BANKING SYSTEM CONSOLIDATION IN NIGERIA AND SOME REGIONAL EXPERIENCES: CHALLENGES AND PROSPECTS

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1.0 Introduction

The banking industry worldwide is undergoing transformation. The driving force for this attitude globally includes technological innovation; deregulation of financial sector to international competition and globalization. In addition, the banking crises witnessed in the Asian tigers and Latin America had to some extent contributed to these pressures, while in some countries; consolidation was as a result of privatization of state owned banks.

Consolidation is viewed as the process of reducing the number of banks and other deposit taking institutions with a simultaneous increase in the size, concentration and efficiency of the remaining entities in the sector. The process of consolidation has been argued to enhance bank efficiency through cost reduction and increase revenue in the long run. It also reduces industry risk by eliminating weaker banks and acquiring the smaller ones by bigger and stronger banks as well as creates opportunities for greater diversification and financial intermediation. The pattern of banking system consolidation could be viewed in two different perspectives namely, market-driven and government led consolidation. The market – driven consolidation which is more pronounced in the developed countries sees consolidation as a way of broadening competitiveness with added comparative advantage in a global context and eliminating excess capacity more efficiently than bankruptcy or other means of exist. On the other hand, government-led consolidation steams from the need to resolve problem of financial distress in order to avoid systemic crises as well as to restructure inefficient banks. Ownership structures, especially family owned banks, regulatory shortcomings and concerns about job losses continue to be an impediment towards a faster market – driven consolidation in most of emerging economies.

The paper examined banking sector development in Nigeria from the Structural Adjustment era of the mid-1980s and the current reforms taking place in the financial service industry in terms of consolidation. In addition, the paper tried

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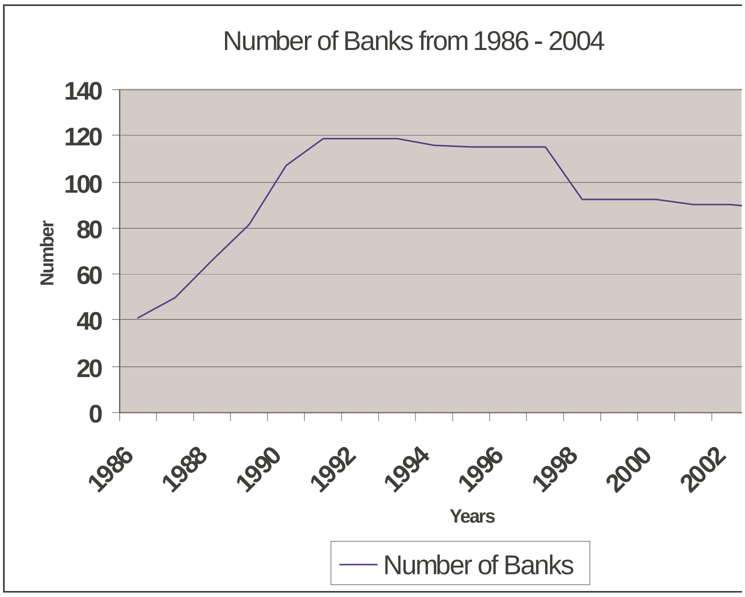
to do some assessments of the banking system consolidation in Nigeria and the challenges and prospects expected. The paper is structured into six parts. Following this introduction, the Part Two discusses an overview of the banking system in Nigeria. Part Three reviews some regional experiences, while Part Four evaluates banking system consolidation in Nigeria and Part Five examines the challenges and prospects. While Part Six, summarises and concludes the paper.

