Bank consolidation/capitalization in the Nigerian Commercial Bank (1986-2006): Causes, consequences and implication for the future

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ABSTRACT: *The CBN Governor noted that the vision or prospect of the CBN and the Federal Government of Nigeria is a banking system that is part of the global change, and which is strong and reliable. It is a banking system which must be efficient, depositors can trust and investors can rely upon. Using descriptive approach, this paper provides an in-depth analysis of the causes, consequences and implication of the policy thrust of the recent bank capitalization/consolidation of the Nigerian Commercial banks. The implications of this paper amongst others, is that reforms, remain a major tool for banking soundness, especially in the light of the recent global financial meltdown.*

Keywords: Bank Capitalization and Bank Consolidation.

1. Introduction

The recapitalization policy is just one of about 13 issues announced in July 2004 by the Central Bank of Nigeria (CBN) in order to sanitize the banking industry. The CBN Governor noted that the vision or prospect of the CBN and the Federal Government of Nigeria is a banking system that is part of the global change, and which is strong and reliable especially with the prevailing global financial meltdown. It is a banking system which must be efficient, depositors can trust and investors can rely upon. This is the Consolidation era (2004- till date). It is the era of "13-point Reform Agenda for Repositioning the CBN and the Financial System for the 21st Century", of which recapitalization was the policy trust. The policy required that the minimum capitalization for banks should be N25 billion with full compliance before the end of December 2005 (that is, 18 months rather than 12 months normally given in many countries).Only banks that met with the requirement above were licensed to undertake banking business.

Others that failed to meet up either merged or were liquidated. For the first time, the Nigerian banking industry witnessed merger between the small and big banks.

Table 1 : *The emerging banks in the nigerian banking industry as at december, 2005*

N/S	GROUP	MEMBERS	SHARE-HOLDERS FUNDS N	TOTAL ASSETS N	TOTAL DEPOSITS N
1	First Bank	First Bank Plc and MBC International Bank Plc	58.9 bn	538.1bn	391.2b
2	Diamond Bank	Diamond Bank and Lion Bank	34.9bn	223bn	144bn.
3	Bank PHB Plc	Platinum Bank & Habib Bank	28bn	156bn	109bn
4	Zenith Bank Plc	Zenith Bank Plc	93bn	608.5bn	392.8bn
5	Oceanic Bank	Oceanic Bank, Stanbic & Int'Trust Bank	37.1bn	371.6bn	310.3bn
6	Intercontinental Bank	Intercontinental Bank, Equity Bank, Global Bank and Gate way Bank	53bn	360bn	252.2bn
7	Fidelity Bank	Fidelity Bank, FSB International Bank &Manny Bank	25.6bn	120bn	78bn
8	UBA	UBA & STB	47bn	851.2bn	757.4bn
9	FCMB	FCMB,Coop. Bank, Nigeria-America Merchant Bank	25.2bn	106bn	70.3bn
10	Access Bank	AB, Marina Int' Bank & Capital Bank	28.6bn	174bn	110bn
11	NIB	NIB alone	35.2bn	112.2bn	61bn
12	Sterling Bank	Trust Bank of Africa, Magnum Trust Bank, NBM Bank, NAL Bank & Indo-Nigeria Bank	35bn	111.2bn	75.0bn
13	Unity Bank	Intercity Bank, First Inter State Bank, Tropical Commercial Bank, Centre Point Bank, Bank of the North, Societte Bancaire,New Africa Bank & Pacific Bank,NNB Inter'	30bn	100bn	N/A
14	ETB	Equatorial Trust Bank & Devcom Bank	28.4bn	109.7bn	72.7bn
15	Ecobank	Ecobank alone	35.3bn	132.0bn	84.0bn
16	Union Bank	UBN, Universal Trust Bank, Hallmark Bank	95.6bn	517.5 bn	275.5bn
17	Spring Bank	Citizens Inter' bank, Guardian Express Bank, ACB Inter' bank, Omegabank,, Fountain Trust Bank &Trans Inter' bank.	Over 25b	131 bn	N/A
18	First Inland Bank	FTB, Inland Bank, IMB,& NUB Bank	29.4bn	130bn	80bn
19	Guaranty Trust	GTB alone	36.4bn	305.1bn	212.8bn
20	Standard Chartered	Standard Chartered alone	26bn	34.72	23.5bn
21	Afribank	Afribank Inter (Merchant Bankers)	27.1bn	129 bn	94bn
22	IBTC – Stanbic bank		Over 60bn	100bn	Over 63bn
23	Skye Bank	Prudent Bank, EIB Inter, Bond Bank, Reliance & Coop. Ban k	37.7bn	176bn	70bn
24	Wema	Lead bank, National Bank, Wema Bank	34.8 bn	127.7bn	78bn

However, banks that are able to exceed the capital requirement stand a better chance of luring customers and instilling confidence in the system. The Nigerian banking industry has been affected by inconsistent monetary policies, unstable macroeconomic variables such as exchange rate, interest rate and general inflation some of which have led to increase in prices of capital and consumer goods thus, lowering effective purchasing power of people and reduced aggregate demand. Like other sectors, this sub-sector is also faced with poor infrastructural facilities and poor performance of regulatory authorities. Like other sectors, this sub-sector is also faced with poor infrastructural facilities and poor performance of regulatory authorities. According to Ajekigbe (2009), from the classical and historical perspective, *several factors led to the failure of banks between 1977 and earlier 2000. Some of the reasons advanced are poor asset quality, under capitalization, inexperienced personnel, illiquidity, inconsistent regulatory policies and supervision*. In the Nigerian Banking Industry, bank capital requirement has been reviewed several times between 1952 and 2006. (see table 2).

