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Impact of Bank Consolidation Strategy on the Nigerian Economy

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Abstract

The Nigerian banking sector was highly oligopolistic with remarkable features of market concentration and leadership. The CBN recent reform to consolidate the banking sector through drastic increase to N25 billion as minimum capital base has led to a remarkable reduction in number of banks changed their mode of operation and their contribution to the economy. This paper through review of literature explores the impact of the reform on the Nigerian economy and found that, the CBN decision has changed the market structure of the banking sector, increased the efficiency and reliability of the banks, created opportunities for financial institutions and market participants, and raised their intermediation potentials. It also became evident that for such strategy to be effective, Central Bank of Nigeria needs to make banks recapitalization a continuous exercise at interval of 5-10 years to catch up with inflation and happenings in other parts of the world. It is equally important to establishing branches by mega banks in the rural areas of the country so as to ensure adequate access to credit facilities and other services.

Introduction

Nigerian banking sector has experienced a boom-and-bust cycle in the past 20-25 years. After the implementation of the structural adjustment program (SAP) in 1986, and the deregulation of the financial sector, new banks proliferated, mainly driven by attractive arbitrage opportunities in the foreign exchange market (Heiko 2007). But prior to the deregulated period, financial intermediation never took off and even declined in 1980s and 1990s (Capirio and Kligbiel 2003).

The sector was highly oligopolistic with remarkable features of market concentration and leadership. Lemo (2005) noted that there are ten banks that control more than 50% of the

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aggregate assets of the banking sector; more than 51% of the aggregate deposit liabilities; and more than 45% of the aggregate credits.

The sector was characterized by small sized banks with high overheads; low capital base averaging less than $10million; heavy reliance on government patronage and loss making. Nigeria's banking sector was still characterized by a high degree of fragmentation and low levels of financial intermediating up to 2004.

This paper is motivated by the need to look in to the Central Bank of Nigeria's (CBN) recent reform strategy that employed certain policy measures to strengthen to Nigerian Banking System by drastically increasing the minimum capital requirement from 2 billion Nigerian naira (N) to N25 billion ($US 190million). Through review of relevant literatures, and analysis of policy documents, official reports and economic information on the banking sector, it became evident that the strategy has led to a remarkable reduction in the number of banks from 89 to 25, by mergers, acquisition, initial public offer and other means at the beginning of 2006 in a short period of time. The article concludes that the reform has resulted in making the banks more efficient and reliable and also their intermediary potentials have also been raised.

Role of banks in the Nigerian economy

Finance sector in general and banking sector in particular contributes to growth/development in the following ways.

Financial Intermediation

Oboh (2005) observed that financial intermediation is an area which banks have the professional expertise of matching the interest of depositors with those of borrowers by providing more or less a coordination functions for the two groups. In more technical terms, banks intermediation functions entail maturity, transformation and separation of the saving and investment function in an economy (Sirri and Tufano, 1995). This implies that in the absence of banking institution, individuals or corporate bodies that want to invest for instance in real sector production would first accumulate enough funds over

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time to be able to meet their fixed and variable cost of investments. In a similar fashion, those individuals or institutions investors with surplus funds would have to search and identify the deficit unit that needs their funds. The two processes would be too cumbersome, expensive and very inefficient. The banking system has become the veritable agent well placed to perform this vital function efficiently. The rate of growth of any economy is a function of the capital formation and the pace at which such economy is moved into the productive investment projects in the real sector (Diamond, 1984 and Boyd and Prescot, 1986).

