Banking Reforms in Nigeria and Its Impact on the Economy

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Abstract: A bank is a financial institution that is licensed to deal with money and its substitutes by accepting time and demand deposits, making loans, and investing in securities. A bank is a licensed and regulated financial institution that lends money, accepts deposits and carries out other financial transactions for its clients. A good and efficient banking structure promotes great amount of investment and this leads to faster economic growth and development. The Financial Services (Banking Reform) aims at attaining higher standards of conduct on all Nigerian banks. Banking Reform also looks to make sure that customers sum of money deposited is protected by outlining plans for the "ring-fencing" of retail and wholesale banking activities. The Nigerian banking sector has witnessed significant reforms and several reforms in order to tackle the lingering effects of the global financial crisis, which culminated in the contraction of some banks’ balance sheets with the attendant economic problems. In Nigeria, most banks had a low capital base, weak corporate governance, insolvency etc. and this necessitated the introduction of the Banking sector reform in Nigeria by 2004. The government aimed to establish a reliable and efficient banking sector so that it could guarantee the safety of the depositors’ money. Thus according to the findings of this research work it can be said that, through banking sector reform the government of Nigeria was able to move their economy forward by achieving sustainable economic growth and development. The Nigerian banking sector reforms remained a reference point for the positive development in the Nigeria economy, African region and the world. Presently, the new banking environment created by the reforms has made possible the delisting of Nigeria from the Financial Action Tax Forces (FATF) register of countries that are in breach of the global anti-money laundering and anti-corruption code.

Keywords: Bank, Banking sector, Banking reform, Customer, Deposit, Financial institution, Money, Economic development & Economic growth.

1. INTRODUCTION
The economic well-being of a country will largely, be dependent on the strength, sophistication and complexity of its banking industry. The regulatory authority on banking in Nigeria, the Central Bank of Nigeria, introduced reforms that will bring sanity to the Banking sector and bring into existence stronger, more viable and more versatile banking institutions in Nigeria. Banking Sector Reform in Nigeria was introduced in 2004. The Government aimed to establish a reliable and efficient banking sector so that it could guarantee the safety of the depositors’ money. The main objectives of
the Nigerian banking sector reforms include; enhancing the quality of banks in Nigeria; to enhance financial stability; and by implication economic stability; to bring about healthy financial sector evolution that will result in the much-desired financial sector inclusiveness; and to ensure that the financial sector contributes to the real sector of the economy.

In 2004 ending, the Central Bank of Nigeria introduced a programme of reforms, which created a new minimum paid-up capital for all banks, from two billion Naira to 25 billion Naira; with a compliance deadline of 31 December 2005. The research design adopted in this study falls within the paradigm of a quasi-experimental study. Data were collected mainly from secondary records and this data where analysed according to performance achieved in the Nigerian banking industry before and after the reform. However, the study revealed that, prior to the 2004 banking sector reforms, many Nigerian banks were undercapitalized and this accounted for their poor performance in terms of low profitability, low liquidity, low returns on investments and lack of sustainability.

The reforms, amongst other programmes, were designed to diversify the banking industry, strengthen the banks to play leading roles in the Nigerian economy, become active players and compete effectively in the African and global financial system and ensure the safety of depositors' money.

2. LITERATURE REVIEW
2.1 Theoretical Framework

The theoretical underpinning of this research is anchored on the nexus that subsist between banking reforms in Nigeria and its impact on the economy. A bank is a financial institution, which is involved, in borrowing and lending money. Banks take customer deposits in return for paying customers an annual interest payment. The bank then uses the majority of these deposits to lend to other customers for a variety of loans and making of profits. Banks play an important role in the financial system and the economy and being a key component of the financial system, banks allocate funds from savers to borrowers in an efficient manner and these financial services help to make the overall economy more efficient.

The financial system is central nervous system of a market economy of which is essential to its effective and efficient functioning. Banks mobilize savings for investment purposes and this brings about growth and development. Most productive sectors of the economy rely heavily on the banking sector for credit and the banking sector finances most developmental programmes and strategic objectives employed in almost all productive and developmental aspects of the private and public sectors of the economy. It is in view of these strategic roles of the banking system to national economic development that the issue of a sound banking system, through proactive reforms becomes imperative. According to Ajayi (2005), 'banking reforms involve several elements that are unique to each country based on historical, economic and institutional imperatives.

Banking reform has been an on-going phenomenon in Nigerian financial sector. In recent times, the regulatory authority on banking in Nigeria, the Central Bank of Nigeria, has introduced reforms that have fundamentally altered the outlook, operation and nature of the banking system in the country. It will be good to note that Banking reforms have resulted from deliberate policy response to correct perceived or impending banking sector crisis and subsequent failure. Banking reform in Nigeria is an integral part of the countrywide reform program undertaken to reposition the Nigerian economy to achieve the objective of achieving economic growth and development.

