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An Economic Genealaogy of Financial Sector Restructuring in Nigeria

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Abstract: The Nigeria financial services industry was born in 1892 with the establishment of the Africa Banking Corporation, which after a series of metamorphoses, combinations and transformations, survives today as First Bank of Nigeria plc. For exactly sixty years thereafter, the available topography of financial services was characterized by an attitude of free for all and all- for- free. The study surveys the incidence of structuring from nativity till date in the finance industry. The approach followed is historical content analysis. The findings indicate the prevalence of an atmosphere totally devoid of regulations from birth until 1952, during which time ninety five percent of indigenous banks established also liquidated; followed by a period of regulations lasting up to 1985, with the minimum of financially distressed situations: the playing ground of deregulations up to 1994, which occasioned another peak in financial sector growth, quickly followed by the worst crashes and maximum of casualties. The study concludes that the present reforms, dating from 6th July, 2004, are the most proactive and anticipatory so far.

Key words: Economic genealogy, financial sector, sarice

INTRODUCTION

The financial sector, as a terminology, is a composite of three elements- financial instruments, financial markets and financial institutions. The organic linkage of the three derives from the commercial flow of financial transitions. Basically, financial instruments are traded on the floor of financial markets by financial institutions. Thus, where you have one, it follows automatically that you have to have the other two.

The role of the financial service industry in the process of economic growth and development has been well documented, especially with respect to a developing economy[1-3]. These roles are summarized in the concept of financial intermediation. In the intermediation process, financial intermediaries engage in reconciling the objectives of borrowers and lenders. They bring savers and borrowers together by selling debt instruments or securities and deposits to savers for money. They then lend such accumulation of money to borrowers. The lender or investor thereof receives claims on the investment which generally has stable values and high liquidity. In plain language, the intermediation process boils down to a translation of the liabilities of the financial intermediaries into additional assets in the financial markets.

Formally, financial markets are characterized as the industrial arrangements through which savings are mobilized from surplus economic units to deficit units. Activities in financial markets traverse both short- and long-term finances, handled, respectively in the money and capital markets, into which the financial markets in the final analysis, bifurcates.

The financial instruments traded in the financial markets are of varying maturational ages in terms of calendar period. In the money market, the maturities range between a few days and one or two years. Some of the money market instruments in Nigeria, with their birth dates given in parentheses, are: treasury bills (1960), call money fund (1962), commercial bills (1968), treasury certificates (1968), certificates of deposit, banker's unit fund and eligible loan stocks (all in 1975)

In the capital market segment of the financial markets, instruments are generally of a minimum maturational age of three years, as the market provides a mechanism for individuals and firms to buy and sell claims on future income. Such claims are exemplified in stocks, shares, mortgages and insurance policies, which constitute the instruments traded therein. The capital market is capable of further sub-division into a primary and a secondary market. In the primary market, new claims are sold for cash and the funds later used for capital investment. In the secondary market only existing claims are traded and no new cash is made available for investment.

The apex regulatory body for the money market is the Central Bank of Nigeria while the corresponding body in

the capital market is the Securities and Exchange Commission.

It is natural to expect the financial system to grow increasingly deep and broad while its structure grows in sophistication, as the economy itself grows and develops. In the process, the system offers a wide range of portfolio services to savers and issuable instruments or securities for investors. The problems emanating from this phenomenon of growth, development and sophistication are what generate the need for reforms and restructuring in the system.

Theoretical issues and framework: Any situation in which the financial system begins to manifest shockers and crises is always causative to uncertainty, fear and anxiety in the rest of the economy at large. Yet, many developing countries have suffered undue exposure to this malaise at different times in their economic history.