Table 1: Deposit Mobilization by Mainstream Banks 1990-2003

Year	Amount (N Billion)	Growth Rate (%)
1990	43.9	37.4
1991	60.3	43.8
1992	86.7	49.7
1993	129.8	49.7
1994	162.9	25.5
1995	196.9	20.9
1996	239.5	21.5
1997	295.1	23.3
1998	349.3	18.4
1999	569.8	63.0
2000	838.6	47.2
2001	1017.2	21.3
2002	1226.6	20.6
2003	1415.8	15.4
Average Growth Rate		31.4

Source: NDIC Annual Reports (Several Issues)

Deposit Mobilization

According to Oboh (2005), banks like any other business enterprises use money inputs in their normal operations. One of such inputs is the customer deposit. Therefore, banks mobilize deposits from both urban and rural areas, from rich and the less endowed for productive investment. In doing this, they create various financial instruments to meet the preference of the heterogeneous customers. Apart from paying interest income to the depositors, banks provide safety for those funds that would otherwise been exposed

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to such risks as fire, theft, and so on if such funds were to be in the owner's physical custody. In other words, banks do not only create liquidity, they also eliminate the hoarding and idleness of cash and loss of funds through safe custody (Delong, 1991). The volume of and the rate of growth of deposit mobilization by banks has been a fluctuating one as can be seen on table 1. From N43.9 billion and 37.4% in 1990 to N295.1 billion and 23.3%in 1997 and N1415.8 billion and 15.4% in 2003. The average growth rate was 31.4% in the period 1990-2003.

Advancing Credit to Borrowers

Ekundayo (1994) noted that the Nigerian Banking Industry has been playing a leading role in the development of the Nigerian Economy. According to him, banks mobilized and disbursed tremendous volumes of funds of both government and private sector investors for the growth of the economy. Oboh (2005), postulated that the primary reason that banks want deposit is to enable them grant credit from which they earn interest income. But more importantly, extension of credit to the economy is the core link that banks have with real sector, acting like a catalyst and contributing to the growth of the economy.

Table 2: Banks Credit to the Economy 1990-2003 (N Billion)

Year	Government	Private	Total	Growth Rte (%)
1990	21.043	36.631	57.674	-
1991	38.498	45.325	83.823	45.3
1992	100.272	56.791	157.0921	91.9
1993	190.979	68.082	263.349	63.3
1994	292.158	117.668	413.946	57.1
1995	264.521	180.189	444.710	7.4
1996	117.560	223.240	340.800	23.3
1997	54.6	276.489	331.169	2.8
1998	133.929	352.359	486.288	46.8
1999	147.497	419.709	658.926	35.5
2000	8.808	530.373	521.565	20.8
2001	29.208	854.99	829.790	59.0
2002	373.639	955.762	1329.401	60.2
2003	416.6	1292.8	1709.8	28.0

Source: NDIC Annual Reports (Several Issues)

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By financing production, consumption and commerce, banks lubricate the process of economic growth with multiplier effect across all sectors of the economy. Banks credit to the Nigeria economy was N21.043 billion to the government, N36.631 billion to the private sector in 1990. It was N54.6 billion to the government, N276.489 billion to the private sector in 1997; in 2003 it was N416.6 billion to the government, N1292.8 billion to the private sector. The growth rate of banks credit to the economy was 45.3% in 1991, 2.8% in 1997, 60.2% in 2002 and 28% in 2003 (see table 2).

Sector Specific Lending

Oboh (2005) enunciated that banks have always collaborated and cooperated with government in lending especially with respect to lending to macro, small and medium scale enterprises (SME) as well as real sector. Up till 1997, when compulsory sectoral allocation was phased out as a policy instrument used by CBN, mainstream banks were made to meet specific targets in their lending to the productive sectors especially agriculture, manufacturing, particularly the export and solid mineral. From 1980 to 1983, an annual average of about 58.3% of commercial banks aggregate lending went to agriculture and manufacturing sectors (OluaJakaiye, 1995). Commercial banks total loans to small scale enterprises increased from N20.4 Billion in 1992 to about N42.63 Billion in 1998, representing an average of about 21.5% of the aggregate loan granted by commercial banks during the period.

