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BANK RECAPITALIZATION IN NIGERIA: PROFIT PERFORMANCE ANALYSIS

¹S. O. Ashamu and ²S. T. Durowaju

¹Dept. of Accounting and Finance, Lagos State University, Ojo, Lagos State, Nigeria

²Dept. of Business Administration and Management Tech., Lagos State University, Ojo, Lagos State, Nigeria

ABSTRACT

Banking is undoubtedly one of the most regulated industries in the world, and the rules on bank capital are one of the most prominent aspects of such regulation. Bank recapitalization or consolidation is a banking system policy programme introduced by the Central Bank of Nigeria to increase banks' capital base and correct deficiency in the financial sector. The effects of the recapitalization reform on the performance of Nigerian banks are diverse (that is, improved healthy competition, raise efficiency, strengthen the banking system etc). Several empirical studies have been carried out on the reform on Banks' performance as a whole, but the effect on improved profitability as a whole, but the effect on improved profitability as a simple variable has received no serious attention. This study is established to investigate the impact of previous bank recapitalization reforms in Nigerian banking system on improved profitability. The research problem had been whether banking system recapitalization will reduce frequent bank busts (where depositors as well as shareholders lost their money) and generate bank higher returns. A secondary data of the previous profits of twenty four banks (excluding savannah Bank) was used to subject the variable to statistical test. Regression analysis was used to analyze the data for 2007 period. The study reveals that there is a positive linear relationship between bank recapitalization and improved profitability for the twenty four (24) banks studied.

INTRODUCTION

The engine for economic growth of any society is banking institutions. No doubts, that in the past the banks have experienced a lot of pitfalls even till this present day. Banks by its nature mobilize funds from the surplus spending units into the economy and by on-loading such funds to the deficit spending unit for investment, banks increase in the process, the quantum of national savings and investment. Through an appropriate investment multiples, the volume of goods and services produced in an economy increases over time as a result of the investment projects embarked upon through bank direct and indirect contributions towards the growth of the national economy is achieved. They (bank) succeed in promoting an efficiency payment system, and creating banking habits and thus developing the society at large. However, an efficient banking system needs a solid capital base. The need for banks to maintain adequate capital in order to conduct its business in prudent manner, form the basis for the recent recapitalization exercise in the Nigerian banking system. Similarly, bank recapitalization is one of the most recent reforms introduced by the federal government to improve the national economy and create healthier financial system. The Central Bank of Nigeria in July 2004, issued a directive to all banks operating in the country to raise their capital base to N25 billion (twenty-five billion naira). This recapitalization programme/policy have not only brought into prominence, the need to enhance the quality of customer service delivery but have essentially made it a necessity for continued corporate existence and profitability. The objective of this paper is to determine the impact of bank recapitalization requirement on the profitability of banks in Nigeria banking system.

HYPOTHESIS

- Ho: Recapitalization has no significant impact on profitability of commercial banks in Nigeria.
Hi: Recapitalization has significant impact on profitability of commercial banks in Nigeria.

LITERATURE REVIEW AND THEORETICAL FRAMEWORK

Over the years, the banking sector has been unable to significantly support the long-term financial needs of the real sector (Donli, 2004). This is in spite of the fact that the growth of the national economy hinges on the extent to which the real sector is effectively supported by the banking and financial sector, which play a catalytic role in the growth process. Structurally, the Nigerian banking system was weak with low capital base. Before the commencement of the consolidation, no bank in Nigeria was rated very sound by the CBN, (Nwanna, 2007). For instance, the capital adequacy ratio of banks in operation was below the international standard minimum ratio of 8%. Similarly, as at the end of March, 2004, CBN classified only 62 of these banks as sound/satisfactory. They were also 14 rated marginal, while 11 were classified as unsound.

