Challenges of Banking Sector Reforms in Nigeria: An Appraisal

Asekome, Mike Ozemhoka
PhD Candidate
Lecturer
Department of Economics, Banking and Finance
Benson Idahosa University
Nigeria

Aihie John Abieyuwa
PhD Candidate
Lecturer
Department of Economics, Banking and Finance
Benson Idahosa University
Nigeria

Abstract

This paper attempts to appraise the major banking sector reforms in Nigerian from 1958 to 2011, and the challenges posed to both the banks, the apex authorizes as well as the Nigeria financial system. The paper observes that most of the banking sector reforms in Nigeria were reactive rather being proactive and were also directed towards particular issues that arose from time to time. They were therefore not strategically holistic in approach hence most of the positive impacts of many of the reforms were short lived and unsustainable. The paper recommends the need to strengthen monitoring and supervisory capacity of the apex authorities through effective training and capacity building for CBN and the NDIC to strengthen their effectiveness. The paper also recommends the need to release some of the functions of CBN to other apex agencies such as the NDIC as the CBN appears to be over saddled with too many responsibilities beyond its present capacity.

Introduction

In any economy, a sound banking system ensures the provision of effective and efficient financial services needed to boost economic activities, provide a platform for sound monetary policy implementation as well as facilitates economic development. In Nigeria the banking industry has for a long time been characterized with operational and structural inadequacies which gave rise to the need for several reforms over time. Hitherto, many Nigerian banks according to NDIC various reports were associated with weak Board and Management oversight, non-performing insider-related facilities, declining asset quality and attendant large-provisioning for bad debts, frauds attributable to weak internal control systems, over-dependence on public sector deposits, foreign exchange trading, dearth of skilled manpower and inadequate extension of credit to the real sector of the economy (NDIC 2008).

Reforms can be described as innovations, new ways or strategies put in place to improve or replace the old ways in which things were being done which are usually introduced either in response to evolving developments, operational challenges or as proactive measures both to strengthen the banking system as well as to prevent systemic crisis.

Nnanna (2005) stated that historically, the Nigerian banking industry has evolved in four stages, each of them witnessing various reforms.

The first stage has been described as the un-guided liaise-faire phase (1930-59), during which several poorly capitalized and unsupervised indigenous banks failed in their infancy. The second stage was the control regime (1960-1985) during which the Central Bank of Nigeria ensured that only capable and credible organizations were granted banking license, subject to the prescribed minimum paid-up capital.

The third stage was the post structural adjustment program (SAP) or de-control regime (1986-2004) during which the liberalization or free entry philosophy was over-stretched and banking licenses were approved by the political authorities without adequate credibility and capability screening. The fourth stage was the era of consolidation (2004-2009) where the minimum capital base of banks was raised to N25 billion. This led to mergers and acquisitions of several banks in the system. Presently another stage, which this paper refers to as sanitization and bail-out stage (2009-2010) has been added. The question is how effective and positively rewarding have been the outcome of the previous and the on- going reforms.

Objectives of this Paper

This paper attempts to examine the banking sector reforms in Nigerian from 1958 to date, and the challenges posed to both the banks, the apex authorizes as well as the Nigeria financial system.

Early Reforms in the Nigerian Banking Industry (1958-2004)

The CBN Act of 1958 established the Central Bank of Nigeria and charged it with the responsibility "to promote monetary stability and sound financial structure in Nigeria".

The major aims of the Central Bank Monetary policy were price stability, output growth, full employment and equilibrium in the balance of payment. Thus in the early years of Central Bank of Nigeria, operations was essentially that of reliance on direct tools of monetary control, such as credits (aggregate and selective), special deposits, interest rate, and issuance of stabilization securities. It was a highly regulated financial environment, a non-market operating strategy to directly control the banks aggregate credit to the economy. Entry into banking business was restricted and public sector owned banks dominated the industry. Thereafter came the deregulation period of 1986. The neo-liberal era witnessed the dismantling of the prolonged regime of economic and financial controls to make way for increased reliance on market forces in 1986. This was embedded into the so called Structural Adjustment Program (SAP). The major reforms in this era included deregulation of interest rates and exchange rate, removal of preferred sector credit allocation and free entry into banking business subject to satisfaction of various other conditions for obtaining a banking license.