Capital constitutes an important part of any business. It serves as a measure of the degree of financial commitment of the owners in that business/project and also serves as a veritable loss absorber. Capital becomes imperative when reserves of the business are not sufficient to cushion or cover operational losses. The evolving competition in the banking industry as a result of globalization has made it difficult for Nigerian banks to play their major role of financing economic activities arising from inadequate capital. Inadequate bank capital has led to a crisis of confidence in the banks to the extent that the original functions which is to support the volume, type and character of a bank's business, to provide for the possibilities of losses that may arise there from and to enable the bank to meet a reasonable credit need of the community have been eroded. Losses suffered by banks led to bank failure especially in the areas of lending. The soundness, safety and profitability of a bank affect the quality of its loan portfolio.

The last few years have both been traumatic and revolutionary for the Nigerian banking system. According to Eke (1999): "Since the introduction of structural adjustment programme (SAP) in 1986 and the deregulation of the nation's financial system, banking business has raised a variety of performance questions. Although insured banks had recorded an appreciable increase in the volume of assets and deposits, their overall financial condition had deteriorated tremendously".

In the past, the Nigerian banking industry had been plagued with small size banks with low capital and high cost of operations. This weakness inhibits bank management in the performance of its development roles in the economy, thus hindering the achievement of government objectives such as price stability, macroeconomic stability, provision of employment and increased output. It also affects the ability to compete effectively in the international market. Since the banking sector is the hub around which all other economic activities revolves, the health and prosperity of the bank is a major source of concern to Nigerians especially the regulators. According to the Governor of Central Bank of Nigeria cited in Egene (2009), of the ten (10) banks audited so far as at August 2009, the banks' balance sheets of five

banks (Union bank, Finbank, Oceanic bank, Afrique bank and Intercontinental bank) had shrunken, shareholders' funds impaired and they now have liquidity problems.

Table 2: *Trend in the capital structure of nigerian banking (1952 - 2006)*

YEAR	FOREIGN (Commercial)	INDIGENOUS (Commercial)	MERCHANT
1952	£200,000	£25,000	--
1958	£400,000	£25,000	--
1969	£1,500,000	£600,000	--
1979	N1,500,000	N600,000	N2,000,000
FEB. 1988	--	N5,000,000	N3,000,000
OCT.1988	--	N10,000,000	N6,000,000
OCT.1989	--	N20,000,000	N12,000,000
FEB.1991	--	N50,000,000	N40,000,000
1998	--	N500,000,000	N500,000,000
2001-Universal Banking	--	N1 billion (old banks) N2 (new bank)	N1 billion (old bank) N2 billion (new bank)
1st January, 2006	--	N25,000,000,000	--

Source: CBN Annual Report (Various issues)

Their huge exposure to non-performing loans (margin loans) has affected the banks. These banks had spent length of time at the expanded discount window (EDW) introduced in September, 2008 by the apex bank. These five banks accounted for 90% of transactions at the EDW. The remaining banks accounted for 10%.According to the apex banks, these banks took money from the inter-bank to repay their exposure to the discount window. It is an indication that their balance sheets had shrunk. The management teams had acted in a manner that was detrimental to the interest of their depositors and creditors. According to the apex bank, the temporary capital injection of N420 billion into the banks in the form of Convertible Tier 11 Debt, is expected to be repaid to the CBN once the banks are recapitalized. Considering the fact that ownership of banks has moved from family to private, existing shareholders have not been informed how these funds would be converted when the bailout fund is fully repaid. The measure adopted by CBN to bail out the banks is adjudged as misuse of taxpayers' money and may eventually displace existing shareholders.

Therefore, the objective of this paper is to evaluate the causes, consequences and future implications of the capitalization/consolidation within the Nigerian commercial bank, and review the extant literature. The remainder of this paper is organized as follows: Section 2 discusses the related literature

while Section 3 presents the country experiences, while section 4 dwells on causes, consequences and implications of capitalization/ consolidation for the future. The final section summarizes and concludes.

