

## INCESSANT BANK DISTRESS AND THE POLICIES OF CENTRAL BANK OF NIGERIA

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### Abstract

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The paper examines the nature and extent of the incessant banking distress in Nigeria and the implications for policy formulation and implementation. Descriptive statistics were employed to analyse data from the secondary source. The paper calls for a more pragmatic and pro-active approach by the Central Bank of Nigeria in dealing with the problem of banking crises. It was stated that, although the recent consolidation exercise made the banks to be heavily capitalised in line with global financial system, it did not guarantee sound financial stability, as a result of implementation problem. The paper, therefore, recommended strict enforcement of all the measures of financial stability such as management, liquidity and corporate governance, and other prescribed standard international regulations by the monetary authorities.

### Introduction

The incessant banks' distress in Nigeria suggests that there is something wrong with the economic and monetary policies of the government that have created rooms for the banks not to comply with them. It is an indication that the policies of government have not been properly evaluated to create value for the banking system and the economy. For instance, the banking failures of late 1940s and early 1950s, and that of 1994-2000, had led to the erosion of confidence in the banking system. Between 1994 and 2000, a total of 33 terminally distressed banks were liquidated (CBN, 2001). Also, the number of banks was reduced from 89 banks in 2004 to 24 groups of banks at the end of 2005. With 9 banks now adjudged to be in grave situations in October, 2009, the number of banks will likely reduce progressively in future. The consequences of the scenario above are that: First, many people are hostile to the banking business, and large amount of money will be kept outside the banking industry. This implies that the ability of the banks to operationalise the monetary policy of the government will be seriously constrained. Second, the banker-customer relationship will be threatened as people have lost confidence in the industry. Third, the distress in the financial sector will have a contagious effect on all other sectors of the economy, with the tendency of reducing the rate of economic growth.

However, the basic questions are: What has happened to the various financial reforms of the government over the years? Does it imply that financial reforms failed in accomplishing the intended objectives? Or, is the problem with non-compliance on the part of financial institutions? Have the monetary authorities failed in their implementation duty and efforts? Will the banks' safety be guaranteed and hence practice banking as stipulated in the economic and monetary policies? Answering these questions will assist the monetary authorities to properly design policies that will meet the test of time in regulating the financial system.

There is therefore, a need to examine the nature and extent of the banks' distress and ascertain the adequacy of the economic and monetary policies of government to solve the problem of the festering financial crisis in Nigeria. The current research will ultimately contribute to the identification and resolution of the issues that touch on financial crisis in Nigeria. The findings of the research will be of immense benefits to the banks, public, shareholders and monetary authorities in curbing the festering bank crises in Nigeria.

The paper employed descriptive statistics to analyse the secondary data obtained from the publications of the Central Bank of Nigeria such as the Statistical Bulletin, Annual Reports and Financial Statements and Banking Supervision Annual Report.

### The Nature and Extent of Bank Distress in Nigeria

Bank failures in Nigeria started in 1894, when the African Banking Corporation (ABC) was taken over by the Bank of British West Africa, now known as the First Bank of Nigeria PLC. This happened two years after modern banking started in the country. The periods of 1927 to 1951 witnessed banking boom and banking doom, with 22 of the 25 indigenous banks failed within the period (Imala, 2005).

With the policy of financial liberalization in 1986, the conditions for licensing banks and other financial institutions were relaxed, leading to proliferation of banks and other financial institutions. For instance, the number of banks in the country increased from a low level of 40 in 1985 to a high level of about 120 in 1993. Between 1994 and 2000, a total of 33 terminally distressed banks were liquidated (CBN, 2001).

Several schools of thought have evolved over the years on the causes of financial crisis. Schwartz(1985) and others in the monetary school argued that financial crises are caused by the failure of the authorities to respond correctly to financial distress and are aggravated by private sectors uncertainties about the correct policy responses. In Nigeria, the main causes of the crises in the banking sector have been undercapitalisation, mismanagement, fraud, government interference, board room politics, management incompetence, unstable economic and political environment, frequent changes in government policies, among others.