In 1991, the government established the Central Bank of Nigeria (Act No 24) and the Bank and other Financial Institutions act (No 25) which contained comprehensive guidelines for bank regulation, supervision and liquidation. The liberalization of the banking industry resulted in the establishment of many new banks. Within three years, the number of banks existing in the system doubled (from 45 in 1987 to 76 in 1989) and steadily rose to (119 in 1991). The competition that resulted from the entry of new banks and the liberalization of interest rates brought about a sharp rise in minimal deposit and lending rates as well as other regulatory and management challenges. The banking environment that emerged from the reform gave rise to inefficient, risky, inadequate liquidity and poorly capitalized banks that consequently generated lower return on assets relative to the pre-reform period. (Sobodu and Akiode 1994). The incidence of fraud and of non-performing loans also increased with the reform as revealed by Central Bank of Nigeria (CBN) and the Nigeria deposit Insurance Corporation (NDIC) study of distress in the financial system. The quality of management which is a major determinant of bank's long-term survival (Siems 1992), and the dearth of qualified personnel to meet the challenges of sudden growth in the industry contributed to the poor health of the banking industry. This led to another distress era soon after the liberalization reforms. To further widen the scope of the liberalization of the financial sector as well as diversification of products and services, the universal banking scheme was introduced in 2001 to create a more level-playing field for financial sector operators. This was to encourage greater efficiency through economics of scale and scope towards fostering competition by opening up various areas of entry to banks as well as the provision of a wide range of products and services.

The Central bank of Nigeria (CBN) also adopted the core principles of the Basle Committee on banking supervision, including the prudential guidelines (1990) for licensed banks to promote banking soundness and financial sector stability. Consequently all the regulatory activities were coordinated through the Financial Sector Regulation and Coordinating Committee (FSRCC) under the chairmanship of the CBN. More banking laws were established to safeguards against insider abuses and promote good corporate governance.

Some of these laws include Failed Bank (Recovery of Debts) and Financial Malpractices Decree No 18 of 1994: Money Laundering Decree No 3 of 1995, foreign Exchange (Monitory and Miscellaneous Provisions) Decree No 17 of 1995.

In the early few years of the reform, the keen competition fostered by the deregulation provided powerful incentives for financial innovations. It also led to growth in securities trading and active interbank transactions. The 1990 prudential guidelines sought to strengthen bank supervision and promote the viability of the banking system, including new measures on bank capital adequacy, asset quality, liquidity and funds management, earnings and quality of management of banks.

However, many weaknesses, defects and challenges were still identified in the banking sector as at 2004. They include low capital base, poor asset quality, increased number of unsound banks and weak corporate governance, over-dependence on public sector deposits and foreign exchange trading as well as the neglect of small and medium scale enterprises, among others. These inadequacies led to another round of reforms in 2004.

The Nigeria Banking Sector Reforms in 2004

The banking sector reforms of the year 2004 which placed emphasis on recapitalization has been generally described as banking sector consolidation in Nigeria. The main objective of the 2004 reform was to consolidate, deepen and enhance financial sector stability and competitiveness. Towards this end, CBN launched a 13 point reform agenda for the banking sector on July 6, 2004 with the main objective of recapitalizing the banks to meet a new minimum capital base of N25 billion. Other aims of the reform according to Soludo (2004) include (1) Consolidation of banking institution through mergers and acquisition: (2) adoption of a risk-focused and rule based regulatory framework, (3) adoption of zero-tolerance in the regulatory framework especially in the area of data/information rendition and reporting, (4) strict enforcement of the contingency planning and for systemic banking distress, (5) the establishment of an Asset Management Company as an important element of distress resolutions, (6) the automation process for the rendition of reforms by Banks and other financial institutions through the enhanced Financial Analysis and Surveillance System (e-FASS), (7) the promotion of the enforcement of dormant laws, especially those relating to the issuance of dud cheques, and the law relating to the vicarious liabilities of the Board members of banks in cases of failing by the banks; and (8) closer collaboration with the Economic and Financial Crime Commission (EFCC) in the establishment of the Financial Intelligence Unit (FIU); and (9) the enforcement of the anti-money laundering and other economic crime measures. (CBN: 2004)

Impact of the 2004 Reform on Nigeria Economic Growth

The 2004 reforms carried out by the then Governor of Central Bank Professor Charles Soludo were to standardized the Nigerian banking system in line with global trend, the major measure was to raise the minimum capital of banks to N25 billion with effect from January, 2005. Twenty-five banks emerged from the 89 banks that existed as at June 2004. The successful banks accounted for about 93.5% of the deposit liabilities of the banking system. N406.4 billion was raised out of which N360 billion was verified and accepted by the CBN.