2. Literature review

Ojo (1992) and Oluyemi (1995), cited in Eke (1999) opined that the financial condition of banks can be assessed using some basic indicators and trend analysis such Capital Adequacy, Asset Quality, Earnings and Liquidity. Apart from quantitative factors, qualitative factors such as quality of management, the degree of compliance by banks with applicable banking laws and regulations (e.g Monetary and Credit policy Guidelines), as well as banking services to the local economy are relevant. The measures of ascertaining a bank's financial condition and Performance by the regulatory authority are encapsulated in the acronym CAMEL, which stands for: Capital Adequacy (Owners fund to total risk-weighted assets); Capital Adequacy, a quantitative factor is one of the important indicators of the strength and performance of a bank. The best management cannot turn around an ailing bank if it does not have adequate capital. Assets Quality (Non-performing assets to total loan and advances portfolio); the incidence of large amounts of non-performing loans (bad debts) can put bank management under severe stress. Management (in terms of quality, competence and depth of experiences); the quality of management can make an important difference between sound and unsound banks. Poor management often manifests itself in the form of excessive operating expenses, inadequate administration of loan portfolio, overly aggressive policies to attract deposits. Earnings/Profitability (adequacy and sustainability of earnings over the long term); continued build-up of non-performing assets, would seriously affect banks in generating adequate income on their loan portfolio. The implementation of CBN Prudential Guidelines in 1991 for licensed banks has reduced the paper profit formerly reported by some banks. Liquidity (in terms of adequacy to meet maturing obligations and demand for new credits; inadequate liquidity damages banks' reputation while excess liquidity will retard their earnings.

Where a bank management fails to pay close watch to any of these indices, it could have adverse effect on bank performance. Where a bank is distress or healthy it would ultimately have recourse to new prospective investor, both local and foreign. Any attempt aimed at successfully recapitalizing any bank must focus on the bank's assets quality, management competence and experience, level of earnings, adequacy of liquidity and image/perception among other factors outside the control of the banks themselves. Healthy banks that intend to attract potential investors should start getting their overall business strategies and focus right. The findings of Modigliani and Miller (1958), Berger, Herring and Szego, (1995) as reported in White and Morrison (2001) posited that in a world with perfect financial markets, capital structure and hence capital regulation are irrelevant. It was also reported in White and Morrison (2001) by Rochet (1992) that capital adequacy help to reduce risk– shifting by bankers whose assets are insured while Diamond and Dybvig (1983), Diamond and Rajan (2000) posited that capital adequacy help in preventing destructive bank runs. Ross (2002) used selected capital ratios to

measure capital adequacy such as: total capital / total deposits, total capital /total assets.

Where risk assets include all bank assets, if a bank has excessive asset quality and earning problems, more capital will likely be necessary. The idea of minimum capital on all banks actually began in the United States in December 1981.Prior to that date subjective approach was used and it relied on peer group comparisons to decide if a bank had enough capital. The judgment method for assessing the adequacy of a bank's capital looks at the following: Management quality, Asset liquidity, Earnings history, Quality of ownership, Occupancy costs, Quality of operating procedures, Deposit volatility and local market conditions. It was reported by Nwude (2005) "that the amount of capital funds a bank needs should be related to the risks it assumes. The greater the risks, the more the capital funds. It can increase its capital as the risk it assumes increases, or invest in assets that are relatively free of risk. He opined that capital adequacy is the relationship between the degree of risk a bank takes and the amount invested by its owners".

Ross (2002), Macdonald and Koch (2003) explained that banks are faced with several risks, such as credit risk, liquidity risk, interest rate risk, operating risk, exchange and crime risk all of which affect shareholders/ funds. Credit risk occurs when the customers fail to pay interest and principal payments on due date which eventually erode bank's capital. Liquidity risk is the danger of not being able to meet credit request of customers due to shortage of cash. Interest rate risk is the probability that fluctuating interest rates will result in significant appreciation or depreciation in banks assets. Operating risk results from fluctuations in economic conditions that could adversely affect the bank's performance. Exchange risk results from adverse movements in currency prices while the bank is trading for itself or for its customers. Crime risk is the danger that a bank will lose funds as a result of robbery. According to the CBN Bullion (2003), a bank's capital adequacy is based on what is known as the capital ratio, which involves the weighting of a bank's capital base against the portfolio of risk assets, carried. This is in line with the Basel Committee of the Bank for International Settlement of 1988 and 1992. Banks are to maintain, as capital funds, not less than 8 percent of their total risk-weighted assets with effect from January 1992. Also 50% of the bank's capital must comprise of primary or Tier 1 capital defined as paid –up capital and undisbursed reserves of statutory and general nature. In the literature, MacDonald and Koch (2003) reported that Financial Institutions Rating System encompasses six general categories of performance labeled **CAMELS:**

- C = Capital Adequacy,
- A = Asset Quality,
- M= Management Quality,
- E =Earnings,
- L= Liquidity,
- S = Sensitivity to Market.

The Federal Deposit Insurance Corporation in America (FDIC) as reported in Macdonald and Koch (2003) numerically rates every bank on each factor, ranging from the highest quality (1) to the lowest quality (5). A composite ranking of 1 or 2 indicates a fundamentally sound bank, while a ranking of 3, 4 or 5 signifies a problem bank with some near term potential for failure.

A bank must adhere strictly to all capital adequacy guidelines issued by the CBN.