Payment System

Oboh (2005) Greenwood and Jovanovich, (1990) noted that where ever there is trade, there must be exchange of goods and services. As a result, the banking institutions have invariably performed the role of payment vehicle in the trade system all over the world. Therefore, rather than carry money about looking for goods and services, traders only need to provide information regarding themselves and their customers and how transaction related bills should be settled. This is the very essence of the payment function of banks.

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There are two major perspectives to the role of banks in the payments system according to Oboh (2005), Carlin and Mayer, (2003), as follows.

International trade

Some of the international trade services provided by banks include the following; Provision of foreign exchange for business, traveler and payment for imports, Collection of export proceeds on behalf of exporters, advice on foreign trade regulation, advice on methods of hedging exchange risk etc.

Payment Mechanism and Funds Transfer

In an economy involved in trade and exchange within and across national borders, goods and services are produced and sold. Partiers involved are paid and must pay. Bank's check clearing and funds transfer facilities have impacted positively in the volume of trade and other business transaction by deployment of IT in banks, the speed of service delivery has improve while the cost of doing business has reduced tremendously. As it is possible to move millions of Naira through electronic media (Electronic transfers) and chip based cards such as credit cards, debt cards, ATMs, or even through the fast growing electronic purse (value cards). This development impacts positively on the aggregate production and economic growth of any economy (Carlin and Mayer 2003) and Nigeria in particular.

Business Advisory and Consultancy Service

Oboh (2005), concluded that in additions to the normal lending activities, banks now engage in business advisory and consultancy services, now that business fail simply because of management, faulty investment decision, unrealistic assumptions, efficient capital structure and planning, all of which banks can provide today, to ensure that economic growth is not retarded.

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Trends in Banks Consolidation

According to sloan and Arlond (1970) consolidation is a fusion of the assets and liabilities, in whole or in part of two or more business establishment. Consolidation represents the idea of investment and the coming together of firms; it can also mean larger sizes, larger shareholder bases and larger number of depositors. According to Adamu (2005) bank or corporate consolidation could be achieved by way of mergers/acquisition and recapitalization. It is more than mere shrinking of number of banks in any banking industry.

According to Hall (1999) consolidation is a global phenomenon, which started in the advanced economies of the world. For example, the enactment of Riegle-Neal Act, which allows interstate branch banking beginning from 1997 this led to increase in bank mergers in the USA (Akhavin et al and kwan 2004). Consolidation allow a mega bank to enjoy higher profit, increase revenue and low problem loans. Japanese banking industry also experienced consolidation in the 1990s which resulted to economies of scale (Fukuyama, 1993; Mckillop et al 1996).

Consolidation in financial services in the USA and other industrialized countries has occurred along 3 lines, namely: within the banking industry, between banks and other non-bank financial institutions, and across national boarders. In the USA, most of the consolidation that took place occurred within the banking sector, for instance, in that country, the number of banking organizations fell from about 12,000 in the early 1980s to about 7,000 in 1999, a decrease of more than 40%.In Canada, there has been trend toward consolidation of commercial banks and merchant banks, whereas in Europe, where the universal banking model is more prevalent, the trend has been to combine banking and insurance business. While most of the bank consolidation in the developed economies occurred within the domestic front, there are signs of increased cross boarder activities. Such cross boarder activities have been facilitated in Europe with the lunch of the euro.
The trend towards financial consolidation in Europe, USA and Canada could be traced to several factors such as (1) the need to eliminate week or problem financial institutions during the thrift and banking crisis of the late 1980s and early 1990s (2) some European

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countries experience problems with institutions weakened by exposure to real estate lending.(3) advancement in telecommunication and information technology has also accelerated the face of bank consolidation. It has reduced the cost of providing financial services (Adeyemi, 2005).