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Two banks, according to CBN, did not render any returns during that period, and thus could not be classified. According to the CBN, the 11 unsound banks had no capital to operate. In fact, some of them had negative shareholders' fund. This means that the shareholders' funds were less than the assets they were carrying on their books. The structural weakness of the banking system, which has hindered the performance of its developmental role in the economy and seriously curtailed the achievement of Government's objectives of ensuring price stability, economic growth and high employment level prompted the CBN to embark on the recapitalization policy. Imala (2005), observed that the average capital base of banks in Nigeria before recapitalization was US\$10 million, which is very low compared to that of banks in other developing countries like Malaysia where the capital base of the smallest bank is US\$526 million. Also, the aggregate capitalization of the Nigerian banking system at N311 billion before the exercise is gross low in relation to the size of the Nigerian economy and in relation to other capital base of US\$688 billion for a single banking group in France and US\$541 billion for a bank in Germany. Adeyemi (2005) comment that prior to the consolidation programme induced by the CBN 13-point reform agenda, which was announced on 6th July, 2004, the Nigerian banking system was highly oligopolistic with remarkable features of market concentration and leadership. The system was further characterized by a generally small sized fringe banks with very high overhead costs; low capital base averaging less than \$10 million or N1.4 billion and heavy reliance on government patronage (with 20% of industry deposits from government sources). Furthermore, twenty-four out of the eighty-nine deposit-money banks that existed then exhibited one form of weakness or the other. Prominent among such weaknesses are undercapitalization and/or insolvency, illiquidity, poor assets etc. Soludo (2005) cited in Adegbaaju and Olokoyo observed that many banks appear to have abandoned their essential intermediation role of mobilizing savings and inculcating banking habit at the household and micro enterprise levels. The difference of banks towards small savers, particular at the grass roots level, has not only compounded the problems of low domestic savings and high bank lending in the country, it has also reduced access to relatively cheap and stable funds that could provide a reliable source of credit to the productive sectors at affordable rates of interest. Afolabi (2004) also remarked that before the 2004 banking sector reform which has recapitalization as its first agenda, the banking sector enjoyed a healthier operating environment. The total banking sector's asset increased to N3,365.21 billion by the end of 2003 from N2,980.49 billion as at the end of 2002, representing an increase of 2.9%. However, in 2004, the profitability indicators of the insured banks declined when compared to what obtained in 2003. Besides, the liquidity position of the banks also declined during the year. The depression experienced in recent years in the national economy and several weaknesses characterised the Nigerian banking system along side other sectors makes recapitalization necessary. According to Phillip (1998), recapitalization in recent past years has been sustainability stimulated by the need for banks to build up capacity to carry on their conventional business. In his address, Soludo (2004) maintained that adequate capital is the foundation of a safe banking system". He further stated that "an enhanced capital base gives bank a competitive edge, enables it to acquire relevant technology, engage in high personnel, absorb losses, provide better services and ultimately increase earnings". Furthermore, Soludo (2004) emphasized on the reasons for recapitalization of a particular financial institution. The basis could be any of the followings: to fill a hole, to provide capital project; to provide cushion for shocks, and to meet statutory or prudential requirement. Ajayi (2005) posited that the vortex or previous recapitalization policy in the Nigerian banking system is around firming up capitalization. Capitalisation was regarded as important component of reform or recapitalization requirement because a bank with a strong capital base has the ability to absorb losses arising from non-performing liabilities (NPL). Adedipe (2005) opined that the process of recapitalization would cause to evolve banks that are better capitalized and bigger because the new minimum capital of N25 billion is a growth inducer. Jika (2004) cited in Adegbaaju and Olokoyo (2008) maintained that increasing the capital base of banks in Nigeria would strengthen them and, in the process, deepen activities within the industry. "Growing the Nigerian economy is about the number of banks that have the capacity to operate in all the states of the federation, fund agriculture and manufacturing concerns, and in the process generated employment for Nigerian". Besides the summary of the various uses of recapitalization is that a financial institution possibly more than other institutions needs substantial long-term cheap and stable fund to carry out its business. "Recapitalization is a reinvigorating exercise and therefore it is crucial (Soludo, 2004)". The bank need for it may become more crucial if the nature of its services become more complex.

HISTORY OF BANK RECAPITALIZATION IN NIGERIA

The history of bank capitalization in the Nigerian banking system dated back to 1958 when the 1952 Banking Ordinance was reviewed and a new Banking Ordinance was enacted. Under this Act, the conditions for establishing new banks were tightened and capital requirements, especially for foreign banks,

were doubled from N200,000.00 under the 1952 Act) to N400,000.00. This was again increased to N1.5 million in 1969 with the enactment of the 1969 Banking Act. Several other capitalization reviews were to follow as the years roll by, culminating in the current N25 billion recapitalization policy of the Central Bank of Nigeria. A summary of the history of increase in capital base for banks in Nigeria is presented in Table 3.1.

Table 3.1: History of Increase in Capital Base for Banks in Nigeria

S/No.	Period	Amount ₦
1.	1952	25,000
2.	1958	250,000
3.	1962	500,000
4.	1969	600,000
5.	1979	6,000,000
6.	1988	10,000,000
7.	1989	20,000,000
8.	1991	50,000,000
9.	1997	500,000,000
10.	2001	2,000,000,000
11.	2005	25,000,000,000

Source: CBN, 2005

INSTRUMENTATION, SOURCES AND DATA DESCRIPTION

The study borrowed from the structure- conduct-performance theory and work of Adegaju' and Olokoye (2008). The study employed secondary data obtained from NDIC annual reports and financial statements of various issues. The data were analysed using both descriptive and analytical techniques. The test statistics employed were regression analysis of the Ordinary Least Square (OLS) method, the correlation analysis techniques (R²), the students T-Test and F-Test were employed to measure the significance of the relationship that exist between the indicators. The study focuses on commercial banks in the nation as our sample study to give good representation. It covers the period from 1994 – 2004.