According to CBN Bullion (2004), capital adequacy can be measured amongst others by the following:

*Equity/Total Asset Ratio, Equity/*Risk Asset Ratio, Equity/Fixed Asset Ratio, Equity/Total Deposit Ratio, Debt/Equity Ratio,*Equity = Unimpaired or Adjusted Bank Funds,*Risk Assets = Adjusted loans & Advances. Where these ratios of our banks are below the industry average and as recommended by Basel Accord 1 and 2, the need for recapitalization becomes imperative. In finance literature, some of the identified weaknesses that led to bank recapitalization in Nigeria and the world over are size of banks and degree of soundness, stunted growth in the real sector, high lending rate and shunning of real sector, over-dependence on public sector deposits, unprofessional and unethical conducts, illiquidity and insolvency (Soludo, 2004). Like the CBN, the Nigeria Deposit Insurance Corporation (NDIC) also oversees the activities of insured banks registered with it. One of the greatest risk facing banks is the inability to meet depositors request for demand deposit at the appropriate time. This form of risk is usually due to bank failure. As a result, the NDIC was set by Decree No. 21 of 1988 to pay bank depositors on liquidation of any bank provided such bank has paid 1% of 15/16 of its deposit liabilities to NDIC.

Until recently, while commercial banks avoided merger; significant progress was achieved in the merger of various development finance institutions (DFIs), which had overlapping roles. The process, which commenced in the year 2000, was an attempt to give the institutions a better focus and to promote socio-economic development of the country. The Bank of Industry Limited came into being in October 2001, by the merger of the Nigerian Industrial Development Bank (NIDB), Nigerian Bank for Commerce and Industry (NBCI) and the National Economic Reconstruction Fund (NERFUND). Nigeria Agricultural Cooperative and Rural Development Bank (NACRDB) were formed from the merger of Nigeria Agricultural and Cooperative Bank (NACB), Peoples Bank of Nigeria (PBN) and the Family Economic Advancement Programme (FEAP). The Nigerian National Mortgage Bank (NinamBank) originated from the merger of Federal Mortgage Bank of Nigeria (FMBN) and the Federal Mortgage Finance Limited (FMFL).

Lemo (2005) opined that consolidation of banks will stimulate overall investment climate and enhance growth and development. He expatiated that post consolidation would enable banking institutions to support public and private sector partnership in the financing of projects hitherto the exclusive reserve for the public sector, particularly in the areas of infrastructure and social services. Consolidation would help in no small way in meeting the long-term vision of NEEDS and the New Partnership for African Development (NEPAD) and also to meet the target of the Millennium Development Goals intended at creating wealth and reducing poverty.

As stated in Ross (2002) the representative of the United States and representatives from 11 other leading industrialized countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and Luxembourg) agreed on new capital standards-often referred to as the Basel Agreement. Banks were required to consider the off-balance sheet

commitments in determining their capital position. Nwagwu (2000) opined that adequacy of capital structure has remained a major concern in the administration of indigenous commercial banks in Nigeria. One of the reasons for the collapse of indigenous commercial banks in the 1930's, 1940's 1950's 1990's was due to inadequate capital structure. Hempel and Simonson (1999) carried out a study on the effect of bank size on the acceptable and permissible levels of financial leverage. The result showed that small banks usually have a higher return on assets and a higher percentage of equity to asset The large banks usually have lower than average return on assets and a lower than average percentage of equity to assets, which produces a higher leverage multiplier (assets/equity), and a close to average return on equity because of the greater leverage. Nwude (2005) posited that recapitalization has both positive and negative implications:

The positive implications are strong, sound, competitive and reliable big banks, quality management and best practice in corporate governance, improvement in profitability, improvement in credit availability and enlargement of areas of operations, improved professionalism and ethical practices, diluted ownership structure giving rise to professionalism, improved capacity to finance projects, improved depositors/investors confidence, healthy competition, reduction in regulatory abuses, reduced lending rate, higher economic growth rate, deepened level of the Nigerian capital market, attractive investors returns, attractive concessions and creation of new entrepreneurs. The large banks have greater management depth. The negative implications of recapitalization include amongst others are loss of identity, sanction on erring banks, downsizing the workforce, flight to safety by depositors, higher shareholders expectation, collusion to form monopoly, business failure, dilution of ownership control, merger and acquisitions, excessive pricing of assets and insufficient attention and follow-up efforts to post-merger implementation.

A vibrant banking sector and an equally vibrant real sector would enhance capacity utilization, which will in turn boost employment and growth in the economy. However, this would be possible if there is good corporate governance. Chukwudire (2004) posited, that in the immediate past two decades the financial services industry has experienced fluctuating fortunes leading to high profile cases of corporate failure and consequent near loss of public confidence. The industry's problems are consequences (directly or indirectly) of bad corporate governance. Good corporate governance leads to public confidence, market efficiency, integrity, financial stability and growth and a fair share of global capital flow to the economy. Unegbu (2004) opined that the crisis witnessed in the Nigerian financial system, especially in the nineties could essential be linked to non-compliance with the principles of sound management which therefore underscores the need to continually raise the awareness of the Nigerian private sector, especially the banking sector, in the area of good corporate governance.

