidation in Nigeria suggests that the relevant institution are likely to be faced with serious post-consolidation integration challenges.[15]

High cost of mergers and acquisition: The experience with the concluded bank consolidation has shown that it is quite an expensive exercise. Most of the weak and marginal banks had to incur cost to go to the capital market to raise funds. They also had to bear the cost of mergers and acquisition. This involves the cost of preparing due diligence reports, cost of paying consultants, cost of preparing the scheme document and other related costs. The issue of high cost of consolidation is not restricted to the weak banks, as the big and strong banks that acquired smaller banks had to bear similar and bigger costs.[16]

Lack of cooperation from some of the consolidating banks: Ironically, some banks found it difficult to find a group to merge with or find a big bank to acquire them because, initially some of them were foot-dragging and some had refused to cooperate with the banks that showed interest in acquiring them as they continued to give difficult conditions with regard to some important issues, such as, the worth and the value of their shares, quality of their risk assets, number of representations on the board of the new bank and general lack of transparency in providing a timely information.

A lot of human resource related issues arise with regard to the consolidation programme. In the first instance, once two or more banks begin to talk about merger or acquisition, the staff of the affected institutions become jittery about job security which invariably affect their productivity. Certainly, consolidation might lead to job losses at the executive, general management, senior and junior staff cadre. For instance, it is not feasible to have two Managing Directors/ Chief Executives in an organization. The second issue of concern is the variance level of compensation/remuneration packages of merging banks. In most cases, there exists a wide and unrealistic disparity in the remuneration packages of banks that have merged or have been acquired. This issue is more problematic in the case of merger/acquisition between a big bank with a large workforce and smaller banks with small staff strength but high personnel cost.[17]

Information and Communication Technology (ICT) Related Issues: It is a well-known fact that different banks employ different banking applications software to gain competitive edge. The challenge here is that some of these ICT packages are not compatible and banks have already incurred huge costs in the acquisition of these technologies. This, therefore increases the cost of consolidation, as the banks worked under one IT platform.[18]

The post consolidation challenges include; Corporate Governance: The status of corporate governance in the banking industry is expected to improve remarkably following the change in the ownership structure. Thus, the dilution of ownership engendered by the new dispensation would ensure that a few individuals and their cronies do not have overbearing influence in the running and management of the banks unlike what used to happen in some privately owned banks where the influence of a few directors was very pronounced. However, the enlarged board membership that would result from consolidation could give rise cleavages or "camps" that could result in boardroom squabbles. The leadership of the board should, therefore, be equipped to handle such division of opinion. Otherwise it could become a source of setback to the mega banks.[19]

Post-consolidation integration: To merge or acquire an institution is one thing, but to get the institutions involved to work harmoniously is another. The post consolidation integration will pose more challenges in a consolidation case involving more than two institutions. The new organization may lack flexibility in responding quickly to changing market situation due to the large size. Additionally, every organization has its own corporate culture. When two or more organizations come together to form one company, there is bound to be culture conflicts. Such conflicts would be more where the style of management of the organizations differs. Thus, the integration of the operations, processes, procedures, people and products to let the consuming public see the emerging entity as one group is a daunting challenge which the consolidated banks have to contend with.[20]

Challenge of increased returns on investment: With the minimum capitalization of ₦25billion for consolidated banks, the management of such banks is bound to operate under undue pressure from shareholders, who would be anxious to see higher returns on their investments. Currently, the average Return On Invested Capital (ROIC) in the Nigerian banking industry is estimated to be about 38%. With the substantial increase in shareholders' funds engendered by the consolidation programme, each bank would need to generate an average minimum of ₦9.5billion in profit before tax in order to maintain the same rate of return. Thus, the pressure that would mount on the management of the mega banks would force them to be more innovative and creative in

conning up with new products and exploring other businesses, such as financing the real sector, which has hitherto been neglected. However, such pressure could also precipitate sharp and unethical practices by the banks if the regulatory environment is not tight.[21]

