INTERNATIONAL JOURNAL FOR INNOVATIVE RESEARCH IN MULTIDISCIPLINARY FIELD ISSN: 2455-0620 Volume - 5, Issue - 7, July – 2019
Monthly, Peer-Reviewed, Refereed, Indexed Journal with IC Value: 86.87 Impact Factor: 6.497
Received Date: 11/07/2019 Acceptance Date: 18/07/2019 Publication Date: 31/07/2019

Reforming Nigeria's Financial Institutions: An Issue to Restore Public Interest

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Abstract: *The depreciation of the naira in 2004 when the last banking recapitalization took place has cut the value of the capital of each deposit money bank by about $175m. Some short comings worsened the banking sector problems and its performance, these in 2019 led CBN to plan a fresh bank's recapitalization as capital base weakens by $3.5bn. The objective of this study is to provide insights to Nigeria's financial institutions on a better way to improve their performance and restore customer's confidence on their activities. The study used an expository survey of existing literature on the subject matter and explained major concept, theories and empirical studies from which discussion of findings on Nigeria's financial institutions performance of deposits money banks was made. The study concluded and recommended that to achieve financial system stability, a resilient and stable financial system is imperative for continued growth of the country's economy given the intermediation role of the financial institutions to support the needs individuals and businesses.*

Key Words: *Financial institution, Deposit money banks, Recapitalization, Performance, Consolidation, Public interest.*

1. INTRODUCTION:

The financial sector is one of the dominant economic sectors in Nigeria. Banks are key players in any country's financial sectors; they occupy a delicate position in the economic equation of any country such that their (good or bad) performance invariably affects the economy of the country (Wilson 2O06). Studies here shown that the banking sector which actually started in Nigeria in 1892 (Nwankwo 1980) has been largely volatile within spates of banking failure experienced in most parts of the 1990s and in the early and mid 2000s. The strategy often utilized to strengthen banks in Nigeria and save them from financial distress is capital regulation by the central bank of Nigeria (CBN). A cursory look at the history of banking in Nigeria reveals that the CBN has found reason to shore up the capital base of Nigeria bank, a number of times since 1980s from a modest value of N10million naira minimum paid up capital in 1988, Nigerian.

This was an effect to instill discipline into the financial system and to reposition Nigerian banks for global integration the governor of the CBN Charles Soludo (Prof) on 6th July 2004 presented the l3point reform agenda at a special meeting of the bankers committee in Abuja on this new bank reforms. The agenda was envisaged to facilitate greater mobilization of resources and improvement in financial intermediation, deepen and widen the capital and money markets and ultimately stimulate development of the private sector.

2. STATEMENT OF THE PROBLEM:

The depreciation of the naira in 2004 when the last banking recapitalization took place has cut the value of the capital of each deposit money bank by about $175m. Commercial banks were required to maintain capital not below N50mllion in 1991. Between 1991 and 2005 subsequent increase have also been made ranging from N50million in 1979 N1billion 2001; N2billion in 2002 to N25billion in 2005. Within 18months and also to consolidate the banking institutions through merger and acquisitions before 31 December 2005. These were done as a means of reducing the effects of any crisis that may arise from future failure. But some short comings worsened the banking sector problems and its performance, these has led CBN in 2019 to plan a fresh bank's recapitalization as capital base weakens by $3.5bn.

3. OBJECTIVE OF THE STUDY:

To provide insights to Nigeria's financial institutions on a better way to improve their performance and restore public interest on their activities.

4. RESEARCH METHODOLOGY:

An expository survey of existing literature on the subject matter under review was used in explaining major concept, theories and empirical studies. The choice of this method is necessary given the need to adequately explain the status of the Nigeria's financial institutions performance of deposits money banks in terms of customer's deposits. The paper relies heavily on information collected from online journal, articles, textbooks and other publications.