According to CBN Banking Supervision and Annual Report (2002) reported by Oyewale (2004); it stated that the twin evil that is distress and eventual liquidation experienced in Nigerian banks in the last one-and –a half decades can be traced to ineffective corporate governance when it declared as follows: "A unique feature of banking business is the overwhelming dominance of depositors' fund in comparison with the

shareholders equity". Therefore to check excessive insider lending, among other abuses, which characterized banking business there is need for institutionalization of good corporate governance practices. The issue of corporate governance requires purposeful leadership/management in the financial services industry. According to Ogubunka (2004), "the leadership we desire is one that breed's positive influence…it is about transformation of value into actions, vision into realities, obstacles into innovations, separateness into solidarity, and risks into reward".

3. Country experiences

Banking business thrives on public confidence and such confidence is bed-rock on everything about a bank being seen to be going in the positive direction. Any negative development usually sends wrong signals to the banking public. That makes banking wide risk management imperative especially in this post-consolidation era in Nigeria. Failure to effectively manage risks in banks can therefore lead to such adverse consequences such as: Capital losses, losses of business opportunities; runs on banks; loss of professional standing; loss of public confidence; loss of reputation; possible financial distress. Risk management requires that management should know the severity of the consequences and that management respond accordingly and promptly.

The issue of bank capitalization which often metamorphose into consolidation of banks around the globe has fuelled an active policy debate on the impact of consolidation on financial stability, Beck, Demirguc-Kunt and Levine (2003), Boyd and Graham (1991 and 1998). They concluded banks capitalization/consolidation exercise was designed to improve the banking system efficiency through the enhancement of the composite units. In the literature, concentration levels have been a major determinant of banking system performance by way of efficiency.

The just concluded banks consolidation exercise, mainly through mergers and acquisitions (M&A) in order to attain a minimum capital base of N25 billion (approx $250 million), is an aspect of the first phase of the reforms. It resulted in the compression of 74 banks, which accounted for about 93 percent of the industry's total deposit liabilities, into 25 new banks (Komolafe and Ujah, 2006). The recent merger of IBTC and Stanbic banks in 2008 has reduced the number of banks in Nigeria to 24. The greater subsidy for large banks may in turn intensify risk-taking incentives beyond and diversification advantages enjoyed by them, thereby increasing the fragility of concentrated banking system. Berger, e tal (1995) find evidence that the increase in the proportion of banking industry assets controlled by the largest banking organizations in the 1990s, due to the liberalization of geographic restrictions on banking in the United States, may have been responsible for part of the credit crunch observed in 1989-1992.

Berger and Udell (1996) and Canonero (1997) find that large banks not only tend to have a smaller proportion of their loans made to small borrowers, but also tend to charge lower prices than other banks to small borrowers, indicating that large banks only issue business loans to higher-quality credits. It has also been argued that the higher the concentration in the local banking market, the higher the prices for financial services

and that may lead to increase in the banks profit. This is because banks in less competitive environments charge higher interest rates to firms. If concentration is positively associated with banks having market power, then concentration will increase both expected rate of return on bank assets and the standard deviation of those returns (Beck, Demirguc-Kunt and Levine, 2004). One can infer that the policy implication is that higher market concentration is associated with lower socio-economic welfare and therefore is undesirable. As a consequence of the above, Holden and El-Bannany (2006) opined that in the United Kingdom the Monopolies and Mergers Commission (1996) became wary of a concentration ration that is 25 percent or more of the banking market in terms of total assets or deposits.

According to Ebhodaghe (1994), reported in Oluitan (2004), "Capital inadequacy has affected the financial health of banks. He explained that an analysis of bank capitalization revealed that as at the end of 1992, almost all banks (120) operating in Nigeria required additional capital totaling N0.6billion to support their volume of trading. This amount was the variance between the amount stipulated by the monetary authorities for prudential minimum capital and the aggregate capital outlay. By 1993, this variance further deteriorated to N9.1 billion". No one wish to see a bank collapse inspite of the leverage provided by Deposit Insurance Corporation to customers when it occurs. To instill confidence in bank customers and other stakeholders', safety, soundness and financial condition of banks are crucial. Sachs, et al (1995) reported in Oluitan (2004) in his study of 20 emerging banks, observed low reserves as one of the crisis plaguing banks. Oluitan concludes that these anomalies have led to erosion of public confidence in the banking sub-sector as a result of the growing number of distressed banks experienced in the past, which affected the liquidity position of banks. In recent years, a wave of bank consolidations has spread across the world. According to Amel et al (2002), "more than 8000 bank consolidations occurred between 1990 and 2001 and the total value of the deals reached about $1,800 billion". It is notable that one of the major driving forces of the recent wave of bank consolidations has been government policy. For example, Since the Asian Financial Crisis in 1997, the financial authorities of Asian countries have been promoting bank consolidations and the Japanese government initiated a policy of promoting consolidations among regional financial institutions on the grounds that this policy would contribute to the stabilization of the banking system Berger et al. (1999); Shih (2003). The idea underlying the use of a consolidation promotion policy during a financial crisis is that bank consolidations would assist in risk asset diversification, Shih (2003).