4.4 EFFECTS OF BANK RE-CAPITALIZATION ON THE BANKING SECTOR AND THE NIGERIAN ECONOMY

According to the then Governor of Central Bank of Nigeria, Professor Charles C. Soludo, in his briefing on the "Strategic Agenda of the Naira", outlined some consequences of bank re-capitalization thus; Bank recapitalization/ consolidation; programme to possibly eliminate or reduce government ownership of any bank (to no more than 10percent); improved transparency and corporate governance; zero tolerance to misreporting and data rendition, and strict adherence to the Anti-money laundering regulations; payments system reforms for efficiency especially the e-payment; addressing issues of technology and skills in the banking industry especially in risk management and ICT; launching of a new micro finance policy and regulatory framework to serve the unserved 65 percent of the bankable public; forging strategic alliances and partnerships between Nigerian banks and foreign financial institutions especially in the area of reserve/asset management; encouragement of Nigerian banks to go global, leading to more than doubling of branch network in West Africa since 2004; setting up of subsidiaries in London as well as Nigerian banks successfully issuing Eurobonds and getting listed on the London Stock Exchange.[22]

The grand objective in the banking sector reforms was to re-engineer and fast-track a system that will engender confidence and power a new economy. So far, the grand objectives of that policy are being achieved, and the consolidation progarmme has been adjudged about the most successful and at least cost to the tax payers in the world.[23] The total deposits trapped in the failed banks as percentage of Gross Domestic Product (GDP) is about 0.7% (the lowest in the world), and no private sector depositor would lose a kobo of his/her deposit. "The banking system is the safest and soundest it has ever been in history". Deposits and credits have more than doubled, and non-performing loans as percentage of total loans have gone down from about 23% before consolidation to about 7% currently. Individual banks now finance big projects valued at hundreds of millions of dollars and also operate in the oil and gas sector – a feat they never could do before now. Interest rates are gradually coming down (with average lending rate at about 16.9%, down from 25%). Currently, commercial bank branches have gone up from about 3,200 before reforms to over 4,100, and total employment in the sector has gone up from about 55,000 before reforms to over 61,000.[24] Over $1.5 billion of foreign investment has gone into the sector since 2005. It is speculated that by end 2007, that there will be about 7 or more banks with shareholders fund in excess of $1billion and over 10 banks with market capitalization of over $2 billion each (there was none in 2004). In 2004, there was no Nigerian bank in the top 1000 banks in the world, as at the end of 2006, there were 12 banks in the top 1000, with one ranked 355th (top 500 in the world). The banking system is powering the Nigerian Stock Exchange. As seasoned commentators have observed, it has take Nigeria less than three years to achieve what it took South Africa 20 years to achieve in the area of banking.

On the macroeconomic front, double-digit and volatile inflation rate (which used to be the norm) have been subdued as inflation rate has remained at single-digit since 2004. However, inflation risks remain high. The Naira/US dollar exchange rate (for sometime) was able to achieve some level of stability, and the GDP has maintained a robust growth rate of over 6% per annum, 2003.[25]

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5.0 SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 SUMMARY

The Nigerian banking system has undergone remarkable changes over the years, in terms of the number of institutions, ownership structure, as well as depth and breadth of operations. The changes have been influenced largely by the challenges posed by the deregulation of the financial sector, globalization of operations, technological innovations and adoption of supervisory and prudential requirements that conform to international standards.

By 2004, reputable international financial institutions and rating agencies would not bother to look the way of Nigerian banks for partnership, lending or rating.[1] Not anymore. However, by June 2007, Nigerian banks had become the toast of the international financial institutions and multilateral agencies. Even respected international rating agencies were beginning to adjust their rankings in favour of the Nigerian banks.[2] Henceforth, Nigerian banks were beginning to find it easier to source for money from abroad. The reason for this development was the banking reforms of the first decade of the 21st century.