The process also led to the inflow of US $652 million and 162,000 pounds sterling. (Soludo 2006). The financial market became more liquid and the market capitalization of the banking sub sector increased significantly. At the completion of the reform exercise, the liquidity engendered by the inflow of funds into the banks induced interest rates to fall drastically but this was short lived as banks later reverted to high rates of interest charged on their loans and advances. The ownership structures of the various banks were diluted and this helped to minimize insider' abuses. Nearly all the banks became publicly quoted and this led to wider regulatory oversight by the various apex authorities such as the Securities and Exchange Commission, the Nigerian Stock Exchange, the Central Bank of Nigeria and Nigeria Deposit Insurance Corporation. No doubt the recapitalization exercise boosted significantly depositor's confidence in the Nigerian banks. Year 2007 witnessed a phenomenon where Nigerian banks had grown stronger than ever before with several of them in the league of Africa's top ten banks and 12 of them rated among the world's top 100 banks. There were some banks with shareholders fund in excise of US1 billion during the year under review and had the capacity to undertake big-ticket transactions (NDIC 2007). Examples of macroeconomic indicators before and after the consolidation exercise are indicated in Table 1 below.

Table 1: Key Macro-Economic Indicators (2003 – 2008)

Macroeconomic Indicator	2003	2004	2005	2006	2007	2008
Gross domestic product (N'b at current market prices	7,19.05	8,563.3	14,572.24	18,222.8	22,907.31	23,842.1
No of Banks	89	89	25	25	24	24
Inflation	23.8	15.0	11.9	8.5	6.6	15.1
Total deposits of Banks (N'b)	1,415.8	1,814.75	2,469.07	3,469.07	5,357.2	8,702.0
Ratio of Total Banks Deposits to GDP%	19.7	21.2	16.9		23.29	33.34
Total Assets of Banks including of Balance Sheet Engagements (N'b)	3,365.2	4,046.00	5,463.1		13,011.60	19,261.02
Ratio of Total Assets of Banks to GDP%	46.8	47.3	37.5		56.8	66.62
Total Loans and Leases of Banks (N'Billion).	1,205.03	1,145.7	1,832.18		4,676.34	7,411.43

Source: NDIC (2008).

Based on statistic macroeconomic indicators as shown on the table, the banks consolidation exercise made tremendous impact on the economy. For instance total bank's deposits grew from N1,415.8 billion in 2003 to N8.702 billion in 2008 while banks deposits ratio to the GDP grew from 19.7 percent in 2003 to 33.34 percent in 2008. In a similar vein, Banks total assets to the GDP grew from 46.8 percent in 2003 to 66.62 percent in 2008. The Banks total loans and leases also grew from N1,205.03 billion in 2003 to N7,411.43 in 2008 while according to the NDIC (2008) report, total banks branch network grew from 4,579 in 2007 to 5,134 in 2008.

Specifically, some of the key areas where reforms impacted positively include capital adequacy, ownership structure, in flow of foreign investment and enhancement of public confidence on the banking sector.

According to NDIC (2008) reports, the aggregate paid – up share capital in the Nation's banking industry increased from N119.7 billion in 2003 to N141.87 billion as at the end of the recapitalization exercise in 2005. The capital to risk weighted assets ratio improved from 13.16% in 2004 to 21.25% in 2005. There was also substantial increase in adjusted shareholders fund from N289.83 billion in 2004 to N682.13 billion in 2005, while as at 2008, the Industry shareholders funds increased by 26.91% from N1.712 trillion in 2007 to N2,789 trillion (NDIC 2008).

Thus the recapitalization exercise had a salutary impact on the performance of the banking industry. Within 3 years of the consolidation exercise the total assets of banks grew by 61.53% between 2006 and 2007. By 2008 the growth had increased by 48%. The growth in total deposit liabilities was about 56.6% compared to the 38% growth in the previous year. This further increased by 62% in year 2009.

During the consolidation exercise, there were significant inflows of direct foreign investment into the banking sector amounting to over US $1 billion (117 billion) in 2007. Six (6) Nigerian Banks accessed a total of US $2 billion through Global Depository Receipts which indicated signs of investor growing confidence in the economy at the time.