According to Gbadamosi[4], the following developing countries suffered crises in the periods indicated against them: Colombia (1982-87), Chile (1975-85), Thailand (1983-87), Philippines (1981-87) and Malaysia (1985-88). Without controversy, the crises seriously jolted the financial systems of the countries concerned. In Colombia, 6 out of 26 banks accounting for 23.5% of total bank assets, 5 development finance companies and 8 finance companies became insolvent. The comparative figures for Chile were 13 banks (out of 25) and 6 finance companies (out of 18). In Thailand, 19 finance companies with12% of total financial system assets and 5 commercial banks with 24% of commercial banks assets were insolvent. A total of 182 banks (3 commercial banks, 32 thrift banks and 147 rural banks) failed in the Philippines. In Malaysia, 32 out of 35 deposit-taking cooperatives, 4 and of 38 banks and 4 out of 47 finance companies were insolvent.

The scourge of financial sector misfortunes has hot been a monopoly of third world countries. Some developed countries too have had their own turns in this reversal of fortunes, mainly due to certain domestic macroeconomic policies as well as international economic developments. Gbadamosi[4] cities Spain as having experienced banking failures during the 1978-83 period as result of interest rate liberalization in 1974, oil shock, the decline of terms o f trade from 106 in 1973 to 84 in 1980 and the sharp drop of real growth to 2% between 1975 and 1980. The United States had its our crises during the 1979-90 period, rendering 346 thrift banks (out of a total of 3 147) insolvent. The basic explanatory factor was the tight monetary policy which increased interest rate costs in 1981, badly hitting the major thrift assets of 25-30 year fixed rate mortgages. In the U.S banks failures rose from 40 in 1982 to 200 in 1988.

Financial system ruptures have also formed part of recent British economic history. During 1973-76, the United Kingdom went through her own banking crisis, affecting a total of 26 financial institutions. The underlying reasons were the tight monetary policy of 1973, the oil shock, volatile currency markets and deteriorations in the balance of payments. The shake-ups were so turbulent and violent that the United States liquidated 65 thrift banks and several other banks during the 1979-90 financial system crises. Similarly, the United Kingdom liquidated 8 fringe banks during the 1973-76 crises.

To keep the adversities occasioned by these crises within manageable proportions, many countries have established agencies empowered to conduct an intervention. In Thailand, there is the Fund for Rehabilitation and Development of Financial Institutions (Rahab). The United States has the Federal Deposit Insurance Corporation (FDIC). Spain has the Bank Guarantee Fund (BGF). Colombia has the Deposit Guarantee Fund while Nigeria has the Nigeria Deposit Insurance Corporation (DIC). These intervention agencies normally develop remote sensing capabilities by which they monitor the pulse of the financial system. Based on their feelers and sensations from their network of financial antennae, it is then decided whether or not the system requires a restructuring or a reform.

In the management of reforms and restructuring to ameliorate distress and mitigate the difficulties sequel thereto, three approaches have been most patronized. These are liquidation, rehabilitation and consolidation. Cases of liquidation carried out in the United States and the United Kingdom have already been alluded to. But, governments in developing countries have not exhibited much enthusiasm in having ailing banks liquidated. Their reluctance is attributable to a number of considerations, the fact notwithstanding that the obvious alternative to bank insolvency in a market economy is liquidation.

First, to liquidate every bank associated with insolvency will give rise to a gross erosion of confidence in the entire banking system. It could lead to a bank run and a further chain reaction of disastrous liquidations. Second, the visitation of assets liquidation on every case of bank insolvency will, in the long-term lead to a situation of capital flight from the economy. Escalation in the rate of such capital flight will bring about a slow down to snail speed or even an outright halting of the process of gross fixed capital formation, which will spell dire economic consequences. Furthermore, liquidation of

banks will definitely culminate in the demonetization of the economy. Uncertainly about the longevity of the banks will be so deleterious to banking confidence that people will revert to cash transactions outside the purview of the banks. Finally, liquidations will be detrimental to the vibrancy of the capital market.

Against this back drop, rehabilitation and consolidation are considered economically more affordable, from the national economic standpoint.

In the event of the adoption of rehabihtation as the preferred strategy for financial sector restructuring, the following options are usually available either for sole or for combined application by Gbadamosi[4]: injection of liquidity by government through soft loans; recapitalization and mergers and acquisitions. These measures may be pursued simultaneously or in sequence.

