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Banking Sector Reform and the Nigerian Economy: An Appraisal

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ABSTRACT
The Nigerian banking industry has been characterized by various reform policies seeking to address certain fundamental problems within the industry. The armchair banking style of the older and large banks of the 1980s and their inability to respond to the banakable need of the real sector, small and medium-scale enterprises and the government leading to over dependency on foreign banks by government engendered the 1986 banking reform through the liberalization policy of the deregulation era. Then another major banking reform of 2004/2005 (of consolidation) which raised the minimum capital base to N25b, and the 2009/2010 banking reform. This paper seeks to x-ray the performance of the various banking reforms against the rationale behind them. It was observed that while the various banking reforms had actually recorded huge success vis-à-vis the rationale behind the reforms, each reform tend to throw up further challenges as these reforms had appeared not to be holistic. Finally the paper was in alignment with the 2009/2010 banking reforms, paying no attention to its controversies, it enumerated some cardinal benefits and expectations of the reforms and made recommendations.
Keywords: Banking reforms, deregulation, consolidation, Nigeria economy

INTRODUCTION
Banks as an integral part of economic development process of any economy is an indispensable component of the financial system. The banks mobilize scarce resources from the surplus spending units and channel same to the deficit spending units, and hence to a reasonable extent, exert lots of influence on the pattern and trend of economic development, through their funds mobilization activities. It is based on this background that Nzotta, S. M (2004) stated thus. "It is an accepted fact that the level of economic development determines the extent of sophistication of the banking system. This is primarily due to the fact that the banking system exists to propel and service economic development and thus all shocks in the economic development process affect the banking system positively or negatively".
In a deliberate effort by the Nigerian Government to re-position the banking industry for the purpose of standardization and to effectively play its traditional roles in the economic development of Nigerian economy, has seen the Nigerian banking sector witnessing reform policies in different forms and magnitudes, yielding varying degree of results. However, this paper shall concern itself with banking reforms beginning from the deregulation era of 1986 to the consolidation era (of 2004-date). The law governing the Banks and other financial Institutions (BOFI) has also witnessed some amendments over the years, hence the amendment of BOFID 1991 which defines banking business in Nigeria as "the business of receiving deposits on current, savings or other accounts, paying or collecting cheques drawn or paid in by customers; provision of finance, consultancy and advisory services relating to corporate and investment matters; making or managing investment services and capital market business or such other services as the Governor of the Central Bank of Nigeria, may be gazette designate as banking business".

BANKING REFORMS IN NIGERIA – (1986-DATE)

1. Deregulation Era (1986 – 1992)
2. Distress banks Era (1993 – 2001)
3. Universal banking Era (2002 – 2004)
4. Bank consolidation Era (2004/2005 and 2009 to date)

Deregulation Era (1986 – 1992)

Prior to this liberation policy, the Nigeria banking sector was dominated by older and large government control banks; namely United bank for Africa, Union Bank, First bank, Savanna bank and Afrik Bank, plus a host of other state-owned banks. Most of which are now moribund. This reform saw the privatization of Government interests in these banks and helped spur new nimble players into the market. This era saw the emergence of peoples Bank and Community Banks; also the Nigeria Deposit Insurance Corporation (NDIC) was established through the NDIC decree of 1988, and the CBN was strengthened through the CBN Act of 1991.

Within few years under the deregulation era, the rise in the number of banks was quite phenomenal. At its peak, there were over one hundred and twenty (120) banks in the early to mid-1990s as oppose to less than 20 in 1980. This new generation banks came on board, very smart, dynamic and hungry. These new banks from the word go were plagued with the problem of low capitalization and stiff competition from the well-established older generation banks. Over time, most of the newer banks transformed to nothing more than glorified bureau-de-change with the attendant round tripping, trading in forex and treasury bills and then beautifying their financial statements. As the fortunes of these banks rose through this less than-ethical means, the economy as a whole continued to nose-dive, growing more weaker and less effective, which begged the question as to how the banks were posting those huge and impressive returns. The liberalization policy of late 1980s served as a wake-up call for the older and their money and actually energized the industry and some of these young banks then, are today in the big league.