5. LITERATURE REVIEW:

The concept of Financial Sector Reform and Public Interest

As a result of the various financial sectors reforms carried out since the late 1980s in Nigeria, banking sector has undergone remarkable change in terms of the number of institution, ownership structure as well as depth and breadth of the market. The reforms had been influenced largely by challenges posed by deregulation, globalization, technological innovation and adoption of supervisory and prudential requirement that confirm to international standard. The financial sectors reform is the aspect of economic reform which focus mainly on restructuring financial sectors institutions (regulators and operators) via institutional and policy reforms and as part of the financial sectors, banking sector reforms is that aspect which focuses mainly on getting incentive right for the banking sector to take the lead role in empowering the private sector to contribute more to economic growth (Balogun, 2007).

A critical look at the nation banking sector invariably portend the need for urgent attention, as situation that have made for series of reform of the sector over the year. The recent of all the reform came up in 2004 with a policy aimed at improving the regulatory and supervisory environment as well as restructuring and developing the banking sector entities. Soludo (2004) expresses that the reforms agenda is a pre-emptive and proactive measure to prevent an imminent system crisis and collapse of the banking industry and permanently stop the boom and burst cycle which have characterized the history of our banking industry. More fundamentally the reforms arc aimed at ensuring a sound, responsive, competitive and transparent banking system appropriately suited to the demand of the Nigeria economy and the challenges of globalization. The main trust of the reform package which is anchored on a thirteen point agenda , is to consolidate and recapitalized banks by increasing their share holders fund to a minimum of N25 billion with effect from December 31st 2005.

Public Interest

The task of government, it is often proclaimed, is to serve or promote the public interest. Statutes sometimes include the public interest as a guide for agency action, this notion of the public interest might be more appealing. Sometimes the public interest is depicted as a myth by which policy, however particularistic, can be rationalized as in the general interest and hence made more public acceptable. The reforms according to Oluyemi (2006), had in turn prompted a regulatory induced restructuring in the form of consolidation that would engender the alignment and realignment of banks and banking group in determined moves expected to translate into the merge of some banks and the acquisition of others. The emergence of mega banks no doubt would expose banks to new challenges, which if not properly addressed could adversely affect the operation of the payment system and its credibility. The banking sector reforms have been acclaimed to be necessary but the question is whether they yield anticipated result. The argument on whether or not government should intervene in economic and financial affair has long been debated by classical economist like Adam Smith, John Stuart Mill, Thomas, and Maltus among others. The classical economists proposed free market economy. The Keynesians proposition made reference to market failure as a justification for intervention of government in economic and financial activities.

However, according to Short and O Driscoll Jr (1983) economist differs on the level of government intervention in the economy, particularly on regulation imposed on the financial intermediaries. While some believe that many regulations are necessary in order to protect the depositor's funds, other believes that the banks are over regulated.

Banking Sector Performance

The history of the Nigerian banking system is replete with growth and burst cycles in the number of operating banks and their branches. Usually, growth spurt are experienced when the policy environment present strange business opportunities in the banking sector, or there is a sudden policy shift that makes it easy for ordinary business people to initiate a process that creates access to public funds in the name of bank deposits. In terms of Assets, the total asset of all the 89 banks operating in Nigeria in 2004 prior to the consolidation was N3,753.28billon (US$28.250bilIion) and rose to N6400.78billion (US$49.88billon) indicating a growth rate of 70.54.16 per cent within one year after consolidation. The asset size of an average bank which was N42.ll2billion (US$0.3 174 billion) grew geometrically to N267.4S2billion (US$2.0856billion) within a year after the consolidation exercise, a growth rate of 534.27 percent. This was an impressive performance. However, an assessment of the level of capitalization of an average bank prior to the exercise indicates an equity base (Net worth) of N7.71 billion (US$0.06l68biIlion) rising to N38.S3billion (US$0.31064billion) in 2006, indicating a growth rate of 404 per cent. The leverage ratio measured in terms of equity

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to total asset also declined from 18.28 per cent 2004 to 14.52 per cent in 2006 for an average bank. This ratio compares favourably with the CBN minimum level of 10percent. The post consolidation ratio is also better in terms of its distribution among the banks compared with the pre-consolidation ratio where more than 70 per cent of the equity and assets were concentrated in (the largest five banks) less than 5 per cent of the existing banks.

