THE NIGERIAN BANKING SECTOR REFORMS AND THE MILLENNIUM DEVELOPMENT GOALS

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Abstract

This paper examines the Nigerian banking sector reforms vis-a–viz the Millennium Development Goals (MDG) nexus. The thrust of this paper is that the reform will redirect the banks to focus on the development of SMEs. SMEs have direct relationship with the populace and hence, enhance human development engineering, and impact positively on the goals of millennium development. Finally, the paper calls on the vigilance of regulatory authorities to tighten all loopholes that could arise from large size that may work against the full appropriation of the consolidation synergies and potentials.

1. INTRODUCTION

The collective desire of the members of United Nation Organizations to set timely minimum welfare standards for citizens of member countries has always featured as major agenda of Organization's Conferences. The year 2000 United Nations development goals is an expression of the collective desire of humanity to set welfare targets for people of the world by year 2015. These goals are known as millennium development goals (MDGs). In this regard, member countries are committed to make necessary investments toward the achievement of the MDGs. Millennium Development Goals outlined the key developmental challenges and framework that could be used to roll back underdevelopment and enhance growth and development.

In seeking to achieve these goals, series of economic reforms have been put in place or designed to tackle the structural and other impediments to economic growth. These economic reforms so far put in place in Nigeria are encapsulated in the Nigerian Economic Empowerment and Development Strategy (NEEDS) which commenced in 2003. These programmes of reform includes: The public sector reform, which is meant to inculcate a culture of fiscal discipline in the management of public resources, reduce the size of government, improve governance and accountability, tackle corruption, and free up resources for the development of the private sector. The essence of these is to refocus the public sector on its proper functional perspective of providing enabling environment, infrastructure and delivery of welfare services to the Nigerian economy and also to increase the operational space of the private sector through deregulation, financial sector consolidation, and privatization of public assets. The nation has made considerable progress in the implementation of these objectives with respect to Millennium Development Goals. For instance, the anti-corruption drive as witnessed by the works of the Economic and Financial Crimes Commission (EFCC). Also, there has been a good measure of progress in fiscal retrenchment, auditing of Ministries payroll to remove ghost workers, monetization of fringe benefits, reformation of the pension schemes, subjecting public contracts to due process and restructuring of the banking sector etc. It is important to mention here that the success recorded at fiscal reforms in the president Obasanjo's regime has earned Nigeria a sympathetic hearing on the debt relief issue by the clubs of creditors, as well as shielding the economy from the boom-burst circle of influence on the economy through its financial intermediation functions; they facilitate capital formation, lubricate the production engine bearings and promote growth. This affects the lives of the households (Adeyemi 2005). It is against this background that the banking sector reforms are designed to enable the banking system develop the required synergy to support the economic growth. This paper focuses basically on Nigerian banking sector reforms, its challenges and impact on the Millennium Development Goals.

The next section presents the banking industry before consolidation. The third section briefly outlines the recent banking sector reforms in Nigeria. The fourth examines the strategies adopted by the banks in the consolidation process, and next to this are the implications of the reform exercise. The sixth section assesses the banking consolidation and the realization of the millennium development goals. The seventh section equally assesses the post banking consolidation challenges and MDGs. The eight section presents the conclusion and recommendations.

2. THE BANKING INDUSTRY BEFORE CONSOLIDATION

Prior to the unveiling of the recent banking reform on 26th of July, 2004, most of the existing eighty-nine (89) banks exhibited one form of weakness or another. Prominent, among such weaknesses are under-capitalization and insolvency, illiquidity, poor asset base and quality, weak corporate governance among other vices. In the midst of these vices, was unhealthy competition engendered by the relative ease of entry into the industry. Adeyemi (2005), reviewing the banking sector as at June, 2004 revealed that marginal and unsound banks accounted for 19.2% of the former 89 banks with an industry non-performing assets standing at 19.5%. The implication of this is that there was threat of systemic distress. Again, Soludo (2004), observed that the largest bank in Nigeria had a capital base of about USD298 million compared to USD526 million of the smallest bank in Malaysia. In the words of Ishiaka (2005),"this explains the large-scale distress in the Nigerian Banking Sector and their preference for foreign exchange and treasury bills transactions. Lemo (2005), also noted that the industry was basically characterized with small-sized fringe banks with very high overhead costs, low capital base, heavy reliance on government patronage. These features combined with the fact that the financial sector ought to be the driving force of an economy necessitated the need for banking consolidation. Consolidation in everyday economic parlance could be defined as the action of reinvesting a capital gain made on a speculative share in a more conservation security. According to Adeyemi (2005), the term could also connote the selling of equities at a gain and reinvesting of the proceeds in fixed interest securities. Again, Sloan and Zurcher (1970) explained consolidation as "a fusion of assets and liabilities in whole or part of two or more business establishments to form an entirely new establishment". To Adam (2005), business enterprises consolidation is essential for growth of an economy and could be achieved through several ways such as mergers, acquisition, and recapitalization and through legislation. The essence of consolidation essentially is to enhance synergy, improve efficiency, and induce investor focus, productivity and economics of scale. In all, consolidation represents the idea of investment and the coming together of firms as a large single legal business entity with widespread ownership. It is expected that the few resulting banks through consolidation will become active instruments of capital market development which in turn will lead to financial stability in the economy.