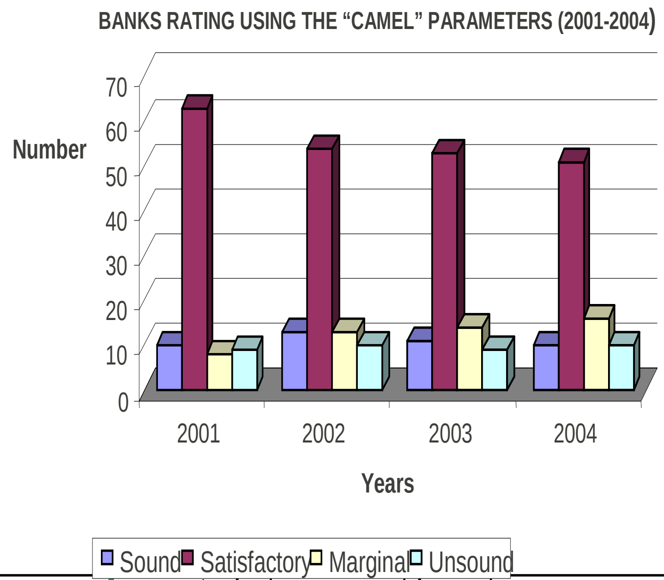
2.0 Overview and Structure of the Nigerian Banking Sector

Banking system is known as the backbone of financial intermediation through the mobilization and channeling of financial resources. Banks in performing their pivotal role in the economy, facilitate financial settlement through the payment system, influence money market rates and provide a means for international payment. The efficiency and success of this financial intermediation is predicated on a sound financial system. The banking sector in Nigeria has undergone significant transformation both in terms of number and product creativity, and the level of operation, which was as a result of the economic reform embodied in the Structural Adjustment Programme (SAP) in 1986. In terms of growth in the number of banks, the Commercial Banks stood at 29 with 1367 branches including 7 branches abroad while Merchants Banks operating during that period were 12 with 27 branches nationwide. This number grew to 54 with 2193 branches for the Commercial Banks and 38 with 113 branches for the Merchant Banks in 2000. With the introduction of Universal Banking in 2001, the number of banks stood at 90. However, in 2003 and 2004, the number of banks fell to 89 and 87 respectively.

Figure 1



In addition to the growth in number of banks during that period and the mid 1990s, the financial sector witnessed the boom and bust cycle, which was characterized by financial liberalization with deregulation of interest rate and the loosening of credit allocation quotas. The multi-tiered foreign exchange market being operated then offered plenty of arbitrage and rent opportunities for banks at the expense of proper financial intermediation. Consequently, there came the emergence of massive entry of new banks that specialized in foreign exchange operations and taking advantage of the price disparity. While the number of banks multiplied during that period and financial sector boomed, even though, financial intermediation, as measured by credit to the private sector and deposits declined. Finally, economic downturn and political instability brought the boom to a halt in 1992 with a major banking crisis crippling the financial sector. The number of banks adjudged as technically insolvent grew from eight in 1990 to 28 in 1993 and 45 by end 1994. As at end-June, 1995, the number of distressed banks had risen to about 57. Factors adduced for the distress included inability of banks to honour their debt obligation, mismatch of



regulatory authorities (CBN and NDIC) had to come in to salvage the situation through the process of restructuring some of the banks as well as the appointment of Interim Management Board (IMB), while the chronic ones were eventually liquidated over time.

Recent development in the banking sector indicated a mixed trend in the performance of banks using the CAMEL criteria. Available data from the CBN Annual Report, 2004, revealed that banks satisfactory rating has been on the decline since 2001 to 2004 from 63 to 51 banks respectively. During the years under review, the number of banks categorized as "sound" had exhibited a mixed trend, while the number of marginal banks has been on the increase. The reasons ...ted to this ...ment were ...apitalization, ...ity, weak/poor quality which ...in poor earnings.

Figure 2

1.0 Review of Some Regional Experiences in Consolidation

Globalisation and financial liberalization has changed the international financial landscape. This has intensified competition in a growing number of market segments with dissolved national boundaries. Thus, to remain a big player in the market, both Industrial and emerging economies see financial sector consolidation as a broader competitiveness issue. Some regional experiences in banking system consolidation are highlighted below.

Central Europe

The banking systems in Central Europe were much more concentrated than their counterparts in emerging markets during the 1990s, and the second half of the decade witnessed a reduction in banks concentration. However, private banks, as a result of large number of bankruptcies, experienced some difficulties in the mid 1990s . This led to consolidation with the stronger banks taken over weaker ones to ensure continued stability. This development was a spill over of consolidation of the parent foreign banks in the European Union. These countries include Czech Republic, Hungary and Poland.