However, the intermediation activities of an average bank improved significantly by about 1,690 per cent from an average deposit base of N10.48billion (US$0.08384) in 2004 to N188.48billion (US$1 .50784) in 2006. The profit efficiency/asset utilization has not been impressive. Although the banks have been able to double their gross earnings from their pre consolidation performance level, their profit and asset utilization efficiencies have declined since the conclusion of the consolidation. For instance, the industry return on equity declined from 35.28 per cent in 2004 to 11.12 per cent in 2006, while return on asset declined from 8.37 per cent to 2.09 per cent over the same period. The asset utilization ratio also declined; while an average bank was able to earn 34 kobo for every N1.0 asset in 2004, this declined to 11kobo in 2006. Thus, while the consolidation has improved the structure of the Nigerian banking industry in terms of asset size, deposit base and capital adequacy, the profit efficiency has not been impressive. The banks will need to become more efficient in terms of their ability to generate enough return to justify the increase in the equity base as well as the resources put at their disposals by their stakeholders. The lending capacity of the banks improved significantly as a result of the consolidation. As at 2004, an average bank could only lend about N14, 371.billion. Whereas, the consolidation strengthen the bank where a typical bank in Nigeria in 2006 could lend an average of N80.188billion. This represents a growth of 462.13 percent growth (Somoye, 2008).

Theoretical Framework
This study adopted the following theories:

Buffer Theory of Capital Adequacy: Banks may prefer to hold a 'buffer" of excess capital to reduce the probability of falling under the legal capital requirements, especially if their capital adequacy ratio is very volatile. Capital requirements constitute the main banking supervisory instrument in Nigeria. The Central Bank of Nigeria (CBN) intervenes little in banks' activities but does directly conduct on-site examination and at times delegating this task to external auditors. By contrast, a breach of the capital requirements is considered a major infringement of banking legislation and is not tolerated by the Central Bank of Nigeria (CBN). Banks remaining undercapitalized for prolonged periods are closed. The withdrawal of some banking licenses at the expiration of the recent recapitalization of banks in Nigeria in 2005 is a pointer to this fact. Banks will require more capital if deposits are not fully mobilize from the public. Capital is more reliable, dependable and can be used for long term planning. Ability of banks to mobilize enough deposits obviates the capital base from being eroded.

The buffer theory of Calem and Rob (1996) predicts that a bank approaching the regulatory minimum capital ratio may have an incentive to boost capital and reduce risk in order to avoid the regulatory costs triggered by a breach of the capital requirements. However, poorly capitalized banks may also be tempted to take more risk in the hope that higher expected returns will help them to increase their capital. This is one of the ways risks relating to lower capital adequacy affects banking operations. In the event of bankruptcy of a bank, the risks are absorbed by the bank, customers and Nigeria Deposit Insurance Corporation (NDIC). At present NDIC pays a maximum of N200,000 to a customer in the event of bank failure. Hence, customers are concerned about capital position of banks at all time. Banks are expected to insure and pay 15/16 of customers deposit liabilities multiplied by 1% to NDIC to enable their customers benefit from the scheme. The above practice of NDIC in Nigeria is applicable to other countries but varies in amount.

Vojta (1980) opines that adequate capital provision against excess loss permits the bank to continue operations in periods of difficulty until a normal level of earning is restored. The benchmark set by regulators of bank capital sometimes differs from those of the bankers. These capital standards have led to questions on whether or not regulators have been able to bring about changes in bank capital when their standards of capital adequacy differed from those of bankers. Aggressive banks may try to extend the frontiers of "imprudent management policy" by operating with less capital base, often in violation of the regulatory guidelines. But the supervisory agencies usually stand their ground by resisting decline of capital to avoid bank failure with the concomitant high cost to the society.