3. RECENT BANKING SECTOR REFORM

Banking reforms in Nigeria is a continuous process. Following the liquidation of twenty-six (26) distressed banks on 29th of June, 1998, there was the commencement of Universal Banking (UB) and the upward review of the minimum paid-up capital for new banks from N1.2 billion to N2 billion. The guidelines for the implementation of Universal Banking in Nigeria were issued by the Central Bank of Nigeria (CBN) on January 01, 2001. This broad based scheme enable banks diversify their operations such that they may engage in almost any type of financial activities. The Universal Banking reform also removed the restrictions between money, capital and insurance markets, hence it enable banks to accept deposits, lend, underwrite debt/equity issues, stock broking, insurance services, investment management etc. In order to prepare the banks for full operation in the realities of a global world, their minimum paid up capital was again raised from N2 billion to ₦25 billion. This is expected to promote competition in the industry, encourage increased deposit mobilization, improve access to credit and ultimately promote investment and economic growth. The present reform as noted by Adams (2005), and Adeoye and Adewuyi (2005), is to create a sound and more secure banking system that depositors can trust as well as having the capacity to finance real productive projects and able to stand greater business risks at continental and global levels. It is designed not only to evolve a sector that is part of the global change, but one that ensures efficient market competition and plays active role in the developmental process.

4 REFORM STRATEGIES ADOPTED BY THE BANKS.

The banks in complying with the CBN directives on N25 billion as minimum capital requirement, adopted varied degrees of strategies as: capitalization of profits through rights issue, initial public offers (IPO), and combination of mergers and acquisitions. Generally, the consolidation strategies followed some four scenario of grouping.

Firstly, those banks with regional or cultural affinities such as common shareholders came together to form a consolidated entity, through this emerged Intercontinental Bank made up of former, Equity, Global, Gateway and Intercontinental Banks. Others include, Wema Bank made up of National bank and former wema Bank. Spring Bank PLc also metamorphosed from Citizens, Guardian Express, ACB International, OmegaBank, Trans-International Bank and Fountain Trust Banks.

The second scenario is made up of small or medium but weak Banks coming together to form a consolidated bank, such as Unity and Skye Banks.

Another scenario saw some big banks acquiring smaller or weaker ones as in the case of Union Bank with Universal Trust Bank and Union Merchant Bank Limited.

Lastly, merger between big banks as in the case of Standard Trust Bank (STB) with United Bank for Africa to form the UBA group.

5. IMPLICATIONS

The expected implication of the consolidation exercise can be summarized as follows: Ebong) 2005) expressed the view that corporate governance in the banking industry will improve remarkably following the change in the ownership structure. Given the change in the structure of ownership from private to public limited companies (PLc) in the new dispensation, the situation where individuals and their cronies had overbearing influence on the management of the bank is over. This is because there are now more diverse and board representations in decision making rather than bedroom decisions of private companies.

Again the reform programme has drastically altered and redefined the nature of competition landscape in the banking industry. The significant increase in the minimum capital base for banks from ₦ 2billon to ₦ 25billon has not only raised the barriers for new entrants but has reduced the number of bank from 89 to 25. the direction of competition in the consolidated dispensation is not necessarily based on bank stability and depositors' fund safety but on the ability of banks to deliver superior value to clients and shareholders as well as price of bank products.

Okogu (2005), posits that one important implication of the consolidation reform will be a gradual shift away from the "cash and carry" economy to an increase in the use of financial instruments and credit facilities. To this end, credit worthy consumers may have less of need for cash in order to build or purchase houses (mortgage), vehicles or other domestic appliances. This is so because banks in their practice of Universal Banking delve into mortgages, leasing, outright and installmental sales among others.

It is also expected that the banks will return to the traditional role of financial intermediation and regain banking focus that was lost in the late 1980s. Furthermore, the banking reform will strengthen the capacity utilization of the local manufacturers to enable them compete with their overseas counterparts in a global world, with its attendant impacts.

Other positive impacts include economics of sale, enhanced revenue, and tax gains.

6. BANKING CONSOLIDATION AND THE REALIZATION OF THE MILLENNIUM DEVELOPMENT GOALS

Essentially, the millennium declaration outlined key development challenges. These were encapsulated in the millennium development goals. The eight broad goals include to:

(i) Eradicate Poverty and Hunger (ii) Promote Gender Equality and Empower Woman (iii) Improve Material Health. (iv) Achieve Universal Primary Education (v) Reduce child Mortality (vi) Combat HIV/AIDs, Malaria and other diseases. (vii) Ensure Environmental Sustainability and (viii) Develop a Global Partnership for Development.