In recent times, the regulatory authority on banking in Nigeria, the Central Bank of Nigeria, has introduced reforms that have fundamentally altered the outlook, operation and nature of the banking system in the country. The government aimed to establish a reliable and efficient banking sector so that it could guarantee the safety of the depositors’ money and so that need of a reform became inevitable. The focus of this thesis is to investigate the Banking reforms in Nigeria and its impact on the economy. The research work will also examine the various roles played by banking reforms in the development of the Nigerian financial system in providing a healthy competitive environment among banks.

The Nigeria banking reforms in recent times has not only brought sanity to the industry but has equally brought into existence stronger, more viable and more versatile banking institutions in Nigeria.
2.2 The Nigeria Banking Reform

The banking industry in Nigeria started during the colonial era with the establishment of Colonial Banks, with the primary aim of meeting the commercial needs of the Colonial Government. The banking system in Nigeria is regulated through the Central Bank of Nigeria. This apex bank started operation on July 1, 1959. Banking reform is the reform of the banking sector under the objectives of solving the chronic non-profit earning problems and strengthening of the overall health of the public sector banks to face international competitions. All reforms also aim at strengthening the growth potentials of the Nigerian banks as well as develop its absorptive capacity in case of any eventuality, as in the recent global financial crisis.

According to Professor Charles Soludo to raise the capital base of banks was basically meant to strengthen and consolidate the banking system. Mainly, banking reforms usually set to achieve macroeconomic goals of price stability, full employment, high economic growth and internal and external balances. On Tuesday July 6, 2004, Professor Charles Soludo the Governor of Central Bank of Nigeria at a special session of the bankers committee in Abuja unveiled a 13-point reform agenda to banks chiefs, which included an upward review of banks capital base from N2billion to N25 billion which is the first phase of the banking reforms. The reforms in Nigeria have been directed towards financial intermediation, financial stability and confidence in the system (Central Bank of Nigeria, 2012).

According to Professor Charles Soludo in his paper presented at the special session of the bankers committee in Abuja 2004, he was of the opinion that besides strengthening the Nigerian banks with the new capital base, the reform is intended to exalt full pledge discipline and self-restraint in banks distress that has been a problem to the Nigerian-banking sector. Thus, in Nigeria, banking sector reforms ideally is an integral part of the overall economic reforms programme undertaken to reposition the banking industry to be able to play its critical intermediation and developmental roles, and by so doing reposition the Nigerian economy to achieve its objectives of financial intermediation, financial stability and confidence in the system.

However, it is good to note that the inability to have a sound financial system has necessitated the need to consider the adoption of a reform in the Nigerian banking sector. According to Professor Charles Soludo, the inability of Nigerian Banking System to voluntarily embark on consolidation in time with the global trend has necessitated the need to consider the adoption of appropriate legal and supervisory frameworks as well as comprehensive incentive package to facilitate mergers and acquisition in the country as well as crisis resolution option and to promote the soundness, stability and enhanced efficiency of the system. (Soludo 2004:4).

2.3 Reasons For Reform As Unveiled By Central Bank Of Nigeria (CBN)

The Central Bank of Nigeria (CBN) has unveiled its blueprint for the reform of the banking sector, which is built on four pillars. The former Central Bank Of Nigeria (CBN) Governor, Mallam Sanusi Lamido Sanusi, announced the blueprint during his pre-convocation lecture at the 28th Convocation of the Bayero University, Kano, on year 2012. The four pillars of the reforms are:

- Enhancing the quality of banks:- He said in the first pillar, the monetary authorities would initiate a five-part programme to enhance the operations and quality of banks. “It would consist of industry remedial programmes to fix the key causes of the banking crisis, implement risk-based supervision, reform regulations and regulatory framework and also enhanced provision for consumer protection and internal transformation of the CBN,” Sanusi said.

- Establishing financial stability:- The CBN, in establishing financial stability, seeks to strengthen the financial stability committee within the CBN and establish a hybrid monetary policy cum macro-prudential rules. Sanusi said the banking watchdog would also include the development of directional economic policy and counter-cyclical fiscal policies by the government and further develop capital markets as alternative to bank funding. “Some of the potential levers for the new macro-prudential rules may include limiting capital market lending to a set proportion of bank’s balance sheet, prohibiting banks from using depositors’ funds for proprietary trading, private equity or venture capital investment as well as adjusting capital adequacy and forward looking capital requirement of banks, driven by stress tests by the CBN,
Enabling healthy financial sector evolution: The governor pointed out that the CBN would in enabling healthy financial sector evolution, review the basic one-size-fits-all model of banking. Besides, he said the apex bank would also review the universal banking model mandates, which would make it possible to have international, national, regional, monoline and specialised banks such as Islamic banks, with different capital requirements, commensurate with the depth of their activities.