Deposit Insurance Theory: The deposit insurance theory also provides an insight into the behaviour of commercial banks (Flannery, 1989; Charn, Greenbaum and Thakor, 1992). In the context of this theory, banks are viewed as portfolio of risky claims. As insured banks increase their risk of failure without limit, there is an expected value transfer of wealth from government deposit Insurance Corporation to bank owners. Regulators are concerned about bank's soundness, particular with respect to solvency or the probability of bank failure. Therefore, regulation of bank risks exposure is necessary to reduce the expected losses incurred by the deposit insurance corporation. Deposits solicited from customers are not as dependable and reliable as the bank capital requirement. It cannot be used for long

term planning. However, more deposits means banks can grant more loans and will not obviate the need for excessive capital. Where bank loans and advances are given out to customers without due process it might affect capital and liquidity position of a bank in the long run.

Expense Theory: According to the expense theory of Williamson (1963) cited in Nyong (2001) otherwise called the theory of managerial discretion, managers have the option in pursuing policies, which maximize their own utility rather than profit maximization for shareholders. Such utility include the satisfaction which managers derive from certain types of expenditure. Managers' prestige, power and status are to some extent reflected in the amount of slack they receive in the form of expense account, luxurious offices and building, company cars and other perquisites of office. Operating efficiency attempts to capture this aspect of bank behaviour.

Empirical Studies

Olokoyo (2013) assessed the effects of the Bank reforms on the performance of banks in Nigeria. Data was gathered through the instrument of questionnaire. One hundred (100) copies of questionnaires were administered out of which eighty (80) copies were collated for the analysis. To achieve the objectives of the study, two (2) hypotheses were formulated from the structure of research questions while Analysis of Variance (ANOVA) method was used to test the hypothesis using the statistical package for social sciences (SPSS). The study shows that the recapitalization and consolidation process has had significant effect on the manufacturing sector of the economy and thus on the Nigerian economy at large. The study further reveals that despite the reforms, post consolidation challenges like challenges of increased return on investment still exist. According to some sections of the Nigerian populace, the reforms are seen to have come too soon and thus, rendering sections of the economy such as the lower class, illiterates and the economically active poor, incapable of banking transactions. The reforms however is very necessary for our banks to imbibe best corporate governance practice, improve on self- regulation, institute IT-driven culture and seek to be competitive in today's globalizing world.

Ikpefan (nd) investigated the impact of shareholders' fund on bank performance in the Nigerian deposit money banks (1986-2006). The study captured their performance indicators and employed cross sectional and time series of bank data obtained from Central Bank of Nigeria (CBN).The formulated models were estimated using ordinary least square regression method. The study identified a positive relationship between shareholders fund and bank loan. We also find that there is significant relationship between shareholders' fund and banks' liquidity, bank deposits, and bank loans. The efficiency of management measured by operating expenses is negatively related to return on capital. The implication of this study, among others, is that adequate shareholders fund can serve as a veritable stimulant in strengthening the performance of Nigeria deposit money banks and also heighten the confidence of customers especially in this era of global economic melt-down that has taken its toll in the Nigerian financial system.

Nasiru, Joshua and Nasiru (2012) asked whether capital regulation merely addresses the immediate and short-term problem of illiquidity or it has a far-reaching effect of forestalling distress amongst banks in Nigeria. Data collected from the Central Bank of Nigeria and the Nigeria Deposit Insurance Corporation for the period 1997-2006 was used to test the research hypotheses using correlation analysis. Results show that there exist a relationship between increase in minimum capital base of the commercial banks and their liquidity and asset quality as both liquidity levels and asset quality tend to improve with recapitalization. Despite these findings, the period after 2006 recorded four insolvent banks as evidenced in Ndanusa (2009) and Alford (2010). The paper concludes that the post 2006 crisis were clear indications that increasing minimum capital requirement of banks alone only account for a short-term improvement in the liquidity position of banks and improvement in their asset quality but do not have the long-term effect of forestalling distress. The study suggests that a lot more need to be done in curbing financial distress among commercial banks in Nigeria than mere increase of their minimum capital requirement. Such other approaches as improving the corporate governance of banks must be adopted to forestall future occurrence of the threat of distress in the sector.