Distress Banks Era (1993 – 2001)

The interplay of various negative aggregates led to the distress syndrome in the banking industry during the era. There were illiquidity and terminally distressed banks in the system, which gave rise to the banking reform of this era. The failed banks and financial malpractices decree of 1994 was promulgated and largely succeeded in restoring some level of sanity and public confidence in the banks, which had earlier declined with the large number of distress banks.

The provisions of the failed bank decree was strictly enforced and the NDIC made frantic efforts to reducing the level of non-performing loans, bad lending, outright fraud and insider abuses in the banking system. During this period some banks were acquired by the CBN/NDIC, 4 banks had their licenses revoked by the CBN in 1994, and 26 distress banks also had their licenses revoked in 1998.

Universal Banking Era (2002 – 2004)

The universal banking policy was introduced to dismantle the restrictions between investment and commercial banking activities, fashioned after the US Financial services modernization Act of 1999. The universal banking operations in the banking industry is an attempt to provide a level playing ground for banks which include the conventional banking functions. Banks could therefore choose from one, or a combination of the following:-

- Clearing house activities
- Capital market activities
- Marketing of insurance services

During this period, some banks were known to have been suspended from the foreign exchange action as their owners cum top executives were stripped of their coveted positions. Yet there abound the presence of weak, unhealthy, under capitalized banks, high level of fraud and financial malpractices including electronic fraud.

An Overview of the Nigerian Banking Sector (1980 – 2004)

Within this period, banks grew to 120 and later the number dropped to 89 banks. The bank branches also grew phenomenally, albeit within urban areas and there was a rising level of foreign participation and systematic global integration of the Nigerian banking sector. At this time Nigeria hadn't been blacklisted by the Financial Action Task Force (FATF) as a non-cooperating country in the fight against international money laundering and Advance Fee Fraud. Almost all the banks did not meet the regulatory requirement for funding agriculture, manufacturing and other productive sectors, (the ratio of their loans and advances that must be channeled to the real sector). The emphasis for most of them was to fund short-term trades with rapid turnover, going as far as importing Fast-moving-consumer-goods (FMCG), thereby exerting undue pressure on the foreign exchange market.

The newer banks were more innovative, aggressive in pursuing and attracting customers as opposed to the armchair banking style of the bigger and older banks. Some of the newer banks have to go as far as recruiting pretty female bankers to go after affluent and institutional customers. Most of the newer banks were financially unstable, due to low capital base, relying heavily on a single or few public sector deposits. Yet according to the CBN (2004), more than 20 billion Naira ($151 million) has been amassed within the last 5 years in the small and medium Enterprise Investment Fund, while bankers maintain that there are not enough bankable ideas in the country, preferring to fund importation of merchandise at the expense of local manufacturing as average capacity utilization lags at less than 70 percent.

The banks were operating at low level of capitalization and high loans loss ratio, resulting in long-term financial instability and heightened risk of failure. At the end of March 2004 CBN rating of all the banks showed that 62 banks could be considered as sound or satisfactory, 14 banks as marginal, and 11 banks as unsound, while 2 of them did not render any returns at all during the period under review. Hence the fragmented market structure, with a preponderance of small to mid-sized banks, incapable of funding major long term projects necessary to galvanize the economy. Even the then largest bank in Nigeria has a capital base of $240 million, while the smallest bank in Malaysia has a capital base of over $500 million. The banks were completely prostrate, unable to adequately assimilate the informal sector, by either mobilizing untapped financial resources or financial micro and small-scale enterprises that form the fabric of the economy.

There were noticeable declining standard of corporate governance, lack of transparency and poor accountability, leading to incessant malpractices, outright fraud and unnecessary bad debts. An analysis of the financial reports of the marginal and unsound banks showed that, these banks accounted for 19.2 percent of aggregate assets of the banking sector, 17.2 percent of total deposits, the non-performing assets of the banking sector stood at 19.5 percent of the total assets. Hence, these banks inability to respond to the needs of a growing domestic economy or meet the challenges of an increasingly competitive regional/global market.