METHODS OF DATA ANALYSIS AND MODEL SPECIFICATION

In an attempt to investigate the impact of bank recapitalization on profitability of banks in Nigeria, this study adopts a simple regression technique. Since the adoption of this technique initially require specification of model describing the functional relationship between the variables under investigations.

$$BP = f(PC) \dots\dots\dots (1a)$$

Where, BP = Bank Profitability
PC = Paid-up capital

Given that the functional relationship represented by the equation (1a) above, is a linear one. Then the equation to be estimated in this study is of the form:

$$BP = a_0 + a_1 PC + U_t \dots\dots\dots(1b)$$

Where, a₀ and a₁ are parameters to be estimated, while the U is the error term that captures other variables not explicitly included in the models. It is expected in equation 1b that,

$$A_1 > 0 \text{ and } U_t < 0$$

ANALYSIS OF RESULTS AND DISCUSSION

Data analysis, results and discussion.

The table 2 in the appendix shows the data used in running the regression equation specified for this study. In the estimation, the paid-up capital of commercial banks as well as profitability, are proxies for recapitalization (or capital adequacy) and performance of commercial banks. All data used covers the period

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of 1994 – 2004, a period of eleven years. This periods show various trends of recapitalization in the Nigerian banking system.

Table 4.1: Dependent Variables, Profit

	Constant	Explanatory Variable (capital)	R2	F-Stat.	AY.R.
	37.087 (7.373)	4.337E-05 (6.561)	0.827	43.041	0.808
Std. Error Prob.	5.030 0.000	0.000 0.000		0.000	

Notes: T-Values are in parenthesis

Table 4.1 presents the results of the estimated regression equation. The result of automated data analysis (SPSS) reveals that bank recapitalization or capital adequacy can be held responsible for 82.7% variation on profit of the banks with reference to 1994 – 2004. The F-statistics (ANOVA) of the model indicates that the model has closeness of fit which means that the model is statistically significant at 5% level of significance. The $F(1,9) = 43.041$ is greater than the $F_{tab} = 5.12$, therefore with respect to theoretical expectation, the coefficient of bank capital/recapitalization is correctly signed. The estimated parameters are statistically significant at 5% level of significance. The autocorrelation between the variables under consideration is indicated by Durbin-Watson Value of 0.909, which further confirms the estimates are statistically significant. To test for the significance of the estimates, the students t-test is employed. The $t_{cal} = 78.373$ 1.80 for the parameter estimate, this means that the null hypothesis that recapitalization has no significant impact on profitability of commercial banks in Nigeria (1994 – 2004) is rejected, while the alternative hypothesis is accepted.

The estimated regression model is

$$BP = 37.087 + 4.337 E - 05 BC \dots\dots\dots (1c)$$

The policy implication of the equation 1c is that there is a positive impact by capital adequacy on bank profit, that is increment in bank capital base resulted in increased in bank profitability in conformity with the apriori expectation. The result is further confirmed by the work of Adegbaju and Olokoyo (2008), using simple regression analysis to assess the impact of capital adequacy on the performance of commercial banks in Nigeria. Their empirical findings confirmed with the present study of positive impact of capital adequacy on bank performance (including profitability).

RECOMMENDATION

Based on the findings in this study, we recommended the followings]: The recapitalization exercise should be handled with utmost care so as to prevent unforeseen occurrences that may erode bank returns. Banks could be stratified into investment, universal and mega bank categories with each having a capital base of N5 billion, N12.5 billion and N30 billion respectively. The banks should work closely with other stakeholders in the industry towards evolving strategies and modalities to facilitate smooth recapitalization of banks so that no stakeholder is in any way hurt while the intended objectives are being pursued. The banking public should be reassured of the safety of their investment and deposits.

CONCLUSION

Based on the analysis and interpretation of the data gathered from the research study, the current recapitalization policy will enhance the effectiveness and efficiency as well as profitability of the Nigerian banking system. If done properly, the recapitalization exercise will ensure the safety and soundness of the banks.

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APPENDIX

TABLE 2: Paid up capital and Earning/Profits of Commercial Banks in Nigeria (1994-2004)

Year	Paid up Share Capital (₦b) x	Earnings and Profit (₦b) Y	
1994	5.4694	34.869	
1995	6.5286	35.423	
1996	8.8086	36.617	
1997	18.1320	41.499	
1998	25.9861	45.612	
1999	32.9754	46.528	
2000	46.3513	63.266	
2001	75.2500	95.124	
2002	100.2749	93.203	
2003	119.7053	82.324	
2004	171.0308	97.274	

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However, there hardly could be a conclusive argument on this sensitive issue. This work like other ones, therefore sets the pace for further research in future.

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