Liquidity support, as a rehabilitation scheme, is only of relevance where the solvency problem is lacking depth and serious. It may be given as a soft loan in the form of subsidies, as in Malaysia and Chile, or at market rates, as in Thailand. Such liquidity loans are also convertible to equity as has been known to happen in Chile. The Central Bank of Nigeria (CBN) during the early 1990's did bail out a number of banks through such liquidity assistance.

For situations characterized as involving fundamental solvency incapacity, recapitalization comes under consideration as a restructuring device. Recapitalization concretizes through fresh injection of capital by rights issues or the conversion of support loans. It invariably precipitates a change of management, cutting of overheads, staff rationalization and sanitization of the books by heavy and sensible provisioning for lost loans[5].

Consolidation is the more favoured approach in the on- going financial sector restructuring in Nigeria. The word consolidation refers to the process of uniting or combining things into one. As currently applied in Nigerian banking vocabulary, consolidation is a banking reform which means the coming together of two or more compatible banks to form a mega bank. It is of three parts, namely joint venture, strategic alliance and again, mergers and acquisitions.

Ancestry of reforms:- the pre-sap era: The necessity for a formal financial organization in the formative years of colonial Nigeria was created by the combination of the activities of transnational corporations, the financial transactions of the colonial government, the decline of the barter system and the increasing acceptance of the British silver currency[6]. To take advantage of this unexploited and virgin market, the African Baking Corporation, a financial counterpart of the Royal Niger Company, started banking services in 1872. Following its acquisition by Elder Dempster Lines in 1894, the company metamorphosed into the Bank of British West Africa.

In 1971, the Barclays Bank (Dominion, Colonial, Overseas) came into operation in the colonial country. In 1949, the British and French Bank arrived the country's financial markets. These three banks today have their corporate progenitors as First Bank Plc, Union Bank Plc and United Bank for Africa Plc.

Nigeria's first indigenous bank, the Industrial and Commercial Bank, was established in 1929 and quickly suffered infant mortality when it collapsed in 1930. Records from the CBN show that 30 private indigerious banks sprang up and collapsed between 1929 and 1968. This spate of failures created a crisis of confidence in the financial services industry and over dramatized the need for reforms.

According to Anyanwu[7], the first restructuring was in the form of the enactment of the 1952 Banking Ordinance which abrogated the prevailing free-for- all atmosphere, requiring formal registration and licensing to operate as a bank. More reorganization progress was made when the CBN was established in 1959, which inaugurated effective monitoring and control in the sector. The absence of any scrutiny before commencement of banking operations and especially, the total lack of any supervisory and controlling authority, were the major factors implicated in the excessive mushrooming of feeble banks in Nigeria during the banking boom of the 1940s and 1950s. Onoh[8] reports that over one hundred indigenous banks were established during this period, the only survivors of which were the Agbonmagbe Bank (1945) and the African Continental Bank (1948).

The 1952 Banking Ordinance, among other things, stipulated that only organizations with a minimum share capital of £12, 500 could receive a banking license. The Banking (Amendment) Act of June 1962 raised the minimum share capital to £ 250.000. The Banking Decree No1 of February, 1969 and the Banking (Amendment) Decree No. 3 of 1970 imposed more stringent conditions. An indigenous bank could only open if it had £600,000 in share capital while foreign banks needed a minimum of £ 1.5 million in share capital. These measures went a long way to restructure the financial services sector of the country. By 1960, the country had 8 banks with 106 branches Anyanwu[7] . By 1980, there were 26 banks and 40 in 1985 (Gbosi, 1995), with 1316 branches.

Yet, financial distress had re-established itself by 1980. To address this problem in part, the Economic Stabilization Act of 1982 was introduced as well as the National Economic Emergency Decree of 1985.

Chronolgy of reforms: the era since sap: SAP means Structural Adjustment Programme. It was announced by the President of the Federal Republic of Nigeria on June 27, 1986, to cover the period July 1, 1986 to June 30, 1988. According to Phillips[9], the economic problems which SAP sought to attack were: excessive dependence of the economy on one commodity, chronic lack of self-reliant growth and development, serious balance of payments disequilibrium's, etc. Nnadi and Falodun[10] identify the policy instruments by which SAP was implemented as financial measures and industrial measures, each of which had internal and external dimensions.