However, in spite of this impressive performance by the Banks, there were still a lot of weaknesses identified in NDIC (2008) report such as:- weak Board and Management oversight, inaccurate financial reporting, poor book-keeping practices, non-performing insider-related facilities, declining asset quality and attendant large provisioning requirement, inadequate debt recovery efforts, significant exposures to the capital market through share loans to individuals and marginal loans to stock broking firms as well as frauds attributable to weak internal control systems NDIC (2008). This showed that the perceived gains from this major reform did not provide a sustainable remedy to the apparently intractable problems in the Nigeria banking sector as the sector still faced a lot of challenges.

Challenges Arising from Banking Sector Reforms

Notwithstanding the apparent lapses and inadequacies associated with the outcome of the various reforms, no doubt some of these reforms have been able to address some of the contemporary issues at the time they were instituted as well as exposing weaknesses that needed to be further addressed both on the part of the banks, apex regulatory authorities and the general public in various ways.

Our close review of the banking sector reforms in Nigeria shows that reforms at various stages were directed towards particular issues that arose from time to time rather than being strategically holistic in approach. They appear to be more of fire brigade approach which sooner or later remains incapable for resolving long term issues in a highly dynamic and fast globalizing industry.

The earliest reforms between 1958 and 1986 were more regulatory in nature. While the second stage of reforms between 1986 to 2004 were more deregulatory in nature commencing from the era of the Structural Adjustment Program which paved the way for interest rates deregulation, relaxing of strict conditions for the establishment of banks (free entry and exit) and many other financial institutions.

With the entry of a large number of banks, expanding branch network and sophisticated growth in the deployment of information technology and global influence on financial services across borders, the outcome of the second stage of banking reforms brought about more challenges and greater demand for effective supervision, capital adequacy, board and management incompetence, insider abuses, high level of non performing risk assets as well as liquidity problems.

The 2009 Banking Reforms

The unsatisfactory trend in the banking sector leading for a stress by NDIC in 2008 may have indeed led to the 2009 audit examination of Banks, jointly conducted by CBN/NDIC. The outcome of the exercise revealed according to the CBN, that at least 10 out of 24 banks were found to be in grave liquidity problem. Their capital base had been eroded due to high level of non-performing loans, poor corporate governance practices, lax credit administration process, and non-adherence to the banks' credit risk management practices (Sanusi 2009).
The then Central Bank Governor (Sanusi Lamido Sanusi) commenced his tenure and reforms by wielding his big stick to remove the Chief Executive Officers and Directors of eight troubled banks and with no clear agenda rather that what can be described as sanitizing the banking sector which according to him includes the determination of the tenure of chief executive officers of banks in Nigeria, the commencement of Islamic Banking, abolition of universal banking and the categorization of banks into regional, national and international banks, Islamic Banking, the effective take-off of the Asset Management Corporation of Nigeria (AMCON), bank categorization and abolition of Universal Banking. The categorization implies that banks will be structured into Regional Banks with minimum capital of N15 billion, the National Banks with a minimum paid up capital of N25 billion; and thirdly, the International Banks, operating in and outside Nigeria, with a minimum capital base of N100 billion with a view that the different banks will focus on different risks.

Comments on the Banking Reforms in Nigeria

Notwithstanding the controversial issues regarding these new set of reforms, some gains have also been recorded. Initially the enforcement of huge provisioning for non-performing assets led to bank losses as at the end of the 2009 financial year. This situation has since been reversed even in the first quarter of 2010 financial report of most banks. While some troubled banks like Union Bank; AfriBank and Wema Bank made profits in the first quarter of 2010. Union Bank Plc rose from a loss of N281.2 billion at the end of 2009 to a profit after tax of N3.3 billion. Wema Bank Plc made N795 million pre-tax profit in the first quarter of 2010 compared to the loss of N2.0 billion in 2009.

Having examined the various reforms, limited positive impacts, recurring short comings and inability to resolve banking problems in Nigeria, it would appear that much of the apparent failure of the reforms to achieve sustainable results rest on the apex regulatory, monitoring and supervisory activities because of possible weak capacity for effective supervision and implementation of the reformed agenda. This could be attributed to either that rely on short term measures (fire brigade approach) or they lack the foresight or competence to handle the complexity of issues regarding banking supervision.

Secondly, the problems of the banking sector itself may not be unconnected with Government macroeconomic policy instability which most often puts bank management on its toes which could affect both the banks and their customers business with negative consequences some of which make the banks to attempt to devise short cuts to avoid compliance.