Mailafia (2004) and Ekaete (2004 have all pointed to the prospects for increase inter-regional businesses post-consolidation. In South East Asia, they found that the level of cross-border transactions rose following the consolidation of the 1990s and the beginning of this century. Weak banks cannot participate in the mega-dollar businesses. Apart from the benefits discussed above, Mailafia (2004) also pointed out that consolidation/ bank capitalization involves geographic diversification as a bank can expand into new areas where it was not well represented. This increases its deposit base and enhances the profitability potentials. The result will be

some synergy in terms of the composition/ types of loans, maturity structure, risks, etc. The prospects of higher returns on the investors is also worthy of mention as we consider the benefits of banks consolidation. Traditionally, it is realized that returns are often directly correlated with the level of investment. Consolidated banks are expected ab initio, to have access to more capital and as they invest large sums, they would also receive higher returns. This is facilitated by the improvement in the pressure put on them by the expanded shareholders. Moreover, the reduction in inter-bank borrowing would cut cost and enhance profit margins. Also, the availability of more funds should reduce the level and magnitude of unethical practices with their attendant adverse impact on profitability.

4. Causes of financial capitalization/ consolidation in Nigeria

According to Ige (2006), the reasons for the CBN decision to recapitalize the Nigerian banking industry are not unconnected with the following, among others:

Bad management was rampant in many of them as they were unable to afford the desirable skills and technology, the uncompetitive and distress banks were better acquired or merged with successful banks, or else liquidate a spectre of gloom for depositors, the owners and the economy, the high interest rates for money borrowed, which were far beyond any internal rate of return in Nigeria, could suggest given the appalling management capacity, a good number of them derived a sizeable proportion of their profit from illegal practices, encouraging bunkering, foreign exchange mal-practices e.t.c and many of the banks at their previous levels could not compete globally with their foreign counterparts in the developed and emerging industrial countries of South East Asia and South America.

The recapitalization of Nigerian banks until recently in 2006 was very infinitesimal. Many of them lacked the resources, ingenuity and besides, they were unable to utilize business opportunities in Nigeria let alone those in other countries. Bribery, over-invoicing, illegal deals in foreign exchange and corruption were the modus operandi of Nigerian banks. Sharp banking practices such as high interest rate, exchange rate, inflation stunted the development of a credible macro- economic framework in Nigeria. Banking is bedrocked on risks, hence, the acceptance and management of risk remains an integral part of the business. Banking institutions should neither engage in any business in a manner that unnecessarily imposes risk upon it, nor absorb risks that can be transferred to other parties. It should rather accept those risks that are uniquely part of the array of bank's services. Zero tolerance of risk is certainly not good banking business just as one hundred per cent tolerance is also not good banking. Risk management requires the involvement of all key stakeholders including the Board, Management and Staff. For effectiveness, the risk management process requires: commitment from the Chief Executive and Executive Management of the organization; assignment of responsibilities within the organization; allocation of appropriate resources for training and development of enhanced risk awareness by all stakeholders.

According to CBN Bullion (2005), the following should be considered along with capital ratios as conditions influencing

capital adequacy: the quality of management influences outsider' perception of capital adequacy because, if management is good the bank will be profitably, and efficiently operated and there will be no need to rely unduly on capital to cushion disaster; a bank carrying good quality and adequate liquid assets will not be in danger of prolonged and damaging illiquidity. Consequently, the need for capital will be minimized; the history of earnings and retention thereof: good earnings and write-back policy will continually enhance the capital adequacy of a bank.

A bank that allows itself to be politized and which put ethnic consideration before business prudence can only contribute to the failure of the bank and increase its need for capital; the potential volatility of deposit structure will affect the liquidity of a bank which will in turn affect the profitability and need for capital; the quality of management will impact on the efficiency of operation and consequently the need for capital; the restrictions placed on the maintenance between capital funds and loans and advances, the higher a bank's capacity to meet the potential credit needs of its environment. With Central Bank of Nigeria (CBN) and Nigeria Deposit Insurance Corporation (NDIC), technical and financial support traditionally given to banks in Nigeria, it is easy to tolerate temporary and relative inadequacy of bank capital in our banking system.

5. Consequences of bank capitalization/ capitalization

The consequences of the recent capitalization in the Nigerian Banking Industry which culminated in consolidation of banks can be discussed under the following subheads:

Efficient payments system consequences of consolidation

Consolidation has led to fewer players (Commercial banks) in the banking industry. It has made possible agreed payments standard amongst banks. The operation of payments system exposes banks and participants to various forms of risks, including credit risk, liquidity risk, operational risk, and systemic risk. It is expected that operations of the payments system would be further modernized and standard for realization of desired efficiency.

Safety and Soundness effects

The assumption is that not many large institutions with substantial capital base will have bank run, rather they will experience some degree of soundness in the money market. On the other hand, if the risk of an institution is high, this could raise the probability that the institution will fail or become illiquid before settling some of its payments obligations, thereby exposing other institutions directly to risks as payees or indirectly contributing to panic runs. The larger the institution, the higher the probability of having higher asset base which has the effect of boosting the image and confidence of the banking public.