- **Latin America**

Latin American countries have more divergent experiences in bank consolidation. For example, in Argentina, bank consolidation was as a result of both domestic and external factors in form of financial liberalization. In Brazil, the privatization of state owned banks resulted in their taken by both private and foreign banks through merger and acquisition. In Mexico, the story was different as consolidation was a response to lack of adequate capital after the 1995 banking crisis.

- **Asia**

The Asian continent had witnessed one of the most severe financial difficulties in recent history which affected not only the banking system but also the activities in the stock market and lost of confident by the international community. This development has induced government led consolidation process in some of these countries. Such example is Malaysia were the Central Bank in 1999 selected 10 anchor banks to lead the consolidation of smaller institutions with the government offering tax concessions as part of a package of incentives for bank mergers. While in Korea, government tried to encourage mergers of some banks with overlapping operations in order to curtail unsound and distress in the banking system. The government provided capital support to private banks as an incentive to take over the assets and liabilities of five commercial and 17 merchant banks that were closed.

2.0 Banking System Consolidation in Nigeria: An Evaluation

The structure of Nigerian banking system is fragmented in terms of the number and size of institutions, ownership patterns, profitability and competitiveness. Added to this, is the oligopolistic nature of the industry where very few banks dominate the scene in terms of assets base, profitability and deposit structure with others being followers and competing for a narrow segment of the market. The banking industry consists of mainly two types of services; retail and wholesale. Retail banking is focused towards small groups or individuals, while the wholesale banking caters to larger organizations and other financial institutions.

The ongoing consolidation of the banking system in Nigeria is one of the notable contemporary features of the recent reform programme. Interestingly enough, banking system consolidation is not a new phenomenon in Nigeria. For example, in 1995, Union Bank of Nigeria Plc acquired 75 per cent equity in Citi Trust Merchant Bank now Union Merchant Bank, Guaranty Trust Bank acquiring of Magnum Trust Bank and Intercontinental Bank acquiring of 70 per cent equity in the then Meridien Equity Bank of Nigeria in 1996. Also the acquisition of Nigerian-Arab Bank and Stanbic Merchant Bank by National Insurance Corporation of Nigeria and SBIC Africa Holdings Limited respectively. In 2003, Standard Trust Bank acquired 51 per cent share in Continental Trust Bank. However, these banks that were acquired continued to operate as independent entities with the new owners having controlling share.

Globalisation, Financial liberalization and advance in Information Technology has dissolved national boundaries around the world and Nigeria being an economy not in isolation is part and parcel of the trend that has characterized today's world economies. Currently, Nigeria is repositioning itself through implementing a number of reforms under the National Economic Empowerment and Development Strategy (NEEDS). One of such reforms is the banking sector consolidation, which is aimed at fostering development of domestic financial institutions towards sustainable development and at the same time competes on a wider regional and international basis. This can not be achieved with the present structure of the banking system in Nigeria, where ownership is mainly family owned, coupled with low level of capitalization, which has made it difficult for banks to compete favourably with the best international banks in area such as size, technology, expertise, range of quality of service, facilitate international transaction and achieve higher return on their investment.

The consolidation of the Nigerian banking system started after the announcement on July 6, 2004 by the Governor of the Central Bank of Nigeria to the Bankers' Committee on banking sector reforms. In order to encourage and assist banks to meet the requirements, some incentives were promised by the Central Bank of Nigeria. The incentives are[1]:

- Banks that consolidate will be allowed to participate in foreign exchange market.
- Permission to collect public sector deposits and government revenue.
- Prospect to manage part of Nigerian foreign reserves holdings.
- Tax incentives.
- Reduction in transaction cost
- Provision of technical assistance by the Central Bank.
- Leadership award by the Governor of the Central Bank and
- Provision of help desk by the CBN to fast track approvals.

Further to the above incentives, the CBN Management reemphasized its commitment towards the consolidation process by approving on 6th April, 2005 forbearance package for weaker and distress banks[2]. They include:

- A write-off of 80 per cent Debt owned the CBN by the banks, subject to:
  - i. The recovery of all non-performing loans belonging to owner/ insider related within two months;
  - ii. Injection of any shortfall in the banks' capitalization to solvency stage within two months;
- The conversion of the balance of 20 per cent of the debt to CBN to long term loan of a maximum of 7 years at 3 per cent per annum including two years moratorium.