The restructuring programme of the era began from the internal financial measures, when the Central Bank of Nigeria, in August, 1986, withdrew billions of naira from the banking system and further tightened the monetary policy on August 1, 1987, with an increase in the minimum discount rate from 11 to 15 percent. Major financial sector expansions took place in this era. From 40 banks and 1316 branches in 1985, there were, in 1992, 120 banks with over 2000 branches. Before 1985, the average growth rate of assets of the banking system was less than 10% but it rose sharply to 30.4% in 1986 Anyanwu[7].

Other major financial sector developments of the period include: increase in the number of licensed and non-licensed finance houses to 558 by December, 1992; the establishment by 1993 of 145 mortgage institutions under Decree 53 of 1989, about 500 community banks and 204 Peoples Bank branches in same period; the establishment of the Nigeria Deposit Insurance Corporation and the Nigeria Export-Import Bank, the CBN Prudential Guidelines and also Accounting Standards for licensed banks, the raising of minimum equity capital requirement to N40 million and N50 million for Merchant and Commercial banks, respectively, the introduction of Magnetic lnk Character Recognition cheques and the introduction of Open Market Operations (OMO) and the guidelines for Discount Houses, among others. By the end of 1994, there were 66 commercial banks, 54 merchant banks, 402 community banks 228 People's Bank branches, 145 mortgage institutions, 132 bureau de change, 140 stock brokerage firms, 666 insurance companies and 3 discount houses[1].

Given the unease created by this unmitigated growth in the financial services industry, regulatory authorities tried to do something to reassure stake holders. To begin with, in January, 1997, the Federal Government directed that licensed banks should increase their paid-up capital to N500 million not later than 31st December, 1998. Banks already certified distressed by the CBN were given up to 31st March, 1997 to comply. It should remarked that 8 banks had been distressed as early as 1991, the number growing to 45 by the end of 1994 Toby[6], of which 5 suffered liquidation. By the end of 1998, 12 commercial banks and 13 merchant banks were also liquidated. Until 2001, minimum capital base for banks stood at N1 billion, after which it was reviewed to N 2 billion with deadline for compliance by banks fixed for 31st December, 2004.

On 6th July, 2004, the Governor of the CBN, Professor Charles Soludo made a pronouncement of further reforms, the major planks of which are the increase of the minimum capital base for banks to N25 billion with 31st December, 2005 as deadline, a phased withdrawl of public sector funds amounting to N74 billion, commencing 21st July, 2004, consolidation of banking institutions through mergers and acquisitions; adoption of risk-focused and rule-based regulatory framework; adoption of zero tolerance in the regulatory framework, especially in the area of data/information/recording/reporting and expeditious completion of the electronic analysis and surveillance system for the automation of rendition of returns by banks. Others are establishment of a hotline, confidential internet address (Governor@cenbank.org); strict enforcement of the contingency planning framework for systematic banking distress; establishment of an Assets Management company; promotion of the enforcement of dormant laws vis-a-vis dud cheques, liabilities of board members in a failing bank, revision of relevant laws and drafting of new ones relating to the effective operations of the bank, closer cooperation with the economic and financial crimes commission in the establishment of the financial intelligence unit and enforcement of the anti-money laundering and other economic crime measures and finally rehabilitation and effective management of the Mint.

CONCLUSION

The history of financial sector reforms is of more recent origin than the nativity of the sector itself. The reforms and restructurings which can be dated from the Banking Ordinance of 1952 have, before July 6th 2004, been in the form of legislations and statutes calculated to provide a framework of regulations within which activities in the financial industry are carried on.

The major problem of the reforms was their failure to anticipate even problems in the near future. As a result, the restructuring strategies were, nearly all the time, responses to financial sector disasters that had already taken a major toll on the economy. They were consistently deficient in the element of proactivity and that of foresightedness.

The on-going reforms, inaugurated on 6th July, 2004 so far are the most proactive and anticipatory in intent

and purpose. However, nothing conclusive can be said in good conscience, as yet.

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