Recommendations

The Central Bank of Nigeria (CBN) should embark on long term strategic and proactive planning for reforms rather than the fire brigade short term approach of dealing with serious and sensitive issues. The CBN and the Nigeria Deposit Insurance Corporation (NDIC) should strengthen its capacity through training and deployment of up-to-date technology for bank supervision, collection and analysis of the true financial and management situations of banks. They should hire and retain the services of experienced professionals to support or complement their roles. Training and development of employees are essential, if employees are to perform maximally and add value. All banks should evolve a comprehensive Risk Management Framework (RMF) which should aim at ensuring that (1) individuals who take or manage risks clearly understand them (2) Bank's risk exposure is within the limits established by the Board of Directors (3) Sufficient capital should be available to cushion risk taken (4) Risk based supervision should also be intensified (5) Strong asset quality measures are necessary (6) Risk taking decisions are explicitly in line with the business strategies and objectives set by the bank as well as by the apex regulatory authorities (NDIC, 2005).

The CBN appears to be saddled with too many responsibilities, some of which can be ceded to NDIC particularly the financial supervision and surveillance of banks. The CBN itself should then concentrate mainly on monetary policy which directly affects the economy of the nation.

Conclusion

The paper observes that most of the frequent reforms in the Nigerian Banking system seem to be reactive rather than proactive and the unsustainable positive impact of the frequent reforms may closely be associated the Nigeria Government policy instability that are consequently incapable of addressing banking sector deficiencies on a long term perspective. The paper also observes the apparent weakness and incapacity of the CBN to effectively carry out its supervisory functions and recommends the need for training and capacity building for CBN and the NDIC to strengthen their capacity. The paper also recommends the need to release some of the functions of CBN to other apex agencies such as the NDIC as the CBN appears to be over saddled with too many responsibilities beyond its present capacity.

References

BOFID (1991): A Publication of the Federal Republic of Nigeria Official Gazette: Lagos.

CBN (1958): Banking Act Central Bank of Nigeria

Central Bank of Nigeria (2005): Banking supervision annual Report. A publication of the Central Bank of Nigeria, Abuja.

CBN (1995): Money Laundering decree No. 3 1995.

CBN (1994): Failed banks (recovery of debts) and Financial Malpractices decree No. 18, 1994.

CBN (1995) Foreign exchange (monitoring and miscellaneous provisions) decree no. 17, 1995.

NDIC Nigeria Deposit Insurance Corporation (2005): Annual report. A publication of the Nigeria Deposit Insurance Corporation Garki Abuja.

Nigeria Deposit Insurance Corporation (2008): Annual report. A publication of the Nigeria Deposit Insurance Corporation Garki Abuja.

Nnanna, O.J. (2005): Beyond bank consolidation: The impact on society in CBN 4th Monetary policy conference.

Umoru D. and S.S. Umar (2008): Bank Reforms: The problems and prospects of recapitalization in the banking industry in Nigeria: all Nations Press; Benin City.

Unugbro A.O. (2009): Banks and banking management in Nigeria; Mindex publishing Company Ltd, Benin City.

Sanusi L.S. (2009): Why we sack five Bank CEOs: Press Conference held on 14th August at the CBN Headquarters Abuja.

Soludo C.C. (2005): The outcome of the Banking Sector Recapitalization and the way forward for the undercapitalized banks: Press Conference held on the 16 January at the CBN Headquarters Abuja.

Siems T. (1992): Quantifying Management's Role in Bank Survival: Federal Bank of Dallas Economic Review, First Quarter, 1987. Sobodu and Akiode (1994)

Appendix 1

Table:1 Minimum Capital Regulation Trend for Nigeria Banks (1952 to 2005)

Period	**Types Of Banks**	**Minimum Capital Set Standard ₦**
1952 – 1969	Indigenous banks paid up capital Authorized capital	250,000 500,000
1969 – 1979	Indigenous Commercial Bank Expatriate commercial Bank Merchant Banks	600,000 1,500,000 2,000,000
1979 – 1988	Commercial Banks Merchant Banks	1,500,000 7,000,000
1988 – 1989	Commercial Banks Merchant Banks	10,000,000 6,000,000
1989 – 1991	Commercial Banks Merchant Banks	20,000,000 12,000,000
1991 – 1996	Commercial Banks Merchant Banks	50,000,000 40,000,000
1997 – 2001	All Banks	5000,000,000
2001 – 2002	All Banks	1,000,000,000
2002 – 2004	All Banks	2,000,000,000
2005 to Date	All Banks	25,000,000,000

Sources: Umoru D. and S.S. Umar (2008)