With the banking sector reforms announced on 6th July, 2004, banks were under intense pressure to meet the minimum capitalization requirement of N25 billion for banks, with full compliance before the end of December, 2005. The minimum paid up capital in Nigeria since 1952 is shown in Table 1.

Table 1: Minimum Paid Up Capital for Banks in Nigeria (1952-2010)

Year	Type of bank	Minimum amount
1952	Commercial Banks	£12,500
1969	Commercial Banks	£300,000
1979	Commercial Banks	₦600,000
	Merchant Banks	₦ 2,000,000
1988 (FEB)	Commercial Banks	₦ 5,000,000
	Merchant Banks	₦ 3,000,000
1988 (OCT)	Commercial Banks	₦ 10,000,000
	Merchant Banks	₦ 6,000,000
1989	Commercial Banks	₦ 20,000,000
	Merchant Banks	₦ 12,000,000
1991	Commercial Banks	₦ 50,000,000
	Merchant Banks	₦ 40,000,000
1997	Commercial Banks	₦ 500,000,000
	Merchant Banks	₦ 500,000,000
2000	Commercial Banks	₦ 1,000,000,000
	Merchant Banks	₦ 1,000,000,000
2001	Commercial Banks	₦ 2,000,000,000
	Merchant Banks	₦ 2,000,000,000
2004 (Effective, 31st Dec. 2005).	Commercial Banks	₦ 25,000,000,000

Source: Obamuyi T. M. (2003) "The Development of the Banking Industry in Nigeria Since 1960", in S.O. Arifalo and Gboyege Ajayi (eds) Essays in Contemporary Nigerian History; Pp 297 317; Lagos, First Academic Publishers

To achieve the target of N25 million, banks were encouraged to merge or consolidate. The consolidation exercise that resulted from the pronouncement brought the number of banks from 89 in 2004 to 24 groups of banks at the end of 2005. Table 2 shows the list of groups of merged banks and the members of the groups.

Table 2: List of Consolidated Banks in Nigeria

S/N	Group of merged banks	Members of the Group
1	Access Bank Plc	Marina Int'l Bank, Capital Bank International, Access Bank
2	Afribank Plc	Afribank Plc, Afribank International Ltd (Merchant Bankers)
3	Diamond Bank Plc	Diamond Bank, Lion Bank, African International Bank (AIB)
4	EcoBank	EcoBank
5	ETB Plc	Equatorial Trust Bank (ETB), Devcom Bank
6	FCMB Plc	FCMB Bank, Co-operative Development Bank, Nigerian-American Bank, Midas Bank
7	Fidelity Bank Plc	Fidelity Bank, FSB Int'l Bank, Manny Bank
8	First Bank Plc	FBN Plc, FBN Merchant Bank, MBC Int'l Bank
9	First Inland Bank Plc	IMB, Inland Bank, First Atlantic Bank, NUB Bank
10	Guaranty Trust Plc	GT Bank
11	Stanbic-IBTC Bank Plc	Regent, Chartered, IBTC, Stanbic
12	Intercontinental Bank Plc	Global, Equity, Gateway, Intercontinental
13	NIB	Nigerian International Bank
14	Oceanic Bank Plc	Oceanic Bank, Int't Trust Bank
15	Platinum-Habib Plc	Platinum Bank, Habib Bank
16	Skye Bank Plc	Prudent Bank, Bond Bank, Coop Bank, Reliance Bank, EIB
17	Spring Bank Plc	Guardian Express Bank , Citizens Int'l Bank, Fountain Trust Bank, Omega Bank, Trans-International Bank, ACB Int'l Bank
18	Standard Chartered Bank Ltd	Standard Chartered Bank Ltd
19	Sterling Bank Plc	Magnum Trust Bank, NBM Bank, NAL Bank, INMB Bank, Trust Bank of Africa
20	UBA Plc	Standard Trust Bank, United Bank of Africa, Continental Trust Bank
21	Union Bank Plc	Union Bank, Union Merchant Bank, Universal Trust Bank, Broad Bank
22	Unity Bank Plc	Bank of the North, New Africa Bank, Tropical Commercial Bank, Centre-Point Bank, New Nigeria Bank, First Interstate Bank, Intercity Bank, Societe Bancaire, Pacific Bank
23	Wema Bank Plc	Wema Bank, National Bank
24	Zenith International	Zenith International Bank Plc