An assessment of the outcome of the reforms over time has shown that during the post-reform lethargy era, some of the banks became distressed and were liquidated, thereby reducing their number to 89 and 2220 branch networks by 1998.[3] Although, the Soludo reforms consolidated the banks through mergers, acquisitions and new issues to 25 banks, their total branch networks increased to about 4500 in 2006.[4]

The reforms also brought to fore some critical points. These included the need for strategic management. The re-capitalization announcement came as a shock to most Nigerian banks and revealing that strategic management deserves critical attention. The recapitalization was something operators in the industry probably should have envisaged earlier and prepared for.

Also, the reforms brought to light the depth of the Nigerian informal sector.[5] It showed that with adequate creativity and policy support, the quest to align this sector with its formal counterpart could be achieved in the very near future. There was equally ample evidence in the reforms that whatever Nigeria decides to do was possible once there is a determined and focused leadership.

5.2 CONCLUSION

In conclusion, therefore, a review of the incentives structure and impact of reforms so far show that the outcome fell short of expectations and that this was doomed to be so because of some pitfalls which militated against it. Among these were faulty premise for reforms, wrong sequencing of reforms, conflicts emanating from adopted theoretical models for reforms and above all, frequent reversals or non-sustainability of reforms.[6] In order to harness the opportunities of bank consolidation, the regulators/supervisors should review the supervisory approach as well as the information disclosure requirements by banks while the NDIC should, on its own, put in place some specific deposit insurance design features that will ensure adequate depositor protection. On the part of the operators, they should enhance their risk management capacity, enthrone responsive corporate governance and embrace the right culture that would promote market discipline, among others.

5.3 RECOMMENDATIONS

At the expiration of the deadline given for the compliance with the ₦25billion minimum shareholders' funds requirement, fourteen banks failed to meet the deadline. It is estimated that depositors' funds trapped in these banks amounted to about ₦118 billion.[7] Furthermore, not less than 5,000 job losses would be involved. With the withdrawal of the licences of the fourteen banks, it is now certain that the decision of the regulatory authorities on the first phase of the banking industry consolidation is final.

Since bank consolidation is a policy-induced programme, it is important that all efforts be made to ameliorate the costs of the consolidation programme on all stakeholders. In this regard the decision of CBN to pay all private depositors in full within 90 days is commendable.[8] Furthermore, to ensure that the gains of consolidation are fully harnessed and to ensure the stability of the system, the following recommendations are put forward:

Asset Management Company (AMC): The inability of CBN to get the AMC working, has impacted negatively on the consolidation programme. It would be recalled that the establishment of the AMC was one of the issues contained in the 13-point agenda referred to earlier. This company was supposed to securitise the non-performing assets of the weak banks in order to make them attractive for mergers with other bank or acquisitions by bigger banks.[9] There is still the need to set up this company without delay in order to reduce the risk exposure of the banks that have survived the consolidation programme while enhancing their asset quality.

Training and Manpower Development: Issues related to mergers and acquisitions are so wide and intricate that senior management of banks cannot afford to have a deep-rooted knowledge of them. Therefore, the need for them to have a complete understanding of mergers and acquisitions in all its ramifications is necessary to mitigate all the complex issues and challenges associated with it. Thus, to ensure the success of the consolidation programme, there is the need for the CBN to sponsor training programme on post-consolidation integration and corporate culture conflict management. This would assist to mitigate conflicts associated with consolidation, thereby facilitating the sustainability of the mega banks.

Use of Information and Communication Technology: The experience of banking system consolidation in other countries, particularly the USA and Japan shows that the mega banks in those countries were able to enjoy economies of scale at all levels of output using state-of-the-art ICT. Thus, given that mega banks would emerge from the consolidation process, the time is ripe for banks to begin to think of the appropriate ICT to employ to ensure efficient service delivery.

Cross-Border Merger: With the increased capital base of banks and the enlarged shareholder base, the management of banks are faced with the challenge of fashioning out profitable investment opportunities to maximize the use of the huge assets at their disposal. One of the areas recommended for exploration is cross-border merger. Thus, the emerging mega banks need to spread out to the West African sub-region and the rest of Africa to become more visible players in the sub-regional and regional financial markets.

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