Donwa and Odia (2011) investigated the impact of the consolidation on banking industry in the Nigerian Capital Market between 2004 and 2008 using primary (questionnaires) and secondary data from the Nigerian Stock Exchange. When the data was analyzed with the chi-square test and ANOVA, it was found that bank consolidation affected the industry significantly as most of the banks had to go to the capital market to raise the required amount by issuing securities. They submitted that banks' consolidation had increased public awareness and operations of the Nigerian capital market just as the capital market had continued to be an easy and cheap source of funds for banks in the post consolidation era. Based on their findings, it was recommended that the banks and capital market regulatory authorities should continue to monitor and institute reforms program that would better reposition the banking industry as a major player in the Nigerian Capital Market and the economy.

Bakare (2011) examined the trend and the growth implications of bank capitalization in Nigeria. The secondary data used for the study were processed using sample test technique for difference between two means and the E-view for windows electronic packages. The test of difference of mean helped us to compare the means of the variables before and after recapitalization to see if there is any significant difference between the two periods. The findings showed that there is a significant difference between the two means and hence the two periods. The result indicated that post recapitalization mean at 21.58 is higher than the pre recapitalization mean of 15.09, implying that banks are more adequately capitalized and less risky after the programme. This result also indicated that recapitalization has low but significant influence on the growth of Nigerian economy compare to other variables in the model. The study strongly supported the need for the government to sustain the recapitalization policy.

Okazaki and Sawada (2006) investigated the effects of policy consolidation on the stability of the financial system. The study found that consolidations had a negative effect on ROA, which indicates that consolidations led to inefficiencies, and that this dominated the effect of increased market power, if any such increase occurred. The Nigerian Banker (2004) on 2004 monetary policy implementation observes that in fiscal 2004 and 2005 the CBN expected banks and other financial institutions to operate in such a way as to remain liquid at all times and avoid the spectre of overdrawn accounts and being sent of clearing. The CBN (2004) "rating of licensed banks using CAMEL parameters shows that 10 banks were "sound", 51 were "satisfactory", 16 rated "marginal" while 10 were rated unsound as at the end of 2004. The report also showed deteriorating performance with 17 banks (18.89%) rated either marginal and/or unsound out of 90 banks in 2001, while 26 banks (29.89%) of the 87 banks in existence in 2004 rated either marginal and/or unsound. The marginal and unsound banks were considered to have exhibited such weaknesses as under-capitalization, illiquidity, weak/poor asset quality, poor rating", etc.

Nwude (2005) identified the imperatives for bank recapitalization in Nigeria to include too many banks with sizes being too small to support any sound banking business; stunted growth of the real sector arising from incapability of bank capital ratio and size to fund industrial development; high lending rate and shunning of real sector, and unprofessional and unethical practices. Others include the need to promote public confidence in the banking sector; curtailment of excessive risk taking by banks; reduction in the incidence of insolvency and distress and the need to dilute ownership structure giving rise to professionalism. All equity firms are characterized by greater liquidity positions than levered firms. Bank use a mix of debt but more of equity in their financing.

Some studies of the Nigerian banking industry have linked characteristics of individual bank companies to profitability. These studies include Nwosu and Nwosu (1998), Uche and Ehikwe (2001), Beck, Cull and Jerome (2005) and Brownbridge (2005). In the main, their studies link capital base (Nwosu and Nwosu, 1998), lending activities (Beck et al., 2005) and Brownbridge, 2005), information technology (Uche and Ehikwe, 2001), management quality (Nwosu and Nwosu, 1998) and Brownbridge, 2005) and Bank size (Brownbridge, 2005) to the profitability of banks in Nigeria. However, among all these studies, only Beck et al (2005) employed the intricacies of econometrics in deriving their conclusions. The majority of studies on bank performance, such as Short (1979), Bourke (1989), Molyneux and Thorton (1992), DemirgucKunt and Huizinga (2001), Goddard, Molyneux and Wilson (2004) and Athanasoglou, Brissimis and Delis (2005) use linear models to estimate the impact of various factors that may be important in explaining bank performance. Aburime (2008) in his study of the determinants of bank profitability: company-level evidence from Nigeria; elicited his data from the public financial statement of an unbalanced panel (Athanasoglou et al., 2005 and Baltagi, 2001) of 33 commercial and merchant banks in 91 observations over the 200-2004 period.