Bank Consolidation Era

The 2004/2005 Banking Reform

- In Nigeria, most of the banks had a low capital base, less than $10 million.
- The local banks in Nigeria were not very efficient and also their capacity was low. So, the government had to depend a lot on foreign banks.
- Nigerian banks had been suffering from a weak corporate governance and insolvency for a long time.
- Most of the banks in the country depended upon the public sector deposits which was lowering their capital base.
- The public funds had not been distributed equally among all the banks.

The Reform Process

The Central Bank of Nigeria (CBN) provided some incentives for the banks so that they could achieve the $25 billion Naira minimum capital base within 2005. These include:

1. CBN allowed the banks to deal through foreign exchange.
2. The banks were permitted to take deposit from the public sector and the fiscal authorities were made responsible for the collection of revenue from the public sector.
3. Some tax incentives were provided for the banks in the area of stamp duty and capital allowance.
4. Transaction costs had been minimized.
5. The government formed an expert panel to provide technical support to the banks.
6. Merging of some banks and introduction of some regulatory framework based on certain rules.
7. The establishment of web portal for all the citizens to share any confidential information with the central bank regarding the banking systems.
8. An automated process was developed to report the banks returns.

9. The central bank of Nigeria revised and updated all necessary banking rules and regulations to make the banking system more flexible, effective and transparent.

2009/2010 Banking Reform

The Expanded Discount Window (EDW) was a financial support facility through which the CBN provides liquidity to the ailing banks, for short-term fund needs purposes. Unfortunately, some of these banks became regular costumers to the EDW, borrowing with reckless abandon, and are unable to pay back the funds because they were in precarious cash positions. This abuse if left unchecked is unsafe for the future and continued existence of the banking industry and will further the perpetration of the little or unregulated lending policies which eventually would have plunged the Nigerian economy into deeper crisis. Also critical to the reform are:-

(1) Macro-economic instability caused by the banking sector
(2) Lack of investor and consumer sophistication
(3) Major failure in corporate governance in the banking sector
(4) Inadequate disclosure and transparency about the financial position of banks.
(5) Critical gaps in regulatory framework and regulations
(6) Uneven supervision and enforcement
(7) Unstructured governance and management process at the CBN/weaknesses within the CBN
(8) Weaknesses in the business environment in the country.

THE FOUR PILLARS OF THE 2009/2010 BANKING REFORM

- Enhancing the quality of Banks
- Establishing financial stability
- Enhancing healthy financial sector evolution
- Ensuring that financial sector contributes to the real economy.

Enhancing the Quality of Banks:

In achieving this objective, the CBN intend to initiate as part programme to enhance the operations and quality of Nigerian banks. These programme initiatives will include: data quality, enforcement, governance, risk management and financial crime. These initiatives will be structured in such a manner that the banks do most of the work to imbibe new behaviours in the industry, with the CBN playing a cross – industry programme management role. Individual must be held responsible for their actions. In addressing the failures of corporate governess in the industry, the CBN will establish a specialist function focusing on governance issues to ensure governance best practices are embedded in the industry. The reform programme will strengthen corporate governance in both banks and the CBN, embedding a culture across the industry *good governance is good business.*

Establishing Financial Stability

The key features of this pillar centre around strengthening the financial stability committee (FSC) within the CBN, establishment of a hybrid monetary policy and macro-prudential rules, development of directional economic policy and counter-cyclical fiscal policies by the government and further development of capital markets as alternative to bank funding. Nigeria can only improve its economic performance if it deals squarely with two fundamental issues, which are; Volatility and instability caused by over-reliance on oil and sub-optional management of oil revenue, and ability of the non-oil real sector to productively absorb investment and debt.

Enhancing Healthy Financial Sector Evolution

This include repositioning banking industry structure, banking infrastructure such as credit bearers and registrars, cost structure of banks and role of the informal sector. The creation of the Asset management Corporation (AMC) will provide the first step towards the resolutions of non-performing loan problem in banks and eventually facilitate further consolidation.