It is to be noticed that earlier United Nations declarations focused mainly on economic growth, but the millennium development goals set human well-being and poverty reduction as priority at the center of its global development agenda. It is truism that meaningful economic growth and development can only be achieved in the context of sustained human development. To this effect, bank consolidation can only be worthwhile to Nigerians if it promotes human welfare through lending to businesses at reasonable interest rates. Therefore the most effective way to fight poverty is by *growing* the economy in order to create real jobs, instead of relying on the government sector.

It is expected that the banking sector consolidation will force the financial industry into playing its role as partners in development by recycling resources from simple units to those who want to invest. A revitalized banking sector will be in a position to fund large projects, especially in the oil and gas sector.

The banking sector also has it as a duty to identify investment opportunities outside the areas of trade financing, foreign exchange trading, government treasury bills, corporate bonds, loans and blue chip companies which dominated their portfolio prior to consolidation and have a more favourable look at small and medium businesses development.

One of such areas open to the consolidated banks is in the real estate sub-sector. This will surely facilitate economic development through the multiplier effect. For instance, demand for building materials, labour, architectural services, building engineers, etc will increase. This will contribute towards wealth creation and impact positively on poverty reduction.

A close look at the MDGs reveals that most of the goals are inter-linked, such that progress in one often lead to progress in others. The case of reducing poverty for instance, will also lead to better educational attainment for members of the household as well as improved material health and reduced child mortality. Studies have shown that there is a strong correlation between the level of poverty and low educational attainment. It can be inferred that poor parents are more likely to withdraw their young children out of school and into child labour. Such house holds will do better in getting out of poverty if they are exposed to soft loans or micro-credit as noted by Idumange (2005). Idumange, further views, micro-credit as a facility given to small-scale business proprietors to enable them engage in productive economic activities capable of generating income. It is important to note that the poor whether rural or urban has low propensity to save and hence need credit intervention. Similarly, Osia (2001) observe that the provision of credit facilities, such as micro credit loans to women to embark on small scale businesses is a powerful way to empower them (women) for family care. These include retail trading, tailoring, palm oil and kernel processing among others. Empowering women through a micro-credit or soft loan has the potential of pulling out an average of four children out of poverty (Osia, 2001). Hence the banking industry remains the only effective outlet for the realization of the Millennium Development Goals.

7. POST BANKING CONSOLIDATION CHALLENGES AND MDGs

Since, the status of corporate governance in the banking industry is expected to improve remarkably following the change and broadening of ownership structure, there is the fear that the units that amalgamated to form the whole will become cleavages, camps or cliques in the corporate governance according to their corporate cultures that could result into squabbles at board meetings. A good board leadership however should be skillfully equipped to identify “splinters” and to handle division of opinion to avoid set-back that can arise forthwith. A set back witnessed by a bank may affect her capacity to carry out financial intermediation to business units and in turn, frustrate the attainment of the Millennium Development Goals.

A consolidated bank may lack flexibility in responding quickly to changes in market situation due to the large size. Adequate communication and information is however necessary to enhance performance and operation in this regard, but where there are documents to be signed physically before decisions are implemented it could create room for competitors to catch on clients. Where the clients involved are on small and medium scale enterprises or rural personalities, then the achievement of MDGs may suffer huge set back.

According to Adeoye and Adewuyi (2005), the average return on invested capital (ROIC) in the Nigerian banking industry is estimated to be about 38%, before consolidation. It is expected that the shareholders having participated in the consolidation will put undue pressure on banks in order to have higher returns on their investments. Such pressures will force the mega banks to be more innovative and creative in coming up with new products and exploring other businesses with high risk profile. These businesses with high risk profile averted are basically in the real sector especially those that fall within the small and medium scale range. Hence, it is expected that invisible hand of competition will direct the banks to intermediate in areas that promote poverty alleviation as contained in the millennium development goals.

8. CONCLUSION

This paper examines and assesses the challenges, and implications of the banking reform programme with respect to its role in the realization of the millennium development goals. Prior to the reform, the banking sector intermediation function skewed mainly towards foreign exchange trading, money market instruments rather than the development of small and medium scale enterprises. Banks considered small and medium scale businesses as prone to high risks due to the banks shallow financial base. With banks consolidation competition redirects the banks to now focus on the development of SMEs which have direct relationship with the populace.

The major finding of the study reveals that bank consolidation impacts positively on poverty goal of millennium development. It further shows that the bank reforms occupy center stage of the government effort towards the development Of SMEs thereby contributing positively to human development through banks micro-finance schemes.

The consolidation exercise poses some considerable challenges on the banking sector. These include the fear that the amalgamated units could become cleavage for conflicts, bureaucratic tendencies due to large size, and pressures from enlarged shareholdings.

9. RECOMMENDATIONS

The paper recommendations that for the consolidated banks to be efficient in their intermediation functions, the regulatory institutions and authorities have to be empowered to make adequate guidelines that will take3 care of post consolidation conflicts, and tighten all the loopholes that arise as a result of the large size of banks.

It also recommends that the supervisory/regulatory authorities should use their power to redefine the direction of credit towards SMEs as well as liberalize interest rates so as to make reasonable impact on the millennium development goals.

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