Reasons for Concern over Capital Adequacy in Nigerian Banks

Traditionally, operators and supervisory authorities never gave much thought to the question of capital adequacy in banking. This has however changed in recent years. According to Adewumi (1997), since the early seventies, great concern has been expressed over the issue of adequate capital for banks. Firstly, the industry has witnessed unprecedented competition in the last two decades. This has led bankers to engage in new unknown and riskier fields that the supervisory authorities in particular have expressed concerns over capital adequacy. In Nigeria, the concern of regulatory authorities has been reflected in the continual increase in the capital requirement for banks entering the industry.

Secondly, significantly, as a result of inflation, the volume of banking business reflected in the total assets/liabilities of banks has increased phenomenally in recent years. As the asset will diminish in relation to liabilities if no addition are made to it. This trend has given concern to the regulatory authorities all over the world.

Third, the international and business environment and sectors have become increasingly intertwined as a result of globalization. Consequently too, the bankers have become exposed to risks not directly inherent in the business of the economies in which they operate. The question as to whether existing levels of capital are considered adequate for the increasing levels of risks has risen consequently in debates between supervisory authorities.

Fourthly, although, capital in banking did not attract undue attention in the past, nevertheless capital were calculated and observed. With increase in the volume of banking not matched with corresponding increases in stock, the capital and deposits and total assets have declined. This development has given some concern to practitioners and the supervisory authorities.

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Finally, bank failures have become an important phenomenon in economies of Europe, America and indeed the world over since the early 1980-90s. Significant systematic banking crises have been experienced in East Asia, the US and Europe (Wilmarth, 2002).

Even the very resilient British banking system experienced some hiccup with the bank crisis of the mid 1970's which was contained only by the life boat rescue operation of the bank of England. Empirical studies of bank failures have attributed this to inadequacy of capital of these banks, a few years prior of failure. It has been suggested that capital adequacy be given considerable attention all over the world.

According to Lewis and Stein (1997) structurally, in Nigeria the banking sector was highly concentrated as the largest banks account for about 50 Percent of the industry's total assets/liabilities. Most banks in Nigeria have a capitalization of less than US$ 10 million; even the largest bank in Nigeria has a capital base of about US$240 million compared to US$ 526 million for the smallest bank in Malaysia. This is not healthy for the economy. It was this concern to save the Nigerian Banking Sector from systematic crisis that led to regular reform of the sector and the requirement for banks to raise their capital base to a minimum of N 25 billion with compliance date of 31st December, 2005 in the recent reform.

Regulatory and Legal Framework of Capital Adequacy

As a result of concern of monetary and regulatory authorities over capital adequacy of banks, legal and regulatory actions are being instituted or reinforced to ensure that banks within their jurisdiction operate continuously with adequate capital.
According to Soludo (2004), the Nigerian Banking System faces enormous challenges which if not addressed urgently could snowball into crisis in the near future. Beck et al (2005) noted that since 1952 when the first banking legislation was enacted all the banking laws in Nigeria have specified minimum paid up capital. Up to 1969, the legislations, for this purpose distinguished between foreign banks and indigenous banks the 1979 Decree section 6 states that: the minimum capital required by an indigenous bank to be granted license must be N600, 000.00.A bank directly or indirectly controlled

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from abroad should have paid-up capital of up to N1.5 million. In 1979, different initial capital base requirement were stipulated for commercial and merchant banks. With the promulgation of Nigeria enterprises Promotion Decree and the advent of universal banking, the specification/differentiation between foreign, indigenous, NGO's, Commercial and merchant banking dimension was eliminated.