Ensuring That Financial Sector Contributes To the Real Sector

Development financial institutions set up for specific purposes such as housing finance, trade finance, urban development have not fulfilled their mandates. Many successful emerging economics have witnessed proactive government actions to ensure that the financial sector contribute to the real sector. Nigeria can learn from countries with successful track records in creating financial accommodation for economic growth through initiatives such as development finance, foreign direct investment, venture capital and public private partnerships. The CBN is in a good position to advocate economic development in Nigeria.

The Reform Process

The reform process actually began with the joint audit of the banks (in batches) by the Central Bank of Nigeria (CBN) and National Deposit Insurance Corporation (NDIC) which produced startling revelation. The following are the major highlights of the 2009 banking reform:

- The removal of CEOS and executive Directors of banks found wanting and prosecution of the CEOs of five affected banks.
- Injection of bailout fund (N420 billion) to stabilize affected banks and another N200 billion to other banks.
- Publication of names of outstanding debtors of affected banks.
- The provision of fund by the government to reflate the economy.
- Implementation of tenures for CEOs in the banking sector and the approval of all potential CEOs by the CBN.

Outcome of the Reforms

Some of the benefits of the reform programmes include the following:-

1. The reform programmes forced many large borrowers with non-performing loans, who did not have any intentions to pay back their loans to scramble to pay back or make payment arrangements; thereby reducing the number of non-performing loans and the need for longer loan provisions for most of the banks.
2. Banks with questionable uncollectible and non-performing loans were forced to set up proper loan loss provision, which revealed the true financial health of most of the banks in Nigeria.
3. CBN's decision to set up an Asset Management corporation gave financial institutions the optimism that some percentage of their bad assets will be absorbed by the corporation. Also, investors had renewed confidence that absorption of some bank bad assets will free up capital to banks which will eventually trickle down to investors and the capital market. Although the AMC is not a panacea to most of the problems with the banking sector, the notion of its implementation helped spur the bullish resurgence that the Nigerian stock Exchange has experienced since the beginning of 2010.
4. Many foreign investors who had taken a pause from the Nigeria capital markets are now returning as they are now comfortable with the transparency that the CBN reform has ushered.
5. CEO's who did not act as shareholders custodians, and who thought that the banks were their personal properties were given the boot, dispelling the illusions by most of the former CEO's that they owned the banks and were not accountable to shareholders.

CONCLUSION

The paper revealed that the 1986 banking reform of the then liberalization policy brought about many players into the banking industry. This phenomenal surge in the number of banks with weak capital base, threw up lot more challenges; poor standard in corporate governance, lack of transparency, poor accountability and stiff rivalry among the banks. These furthered the banks involvement in all manner of unwholesome practices (round-tripping of foreign currency exchange, aiding and abetting money laundering, body-marketing, de-marketing of fellow banks, frivolous charges, over charging of customers, and even outright fraud etc).

These situations certainly call for reforms. The banking reform of 2004/2005 raised the minimum capital base of banks from N2 billion to N25 billion. By the end of exercise in December 2005, the 89 banks before the reform collapsed into 25 financially stable banks. Unfortunately, as revealed by the paper, issue of major failure in corporate governance persisted with mammoth non-performing loans which saw some banks permanent feature of the Expanded Discount Window (EDW), among other reasons gave impetus for the 2009/2010 banking reform. So far, 8 ailing banks have been bailed out, and the CEOs and Executive Directors of 5 of the banks were removed, among other measures of the 2009/2010 banking reforms.

RECOMMENDATIONS

Based on the finding of this paper, we recommend that the ongoing reforms should be pursued to its logical conclusion in order to engender lasting sanity, embed culture of globally accepted standard of corporate governance, transparency and accountability in the banking sector in order to restore the banks vitality.

Finally, we also recommend that emphasis should be on private sector development as an engine of stable and sustainable growth.

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