	Bank Plc	
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Source: Central Bank of Nigeria Banking Supervision Annual Report, 2005

Although, the consolidation exercise made the banks to be highly capitalised, it did not guarantee the stability of the financial system. However, at the end of the consolidation exercise, the 14 banks that could not meet the minimum paid up capital of N25 million were set for liquidation or offered for purchase and assumption.

Based on the experiences so far, it becomes worrisome whether the purpose of raising additional capital(see Table 1) has ever been met by the Nigerian banks and whether the objectives of consolidation(see Table 2) were properly formulated and implemented in Nigeria. Sanusi(2010) succinctly puts it thus:

A lot of the capital supposedly raised by these so called “mega banks” was fake capital financed from depositors’ funds. 30% of the share capital of Intercontinental bank was purchased with customer deposits. Afribank used depositors’ funds to purchase 80% of its IPO. It paid N25 per share when the shares were trading at N11 on the NSE and these shares later collapsed to under N3. The CEO of Oceanic bank controlled over 35% of the bank through SPVs borrowing customer deposits. The collapse of the capital market wiped out these customer deposits amounting to hundreds of billions of naira. The Central Bank had a process of capital verification at the beginning of consolidation to avoid bubble capital. For some unexplained reason, this process was stopped. As a result, we have now discovered that in many cases consolidation was a sham and the banks never raised the capital they claimed they did (Sanusi, 2010, p.7).

The Central Bank of Nigeria, in attempt to further strengthen and stabilise the financial system, set up the Audit Committee to examine the health status of the banks in Nigeria. The audit test by the Central Bank of Nigeria of the 24 banks in August, 2009, revealed that only 14 banks were found to have adequate capital and liquidity to support the level of their current operations and future growth, while a banks was asked to re-capitalise before 30 June, 2010, and 9 banks were adjudged to be in a grave situation. Table 3 indicates the health status of the Nigerian banks in 2009.

Table 3: The Health Status of Banks in Nigeria in 2009

Banks with adequate capital and liquidity	Banks in a grave situation	Bank with insufficient capital but not in a grave situation
1. Access Bank Plc; 2. Citibank Nigeria Limited; 3. Ecobank Nigeria Plc; 4. Fidelity Bank Plc; 5. First City Monument Bank Plc; 6. Skye Bank Plc; 7. Stanbic IBTC Bank Plc; 8. Standard Chartered Bank Ltd 9. Zenith Bank Plc, 10. First Bank of Nigeria Plc, 11. United Bank for Africa Plc, 12. GTBank Plc, 13. Diamond Bank Plc 14. Sterling Bank Plc	1. FinBank Plc 2. Oceanic Bank Plc 3. Union Bank of Nigeria Plc 4. Intercontinental Bank Plc 5. AfriBank, 6. Bank PHB Plc 7. Equitorial Trust Bank (ETB) Plc 8. Spring Bank Plc 9. Wema Bank Plc	1. Unity Bank Plc

Source: The Nation, 3<sup>rd</sup> October, 2009

The Central Bank of Nigeria, citing the provisions of the Banks and Other Financial Institutions Act 2004 sacked the Executive Management of the 8 of the 9 banks. The criteria employed for the special examination in all the banks were: Liquidity, capital adequacy, and corporate governance. The apex bank subsequently injected N620 billion (about US\$4.03 billion) into the banks as liquidity support and long term loans.