Lewis and Stein (1997) noted that while the statutory minimum capital requirement largely stabilized during the pre-SAP period, four upward reviews were put in place after SAP to adjust for the inflationary impact of the SAP induced policies. The increase in the number of operators between 1987 and 1990 actual led to the ballooning of loans and advances of banks industry wide and a consequent deterioration in the quality of banks risk assets. The CBN introduced the new famous prudential guidelines, which made it mandatory for banks to recognize early and provide for not performing assets. The effort of those stringent but necessary measures was the erosion of the capital base of quite a sizable number of operators as their accumulated reserves were not sufficient to absorb the huge loses. The almost four time devaluation of Naira exchange rate to the dollar between March 1992 (N 10: $1 to N18: $1) and February 1995 from (N22: $1), dealt a final total blow on the capital base of the banks particularly those that have been pronounced terminally distresses by the CBN. According to Lewis and Stein (1997) the new globally embraced capital adequacy measurement places considerable emphasis on the risk element in the assets of banks. This is to ensure that each bank carries funds that are not only commensurate with its total assets but also cater adequately for the risk-ness of its operation, nationally and internationally.

Consolidation Strategy of CBN and the Emergence of Mega Banks

According to Soludo (2004), the sole objective of banking sector reform is to move the Nigerian economy forward and to proactive position the banking system to be sound reliable catalyst of development. According to Otanngaran (2004), a survey of top 75 banks indicates that the banks as at March, 2003, have a total capitalization of N 94.4 Billion while their shareholders' funds stood at N 298 billion. According to the survey, the top 75 banks represent 84% of the 89 banks in operation. The survey showed that the

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banks need additional N 1.8 trillion which represents 94.7% of the total, N 1.9 trillion that the 75 banks require to recapitalize, while the total 89 banks will require N2.1 trillion.

The enormous amount needed was 6% higher than the Nigerian stock exchange (NSE) capitalization, which stood at N 1.98 trillion as at 2004, which makes raising the money less feasible in less than 18 months. What this implies is that the Nigerian banks have little or no option than to embrace mergers and acquisition or strategic alliance to remain in business. The survey showed that out of 74 banks, only two have capital bases above N3 billion with four of them having capital bases above N 2 billion remaining 69 have less than $ 2 billion. According to Beck et al (2000) and Lewis and Stein (2002) in 1985 the number of banks in Nigeria were 40 with 24.78% claims on the domestic real non financial sector as a share of GDP, there were 107 banks with 11.9% claims on the domestic real non financial sector as a share of GDP in 1990, the number of banks was 89 since up to 2004 and claims on the domestic real non financial sector as a share of GDP fluctuates between 13.71%-21.40% during the period.

Options Employed by the Banks Were (1) Injection of fresh capital through initial public offers, private placement and right issues (2) Conversion of reserve to capital (3) Mergers between banks of like minds. (4) Outright acquisitions by bigger, stronger banks of weak banks (5) combination two or more of the above strategies (Otanngaran, 2004).

At the end of the day 25 banks emerged while 14 banks that were unable to raise the N 25 billion capital base were declared distressed by the Central Bank. According to Otanngaran (2004) the cost has become clearer due to the zero tolerance posture of the Central Bank of Nigeria. Soludo (2004) said at the end of consolidation exercise, many individuals and institutions have come to gain or lose from it. The list of the 25 banks that survived the reform is as shown on table 3.

Banks Distressed after the Consolidation Exercise.

Nigerian Banks that were affected by the consolidation and became distressed include; African Express Bank (APEX), All States Trust Bank Plc, Assurance Bank, City

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Express Bank Plc, Continental Trust Bank, Eagle Bank, Fortune International Bank Plc, Gulf Bank Plc, Hallmark Bank Plc, Lead Bank Plc, Metropolitan Bank Ltd, Societe Generale Bank Ltd, Trade Bank Plc, Truim Bank Plc (CBN 2005).