- A further forbearance on the balance of 20 per cent of the debt, that is (b) above, could be extended to the new owners after its acquisition and meeting the ₦25 billion capital base.

The Deposit Money Banks in their efforts to meet up the requirements stipulated by the monetary authorities have engaged in various discussions among themselves. Some of the developments witnessed in the industry involved:

1. The mobilization of about ₦210.5 billion from issuance of initial public offers through the capital market and private placement aimed at increasing their capital base.

2. About 22 groups made up of group of banks have signified interest in merger and have been granted pre merger consent.

3. The increase in the level of capital inflow and upsurge in the deposit liabilities of the banking sector, especially the domiciliary deposit components.

4. Significant drive towards bad loans recovery so as to improve their balance sheet structure for better bargaining ability.

5. The emergence of the first consolidated bank (United Bank for Africa and Standard Trust Bank).

3.0 Challenges and Prospects

The current movement towards the consolidation of banking systems in Nigeria has held promises and challenges for both the monetary authorities and the deposit money banks in particular. Some of these challenges and prospects bordered on:

Challenges

i. The Central Bank of Nigeria's ability to manage and render assistance to the banking system to aid in the consolidation process has been a big challenge that was applauded.

ii. Another important challenge facing the CBN is in the area of timely computation and application of the cash reserve requirement on banks within the stipulated two weeks maintenance period. This will help a long way in reducing excess liquidity in the system which is presently being experienced, which, if not checked will have a multiplier effect on growth in money that may not be consistent with the design of monetary policy targets.

iii. The consolidating banks in the short run will have to curtail with overall increase in risk profile because of the integration risk and inherent complexity of the rationalization process. The consolidating banks will have to device an effective way of dealing with the situation without detriment to the organization.

iv. The Central Bank of Nigeria has to strengthen its supervisory arm to effectively curtail any post-consolidation bank runs and be pro active in dictating any corporate irregularities in the Industry. A sound banking system is expected to inspire the confidence of depositors.

v. With globalization and financial liberalization in place, the banking system in Nigeria should focus on becoming a dominant player especially in the West African sub region.

vi. As epitomized by the Governor of the Central Bank of Nigeria, Prof. Charles Soludu[3] that "The 21st Century seems to be the Century where SIZE matters. Brazil has taken off; India is not looking back; and China is obviously unstoppable. History beckons on Nigeria—— the largest African country and home to one-sixth of the black population in the world. It will be a global tragedy of the 21st Century if Nigeria's current momentum is truncated for whatever reason, and for us to meet up the expectation, we need a formidable financial system which is basically the growth path of our economy.

Prospects

i. The initial public offerings by banks through the capital market when completed is likely to increase the level of financial deepening as evidenced in the upsurge in the volume and value of trading in the stock market .

ii. The reforms in the banking industry has been able to attract more foreign investment inflow, especially in the area of portfolio investment, this development if sustained will boost the level of economic activity especially towards non oil sector.

iii. The consolidation of banks is likely to attract a significant level of foreign banks entrance into Nigeria which will become a feature in the industry over time. This will bring about more confidence by the international community of the banking sector in Nigeria thereby attracting more foreign investment into the country.

iv. As the level of financial intermediation increase, interest rate is likely to fall and increase lending to the real sector that will generate employment and booster growth.

Summary and Conclusion

The paper tried to evaluate the banking system consolidation in Nigeria and examined some regional experiences in consolidation process. Banking consolidation was brought about as a result of the unprecedented change in the global financial architecture, where continuing technological innovation, borderless barriers, and competition had played a significant role.

The paper had looked at an overview of the banking system in Nigeria, through its boom and bust periods during the economic reforms of the 1980s and the present. Some regional experiences in consolidation were reviewed and discovered that in most of the industrial nations, bank consolidation is driven by market forces generally. Whereas, most of the emerging economies, consolidation is initiated by the government.

The paper evaluated the consolidation in Nigeria so far and posited that remarkable achievement had been recorded and more success is anticipated as shown by the industry's commitment. Also with this historic reform of the banking sector comes with challenges and prospects in the long run which if well harnessed will stimulate the Nigerian economy in to greater heights.

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