Ensuring that the financial sector contributes to the real economy: Sanusi said ensuring that the financial sector contributes to the real economy entails leveraging on the CBN governor’s role as adviser to the President on economic matters. He said the apex financial institution would take the lead in measuring more accurately the relationship between the real economy and financial sector as well as cooperating with state governments to run pilot programmes in directing the financial sector’s contribution to social and economic development within the states. (ThisDay Newspaper/Magazine).

Banking sector reforms have come into play due to banks inability to meet up to required obligations or satisfy their stakeholders which overtime have led to subsequent failures and crises. A banking crisis can be triggered by weakness in banking system characterized by persistent illiquidity, insolvency, undercapitalization, high level of non-performing loans and weak corporate governance, among others.

Bank reform necessitates in Nigeria because most of the banks had a low capital base of less than 10 million US dollars as at the first reform. The local banks in Nigeria were not very efficient and their capacity was low. Again, the government had to depend a lot on the foreign banks. In addition, Nigeria had been suffering from a weak corporate governance and insolvency for a long time so the government failed to provide a sound banking system and most of the banks in the country depended upon the public sector deposits, which was lowering their capital base. Finally, the public funds had not been distributed equally among all the banks. Thus, all this factors where behind what necessitated for a reform in 2004.

2.4 Reform Process

The importance of effective regulation of the banking sector cannot be over-emphasized when it is borne in mind that the business of banking permeates all strata and affects the makeup of society, hence the absence of a stable and effective control may result in macro- and micro-economic disequilibrium. It is important to start the reform process by having well-defined long-term objectives. A first step is to establish if there is a case for reform. It is important to ascertain if there is a political commitment for reform and to develop a political consensus in favour of reform.

Alan (2004) opined that banking reform is the process of changing structures, adding new policies, eliminating distorted banking policies and practices and generally establishing the basis of greater efficiency in both the mobilization and the collection of resources. As stated earlier on Tuesday July 6, 2004, Professor Charles Soludo the Governor of Central Bank of Nigeria at a special session of the bankers committee in Abuja unveiled a 13-point reform agenda to banks chiefs, which included an upward review of banks capital base from N2billion to N25 billion which is the first phase of the banking reforms. However, the Central Bank of Nigeria (CBN) provided some incentives for the banks so that they could achieve the minimum capital base within 2005.

Central Bank of Nigeria (CBN) allowed the banks to deal through foreign exchange, banks were permitted to take deposits from the public sector, and the fiscal authorities were made responsible for the collection of revenue from the public sector. Some tax incentives were provided for the banks in the area of stamp duty and capital allowance and transaction costs had been minimized. In addition, the government formed an expert panel to provide technical support to the banks. All this good measures introduced by the CBN and other state regulatory agencies is to prevent or reduce the chances of bank failure by easing the reform process so that banks do not become insolvent, fail and be liquidated.

Banking reforms involve several elements that are unique to each country based on historical, economic and institutional imperatives. In most cases, bank reforms are embarked upon to forestall banking crises or cushion the effects of crisis. Other steps of the reform the government of Nigeria did was it started merging the banking institutions and introduced a regulatory framework based on some
rules. The government also established a web portal for all the citizens so that they could share any confidential information with the Central bank regarding the banking systems. An automated process had been developed to report the bank returns and the government revised and updated the banking laws to make the banking system more easy and effective.

All this processes where introduced and done with the view of consolidating banks in order to make sure that the reform process is achieved by most banks in the industry.

2.5 Essence Of Banking Reforms In Nigeria

Banking reforms have been an on-going phenomenon around the world right from the 1980s, but it is more intensified in recent time because of the impact of globalization, which is precipitated by continuous integration of the world market and economies. Inability of the bank to meet its financial obligations to its stakeholders results to liquidity problem or financial constraint, which will result to banking crises. However, some banking reform programmes occur, some of the time, independent of any banking crisis. It will be good to have in the back of our mind that bank reforms are implemented to strengthen the banking system, embrace globalization, improve healthy competition, exploit economies of scale, adopt advanced technologies, raise efficiency and improve profitability. The main reason of banking reform is to ensure that banks perform their developmental role of safeguarding customer’s funds, sustaining profitability and enhancing economic growth and development.

The need to achieve a strong and stable financial system for the Nigerian economy necessitate the introduction of banking reform programs in the banking sector by the Central Bank of Nigeria. The major crux of the reforms was the consolidation programme carried out by the CBN, which programme fundamentally altered the makeup of the banking institutions operating in Nigeria. Commenting on the issue, the Governor of Central Bank of Nigeria Professor Charles Soludo stated that:

“Consolidation of Nigeria's banking industry is not only critical to the health of the financial system, but also consistent with the framework of the National Economic Empowerment and Development Strategy (NEEDS). Indeed, bank consolidation has been recognized in both the developed and developing economies, as a veritable strategy for deepening the financial system and growing the economy”.