However, one wonders how the country got to the crisis situation, when there are institutions saddled with the responsibility of supervising and regulating the financial system. This confirms the position of Schwartz(1985) that financial crises are caused by the failure of the authorities to respond correctly to financial distress and are aggravated by private sectors uncertainties about the correct policy responses. The monetary authorities in Nigeria seem to be confused about of their roles or incompetent to formulate and implement enduring and sustainable financial and economic policies. This is because there are warning signals before a bank becomes distressed. The Early Warning Model and the CAMEL (Capital adequacy, Asset quality, Management profile, Earnings quality and Liquidity) model should have shown the true position of the banks long ago for corrective measures to be taken. Meanwhile, some of the criteria usually employed to measure the performance of the banks have been compromised by the Central Bank of Nigeria. This can be seen in the pronouncement of the Governor of the Bank:

The Supervision Department within the CBN was not structured to supervise effectively and to enforce regulation. No one was held accountable for addressing the key industry issues such as risk management, corporate governance, fraud, money laundering, cross-regulatory co-ordination, enforcement, legal prosecution or for ensuring examination policies and procedures were well adapted to the prevailing environment... Critical processes, like enforcement, pre-examination planning and people development were not delivering the results required to effectively supervise and engage banks to enforce good conduct( Sanusi, 2010, p.9).

Ekundayo and Agabi(2009), however, believed that with the conclusion of the bank audit exercise, the country has come to the end of the first phase of the process of restoring financial sector stability. According to the authors, the reform process will focus on building capacity within the regulatory regime; fast-tracking the implementation of risk-based, consolidated and cross border supervision frameworks; easing the flow of credit particularly to the real sector of the economy; improving governance structures and practices in the financial services sector; as well as improving confidence in the economy in general.

#### Evaluations of Central Bank of Nigeria Policies for Solving Banks Distress

As stated earlier, one of the strategies recently employed by the Central Bank of Nigeria to solve the problem of instability in the banking system is consolidation of the banks. The exercise was meant to increase the capital base of

the banks. Adequate capital in banking confers some benefits to the economy. These benefits include the following:

1. Adequate capital serves as buffer between operating losses and insolvency. As argued by Philips (1997) and cited in Obadan (2004):
  - . . . the more capital a bank has, the more losses it can sustain without going bankrupt. Capital thus provides the measure for the time a banks has to correct for lapses, internal weakness or negative developments. The larger sized the bank capital, the longer the time a bank has before losses completely erode its capital.
2. Protection of depositors and creditors in time of failure;
3. Strengthening of banks' ability to assume risk;
4. Influence a bank's ability to attract funds at low cost; and
5. Enhances a bank's liquidity position. The higher the liquidity of a bank the less risky is the bank.

Although, consolidation will make the banks to be heavily capitalized, capital adequacy is just one of the measures for measuring the performance of banks. It does not guarantee quality of management, the quality and quantity of assets, the quality and character of board of directors and effective supervisory and regulatory framework of Central Bank of Nigeria (CBN) and Nigeria Deposit Insurance Corporation (NDIC).

Proponents of bank mergers and acquisitions often cite the consumer benefits derived from increased bank efficiency, competition, and geographical diversification. As Shih(2003) argues, the idea of merger rests on the belief that (i) merging two weak banks creates a healthier bank than both predecessor banks; and (ii) merging a weak bank with a healthier one reduces the chance of a bank failures. Similarly, it was believed that there might be cost savings through consolidation of overlapping functions or even an increase in combined revenues through the sharing of superior marketing skills. However, as Shih (2003) argues, research has suggested that the acclaimed synergy from banks mergers is not automatic, and that bank merger seems as likely to be negative as positive. Therefore, viewed in a risk-return framework, a bank merger would make sense only if it has the potential to increase return and /or reduce risk (Iyiegbuniwe, 1998).