Financial Safety consideration

For instance, the trend in the capital base of banks coupled with manifold expansion of the recent capitalization, could translate to lower rates of interest to the industrial sector if well managed. It may also result in

an increase in the return to ordinary shareholders. The Nigerian Deposit Insurance Corporation (NDIC) would have to create a formal safety net which involves additional cost to the corporation though; the premium payable by individual institutions might need to be reviewed. The safety net may give additional protection to institutions considered "too big to fail", which may be created by the capitalization/consolidation.

Supervisory effects of consolidation

There is need for the supervisory body (CBN) to improve the level of transparency, good governance and the degree of supervision of risk management systems. Transparency has been a recurring problem in the financial industry in Nigeria, and unless, it is improved upon, it has the potential of making nonsense of the efforts of the supervisors in the present dispensation (New Capital Accord).

Service availability consequence of consolidation

With few players in the banking industry giving rise to additional market power will lead to unavailability of services through shut down of unviable branch offices, as well as avoiding "not so profitable business loans. It is also possible to increase the supply of services to customers because better and dynamic banks are able to serve their customers more profitable. Although, this does not mean that large, complex financial institutions associated with M&As would reduce services to all small customers, but for those with strong financial statements and valuable collateral, they may receive essentially the same transactions based services as large customers.

Market power consequences of consolidation

It is argued in the literature that lending to small and medium enterprises may be adversely affected because banks with market power will tend to reduce lending volumes and increase loan interest rates. In the short run, it might be difficult for banks to make the require profit in the short-run but in the long run, as the bank wax strong profit will reach rise beyond the optimal. Studies have also shown that return on assets (ROA) or return on equity (ROE) tend to improve where M&A occur, and the Nigeria banking sector will not be an exception.

Efficiency consequences of consolidation

It could also be a means to change organizational focus or managerial behaviour towards improving efficiency through achieving risk-expected return trade off. Studies have shown that large organizations take the benefits of an improved risk-expected return trade off after consolidation. Such big organizations are able to diversify their risks through increased efficiency which in turn help to lower incidence of insolvency.

Employment effects of consolidation

It is argued in the literature that safety of bank deposits rather than high retrenchment costs (job cuts) should be the concerned of policy makers. There is no doubt that the recent capitalization of the Nigerian Banking industry would bring about a change in the nature and quality of employment. Bankers with traditional banking skills cum information technology (IT) knowledge may not be seriously affected. The capitalized

banks (mega banks) will require management and IT skills as well as other specializes knowledge.

Promotion of depositors' confidence in the system

There is no doubt that in the recent past the banking industry in Nigeria was characterized by failure and loss of depositors' fund, which led to lost of confidence. Thus, Soludo noted in his July 2004 address to the Bankers Committee that the capitalization/consolidation in Nigerian banking industry is expected to promote depositors confidence. Increase in capital base of the banks will make the banks stronger. Financial Commentators in the banking industry have noted that lower capital makes the bank to be weak. For instance, in December 2003, aggregate paid up capital of the banks had increased by 18% from 2002 to N120.3 billion. Similarly, at December 2003, the aggregate shareholders funds stood at N211 billion (CBN, 2004). These figures compare unfavourably with the scenario for banks in South East Asia and even South Africa. Similarly, the share capital requirement was a low N3 million (US$140,000), in 1989, N2 billion in 2003 (US$14.6 million) which are rather low by international standards. The raising of the shareholders funds unimpaired by losses to a minimum of N25 billion (US$180m), is expected to put the banks in a better position to fund the economy.

Better Funding of the Economy

The above point as outlined by the CBN Governor is expected to hold a priori. However, studies elsewhere have found mixed results. For instance, Studart (2003) notes that the World Bank's forecast that consolidation in Latin American countries would increase access to credit did not materialize. Also in a similar vein, Peek and Rosengreen (1997) reported that there was no conclusive evidence that consolidated banks will discriminate against small business. Rather they found that the position shifts from sticking to their pre-consolidation portfolio to liberalization towards SMEs. Specifically, they note that first in roughly half of the commercial and savings bank mergers, the portfolio share of SMEs loans of the acquirer rise rather than fell after the merger. In slightly less than half of the cases, the acquirer had a larger portfolio share of SMEs loans than its target. Finally, it is only when the acquirer is large and less active in SMEs lending, that its loan portfolio share of the consolidated bank is much more likely to decline than to rise after the merger, (Peek and Rosengreen,1997).

Another area where consolidation can be beneficial is cost reduction

While there is evidence on cost reduction potentials of consolidation, there is also opposing evidence. For instance, Linder and Crane (1992) investigated the cost profile of merged and non-merged banks in the USA and concluded that there was no significant difference between the two groups in regard to results that bank mergers raise profits by reducing cost. The evidence from their study of Bank of America and Security Pacific, Chemical and Manufacturers Hanover, etc, showed that reduced operational costs rarely translated into higher profits because of increased loan losses, among other reasons. Later, Kwan and Wilcox (2001) studied a sample of 1,134 bank mergers between 1987 and 1995; employing a change in relative

operating costs for the bank merger. They measured the variables of the ratio of total non-interest expenses to total assets, ratio of labour expenses to total assets and ratio of premise to total assets. The main finding was that "bank mergers reduced operating costs … both labour cost and occupancy expense are found to decline significantly after the merger" (Kwan and Wilcox, 2001). Finally, the issue of cost-reduction in mergers/consolidation is a controversial and an empirical one.