The reforms are designed to enable the banking system develop the required flexibility to support the economic development of the nation by efficiently performing its functions as the pivot of financial intermediation (Lemo, 2005). In 2004, the Governor of Central Bank of Nigeria at a special session of the bankers committee in Abuja unveiled a 13-point reform agenda to banks chiefs, which included an upward review of banks capital base from N2 billion to N25 billion, which is the first phase of the banking reforms. Thus, the reforms were to ensure a diversified, strong and reliable banking industry where there is safety of depositors’ money and position banks to play active developmental roles in the Nigerian economy. In the course of the banking reform, the banks that successfully satisfied the minimum share capital requirement did not have any problem. On the other hand, the banks that failed the obligation of shoring up their minimum paid-up capital were liquidated.

The NDIC is a parastatal under the Nigerian Ministry of Finance. The corporation is charged with protecting the banking system from instability occasioned by runs and loss of depositors' confidence. It operates under the Nigeria Deposit Insurance Corporation Act (1990). According to the deposit insurance agency, NDIC:

“The bank consolidation programme initiated by the CBN in 2004 resulted in the failure of fourteen (14) banks which could not meet the prescribed minimum capital of N25 billion. In order to ensure that depositors of those banks did not lose their funds, CBN and NDIC adopted a novel failure resolution option known as Purchase and Assumption (P&A). The P&A strategy required healthy banks to bid for the assets and assume deposit liabilities of the failed banks. The NDIC has been able to resolve eleven (11) of the failed banks”.
In view of the fact that banks take deposits from the public for safekeeping the need for banking reform becomes very vital and important in order to achieve financial stability and confidence in the system and economic growth and development. Thus, banking reform in Nigeria is an integral part of the countrywide reform program undertaken to reposition the Nigerian economy to achieve the objective goals of economic growth and development.

2.6 Impact of Reform

According to Azeez and Ojo, 2012, Carried out through either government institutions or private enterprises, reforms become inevitable in the light of the global dynamic exigencies and emerging landscapes. Banking reforms are viewed as government intervention in the banking industry to provide a panacea for existing anomalies in the banking sector. Countries reform their banking sectors for a number of reasons, including structural, capitalization and ownership issues (Ogbunuka, 2005).

Banking Sector Reform in Nigeria had been introduced in 2004 with a view of establishing a reliable and efficient banking sector so that it could guarantee the safety of the depositors’ money. The banking sector reform contributed credit to the private sector, loan to deposit ratio and significantly total asset of the commercial banks in Nigeria. Several banks were able to increase their capital base through this reform. By merging some banks, the government established an efficient and disciplined banking system. Many local banks were emerged; therefore, the Nigerian government had no need to depend on the foreign banks fully.

According to Davies Kelvin the current banking reforms have yielded the following results among others:

- The reforms have brought about a new mind-set to the industry as banks are putting in place best practices in the areas of corporate governance and risk management. Transparency and public disclosure of transactions have remarkably improved.
- A number of banks have returned to the profit-making path and improved their balance sheets, as the recent results of their financial statements have shown.
- Banks are gradually resuming lending to the private sector with the additional liquidity of more than N1.7 trillion injected into the banking system through the issuance of AMCON bonds, and significant progress in re-directing credit to the power sector and SMEs at single digit interest rates. These initiatives have saved and helped create thousands of jobs in the economy.
- The Bank has issued a new code of corporate governance. The CEO of banks shall serve a maximum tenure of 10 years. Furthermore, all CEOs who would have served for 10 years by July 31, 2010 ceased to function in that capacity and have handed over to their successors.
- Nigerian Banks are now key players in the global financial market with many of them falling within the Top 20 banks in Africa and among Top 1000 banks in the world.
- The reform has culminated in moderating the spread between the lending and deposit rates to 9.7 per cent as at end-December 2011, from 12.2 per cent in 2010. This has contributed to the existing macroeconomic stability in the economy with inflation moderating to 10.3 per cent as at end-December 2011. The hitherto volatility in the exchange rate witnessed in the foreign exchange market has been brought under control. The premium is within the international standard of 5.0 per cent.

Finally, in one word, it can be said that, through banking sector reform the government of Nigeria was able to move their economy forward.

3. CONCLUSION

The banking sector occupies a vital position in the economy and must be subject to continuous reforms for it to function efficiently. It is indeed evident that the reforms in the banking sector of the Nigerian economy have proved to be of tremendous advantage because it has engendered greater confidence in the banking system among the public and have resulted to a healthy, strong, viable and competitive banking institutions in Nigeria.

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