Table 3: List of Banks Post Consolidation

SN	New Names	Former Banks in the Group	Capitalization
1	First Bank	First Bank Plc. MBC Int, Bank FBN (Merchant) Bankers	48.7
2	Union Bank	Union Bank, Union Merchant Broad Bank, Universal Trust Bank	43.2
3	United Bank for Africa	United Bank for Africa, Standard trust Bank	50.0
4	Diamond Bank	Diamond Bank, Lion Bank	28.6
5	Oceanic Bank	Oceanic Bank, Int. Trust Bank	58.9
6	Intercontinental Bank	Inter-Continental Bank, Global Bank, Gateway Bank and Equity Bank	30.2
7	Fidelity Bank	Fidelity Bank, FSB International Bank, Manny Bank	29.0
8	First City Monument Bank	FCMB, Cooperative Devcom Bank, Nigerian American Merchant	29.0
9	Spring Bank	Citizens Bank International, Guardain Express Bank, Omega Bank, ACB International Bank and Fountain Trust Bank	26.4
10	Access Bank	Access, Marina Int. Bank and Capital Bank International	29.4
11	Unity Bank	Intercity, First Interstates, tropical Commercial Bank, Central Point Bank, Societe Banacaire and Pacific Bank, NNB int. Bank of the North, New Africa Bank.	27.8
12	Equatorial Bank	Equatorial Trust Bank and Devcom	29.3
13	First Inland Bank	First Atlantic, Inland Bank, IMB, NUB	27.5
14	Afribank	Afribank Int. (Merchant) Bank, Afribank of Nigeria.	26.64
15	IBTC Chartered	IBTC< Chartered Bank and Regent Bank	31.3
16	Skye Bank	Prudent Bank, EIB Int. Bank, Bond Bank, Elience Bank and Cooperative Bank	35.00
17	Wema Bank	Wema Bank and National Bank	37.7
18	Sterling Bank	Trust Bank, NBM Bank, Magnum Bank, NAL Bank, Indo Nigeria Bank	26.9
19	Platinum-Habib Bank	Habib and Platinum	26.9
20.	Stanbic Bank	Alone	36.10
21	Zenith Bank	Alone	26.7
22	Nigeria Int. Bank	Alone	37.79
23	Eco. Bank Nigeria	Alone	25.7
24	Standard Chartered Bank	Alone	32.3
25	Guaranty Trust Bank	Alone	27.5

Source: NSE act Book (2006) and financial standard Jan 30, 2006.,

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Impact on the Nigerian Economy

Capital Flow Effect

According to CBN (2005) the consolidation exercise of the banking sector has attracted foreign investment inflow to the sector to the tune of US $86 million, about N12.4 billion and another 162,000 pound (about N 340 million).

An estimated N 359 billion was raised by banking sector from private placements and public offer. Foreign lines of credit of two of the Banks that were among the first set of Banks to consolidate has increased to about US$ 250 million as a result of the consolidation exercise. So the potentials are getting better, foreign investors now have confidence in Nigeria. Tangible benefits have been seen in increased growth improving perceptions and debt relief through the ongoing consolidation. The consolidation provides the starting point for a stronger and more resilient financial economy of scale larger Bank, which is likely to withstand economic permutations and few banks, which are easier to supervise.

Boost to Manufacturing

Bank consolidation is a boost to manufactures following the success so far achieved by the Central Bank of Nigeria in the effect to revamp the manufacturing sector. Some years ago, facilities were in the range of 25/30 percent interest rate. In fact, some facilities are coming at 15 percent now. It is going to be better for the real sector at the final analysis. Okeke (2006) pointed out that before the consolidation, no Bank would fund your project if you did not have a godfather. He said that banks will now virtually be on your door step to give you finances.

Business will expand because of the increase of the access to finance revenue generation will also increase to repay the loan and make good profit. Businesses can now advertise in the media and even employ more hands.

The government wants Nigerians to participate in downstream sector of the oil industry, but it is not possible for many Bans to participate in the oil and gas sector,

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where there is competition and huge financial requirement. Consolidation would strengthen the Banks and that would mean loans to the oil and gas sector. It would make Banks stronger and they would have more resources to do their business (Ayodele, 2005).