On the flip side of the benefits of capitalization/consolidation are the costs. Since consolidation started, costs have been incurred and the trend is likely to continue. An aspect of the costs is the necessity of the process undertaken in the exercise. The merger entails legal expenses such as those on issuing houses, stock brokers, reporting accountants, etc. These are expenses that are avoidable in the absence of consolidation. Of course, this would include security and exchange commission (SEC) fees as well as consultants' fees. Ibrahim (2004) notes that the CBN had pledged to underwrite all these expense and provide a team of technical experts in this regard.

A cause for worry about in the recent bank capitalization/consolidation in the Nigerian banking industry is the future fear of job losses. Already some bank staff have lost their jobs in the processes leading to the merger as the weak banks downsized in the bid to meet the conditions for absorption by the healthy banks. The consequent job loss would swell the unemployment market (Kwan and Wilcox, 2001). One of the cost saving areas is in job reduction.

Empirical work across the areas where capitalization/consolidation had taken place indicated that it resulted in concentration of banking and the consequent reduction in the number of banks in the post consolidation era.

There is the implication that the rural areas could be marginalized in the service delivery. Indeed, Shields, et al (2004) found that in rural Pennsylvania State, USA, "the results show that consolidation is dramatically reducing the number of banks in rural areas", they submit that "should the trend continue, then there would be no banks headquartered in rural Pennsylvania by 2005". In addition, consolidation has triggered off runs on some banks as customers move to prevent their funds being trapped in the banks, coupled with a lull in the interbank market. This arises from corporate customers making massive withdrawals as that of the Oyo State Government (pre recapitalization in 2005) from Trans International Bank Plc. Consequently, the bank was unable to pay its numerous customers and it was barred from the clearing system. While the appropriate authorities (CBN and NDIC) responded by extension of financial assistance to the banks, this will need to be intensified in order to calm down nerves and curb the anxiety that usually accompanied capitalization/consolidation.In spite of all the efforts of the CBN and NDIC, all unsound banks were unable to meet the requirements for merger or acquisition (M&A). Those that failed impose losses on the depositors, on the one hand, and the shareholders, on the other. In addition, the recent CBN audit report of five banks in August 2009: (Union bank, Finbank, Oceanic bank, Afrique bank and Intercontinental bank) revealed that their shareholders' funds have been impaired and they now have liquidity problems. This may also trigger crisis of confidence in the banking system inspite of the bail-out measures adopted by CBN. We

have found in the literature that in some of the countries that have undergone capitalization/consolidation of their banking sectors, not all banks succeeded. Some inevitably failed. It was therefore not surprising that the CBN allowed some to fail partly in order to sanitize the system and partly as lessons for those who had mismanaged their banks before the advent of the consolidation policy.

Implications for the Future

Bank capitalization / consolidation could help to facilitate cross-border consolidation by promoting trade, and reducing the currency conversion costs of institutions operating within the sub-region when economic integration is realized. Reforms present the best way to revitalize the lost confidence of depositors in the Nigerian banking industry. Bank assets should be valued realistically and avoid the temptation to overvalue assets; and bad loans should be reported accurately. There is also the need to increase banking transparency and entrench good governance. High standard of public disclosure by external auditors, internal auditors, banks inspectors are expected to be a kind of road map towards disseminating standards and good practice of accounting principles, as well as methods and payments systems.

The coordination of supervisory policies within and across borders should be well articulated and properly executed. The banking system is hub around which other sectors revolve. Therefore, if the gains of capitalization/consolidation are enhanced it will lead to the creation of larger banks having better access to markets for managing liabilities. It will also affect the pricing of bank loans in response to changes in the monetary policy stance. There is the chance of mergers resulting in geographic diversification of bank portfolios, enhance the safety and soundness of banking institutions, improve payments system, improve the allocation of credit and performance of the economy. Consolidation may reduce the liquidity or increase the volatility of the reserves, making it more difficult for the Central Bank of Nigeria to keep their policy rate near target. On the other hand, consolidation has its negative social consequences such as reduction in availability of services to small customers.

6.Conclusion

The banking industry has witnessed drastic changes especially in information technology propelled by the new generation banks (banks that came on board from 1988). Capitalization is a means of preparing the industry for survival. It makes an institution bigger, more efficient and better capitalized; among others. Though, driven by government but it is also influence by market forces. The impact of capitalization/consolidation is pathway to achieving financial stability. The benefits or gains of capitalization depend on the quality of the regulatory authorities, supervision and financial market sophistication. Bank capitalization/consolidation is vital and deeply rooted in the agenda of the financial system of both developed and developing countries that strives to compete in any global market. It requires bank management to understand the potential effects of capitalization/consolidation as this would serve as a tool for meaningful decision making. The recapitalization process should at all time give premium in building high quality assets to avoid distress syndrome which has been the bane of the Nigerian banking industry in the past.

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