Molyneux, Altunbas and Gardener (1997) underscored the importance of efficiency in banking and pointed out that higher efficiency could be expected to 'lead to improve financial products and services, a higher volume of funds intermediated, greater and more appropriate innovations, a generally more responsive financial system, and improved risk-taking capabilities if efficiency profit gains were channeled into improved capital adequacy positions. They opined that bank efficiency was of critical importance to the evaluation of bank's performance. Onaolapo (2008) employed CAMEL rating system to examine the effectiveness of recapitalization. He found that recapitalization had improved the financial health of banks. This finding was collaborated by Sani (2004). Using a regression model, Sani discovered a positive and significant relationship between recapitalization policy and economic growth in Nigeria. To the contrary, Adegbaju (2008) examined the effectiveness of recapitalization on the performances of 20 Nigerian banks. He discovered that while few banks recorded appreciable improvements in their performances, majority of the banks remained the same or even worse off.

6. DISCUSSION OF FINDINGS:

The simple major reasons why firms opt for growth and expansion of their operations is because growth affects business and the general public opinion as it stands for stability, safety and profitability. It is on record that in spite of government's effort to protect the bank's, failure does occur. Endogenous factors such as bad management, or exogenous ones such as economic recession usually precipitate such failures. Sometimes both factors combine to

bring distress to banks, and when that happens, depositors particularly the small ones, are the most affected. The lesson of distress in Nigeria, swept the banking sector and systematic distress gripped the finance house sub-sector. The banking sector failure had serious implication for the financial system and by extension, the economy. This is based on the fact that banks generate financial resources and put these at the disposal of deficit economic unit for increased consumption or output. Surprisingly fifty years after the country's political independence, the banking sector is performing far below expectations. Among the measures implemented to correct the dismal practices in the sector is recapitalization and consideration of banks.

Prior to the banking sector reforms of 2004 there were 89banks with about 3,300 branches as at July 31st, 2004. The 89banks had a total asset of US and 18.0billion (Bullion CBN vol.30 No. 2). This was in sharp contrast to South Africa for example, where only 8banks had assets worth more than all 89banks in Nigeria put together. The reform of the Nigerian banking industry is therefore aimed at strengthening the banking system and refocusing it to play its intermediation role more effectively. It's a proven fact that building customer trust in company's products or service is a great way to increase profits and build a strong, dependable consumer base. Customer trust is among one of the most cost-effective ways to keep the profits growing. When an organization build customer confidence, it can charge fair prices for products or services, even if competitors are offering some sort of special discount or deal. Customer trust overrides prices when it comes to day-to-day business. The general public will be rest assured that their monies are in safe hands, as sound capital base means good strength to withstand any negative shock.

7. CONCLUSION AND RECOMMENDATIONS:

To achieve financial system stability, a resilient and stable financial system is imperative for continued growth of the country's economy given the intermediation role of a financial institutions, to support the needs of individuals and businesses. The central Bank of Nigeria CBN policy direction to facilitate access to financial services to 95percent eligible Nigerians by 2024 is a welcome development. The emphasis is to: preserve domestic macroeconomic and financial stability; foster the development of a robust payment system infrastructure that will increase access to finance to all Nigerians thereby raising the financial inclusion rate in the country; continue to work with the deposit money banks to improve access to credit for not only small holder farmers and MSMEs but also consumer credit and mortgage facilities for bank customers.

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