More importantly, the issue of consolidation raises some fundamental questions in the minds of analysts. For instance, would mergers, especially those that occur in coercive and crisis environment reduce bank failures? Would the economies of large scale resulting from the mega banks favour SMEs, which are regarded as the engine of growth, especially in developing countries?

Researchers and SMEs experts have also expressed concern that the consolidated banks may significantly reduce the availability of credit of small firms, which account for about 70% of industrial employment and well over 50% of gross domestic product in Nigeria. Frame et. al (2001) claimed that studies concerning the effect of banking industry consolidation on small-business lending are motivated by (i) the stylized fact that small banks are relatively more active in

this market; and (ii) the theoretical emphasis on small-business credit market imperfections.

The traditional theories of small-business credit market, and as confirmed by Berger and Udell (1996) revealed that the provision of banking services to small-business decreases with bank size and organizational complexity. Their arguments are based on two-grounds: (i) small-business lending is fundamentally different from large firm lending, in that in the former credits are more information intensive and relationship driven; (ii) There would be managerial diseconomies of scale with the provision of multiple activities in large, complex organizations.

The studies by Keeton (1995) and Peek and Rosengren (1995) also indicate that small-business borrowers may be affected by consolidation. According to Cole et. al., (1998), large banks typically employ standard financial statement criteria in the loan decision process, while small banks focus more on their impression of borrowers' character. Although, the recent bank capitalization reforms had the tendency of making the banks sound, stronger and more responsive to the country's developmental needs, the few mega banks that emerged from the bank consolidation have far-reaching implications, with the possibility that the small-businesses may be discriminated against in loans procurement. This means that SMEs would encounter difficulties in obtaining loans from the financial institutions, because size is a major consideration in credit analysis (Kotikula, et. al., 20002). Incidentally, Table 4 shows that commercial bank loans to small scale enterprises as percentage of total credit in Nigeria declines progressively, especially after the consolidation exercise in 2006, apart from the abolition of the mandatory banks' credit allocations of 20% of the total credit to small scale enterprises.

Table 4: Commercial bank loans to small scale enterprises as percentage of total credit in Nigeria

Year	Commercial bank loans to small scale enterprises as percentage of total credit (%)
1992	48.79
1993	32.18
1994	22.19
1995	22.94
1996	25.00
1997	16.96
1998	15.49
1999	13.26
2000	8.76
2001	6.59
2002	8.63
2003	7.45
2004	3.62
2005	2.67
2006	1.02
2007	0.85

2008	0.17
2009	0.17

Source: Central Bank of Nigeria Statistical Bulletin, December, 2009

However, the government pronouncement that the existing banks would be stratified into different categories, depending on their areas of operation, may be a relief for the small businesses. Based on the stratification, a bank would be allowed to identify which areas it wants to operate in line with the national economic needs.

Finally, the current reform of the Central Bank of Nigeria at repositioning the financial system, as Sanusi(2010) stated, and based on the four pillars of enhancing the quality of banks, establishing financial stability, enabling health financial sector evolution, and ensuring the financial sector contributes to the real economy, remains valid only to the extent that the reform process will make the operators to be accountable and face personal consequence for non-compliance. In the past periods, banks were prepared to pay penalties rather than complying with CBN directives, because the monetary benefits deriving from non-compliance usually outweighed the cost of complying with the directives.

### Summary and Implications

The paper examined the nature and extent of the incessant bank crises in Nigeria and reviews some of the strategies adopted by the monetary authorities to solve the crises. The motivation for merger or consolidation should be to derive synergistic opportunity for all the parties operating in the financial system. The paper argued that the Central Bank of Nigeria should be more pragmatic and proactive in dealing with the problems of crises in the sector and show more concern about non-compliance by banks with government policies. A situation where banks are prepared to pay penalties rather than complying with CBN directive can only be beneficial to the narrow extent that they failed to consider the development needs of the economy. Such a myopic tendency does not augur well for the safety, stability and soundness of the financial system.

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