Effect on Capital Market

Banking stocks undoubtedly occupy position as growth drives on the Nigerian Stock Exchange (NSE). A review of market performance in 2005 confirms this strategic importance of banking stocks. Seventeen Banks made the 20 most active stocks by volume with nine Banks on the top 10 most active list. Also 10 Banks made the top 20 most capitalized stocks list with banking sector contributing 6 out of Nigeria's 10most capitalized companies.

The consolidation also, ushered in an unprecedented era of new listings of new Banking stocks. Ten banks were listed between July 2004 and December 2005. These include, ACB International, Diamond Bank, Fidelity Bank, First City Monument Bank, Guardian Express Bank, Investment Banking and Trust Company (IBTC), Platinum Bank, Unity Bank, Spring Bank and Zenith Bank.

The recapitalization and consolidation exercise shattered the private ownership domination of Nigeria banking industry and converted to public limited liability companies. These resulted to having only 25 banks listed on the Nigerian Stock Exchange with N 1.98trillion total market capitalization as at 2006 (NSE Fact Book, 2006).

Imala (2005) indicated that consolidation and mergers/acquisition in the financial services sector is beneficial for the following reasons:

(1) Cost savings attributable to economies of scale and more efficient allocation of resources.
(2) Risk reduction
(3) Revenue enhancement, resulting from impact of consolidation on bank size, scope, and overall market power
(4) Shareholders pressure on management to improve profit margins and returns on investment, made possible by new and powerful shareholders blocks

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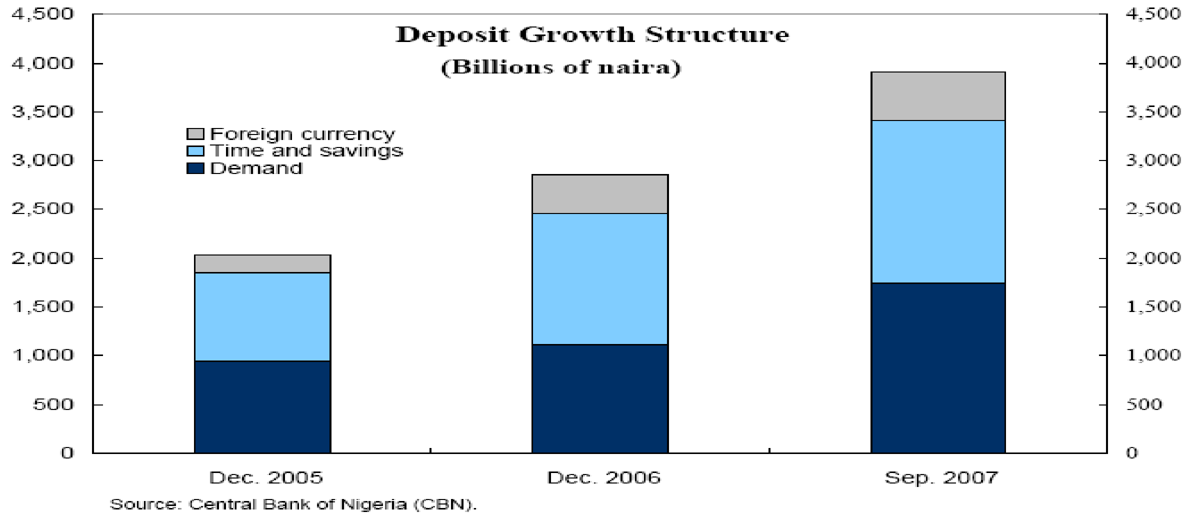
Figure 1. Deposit growth structure (billions of Naira)



According table 4 capital adequacy ratios (CAR) was 18.6 % as at June 2007 from about 14.7% in 2004. Now banks can make much larger loans to a single entity than before.

Non-performing loans-to-total loans ratio reduced to 7.7% in 2007 from 18.1% in 2005. The reasons for the decline in the ratio is the considerable growth in total loans, writing-off of non-performing loans (because of closure of the 14 banks that came because of consolidation) and prudential measures taken by the post consolidated banks to ensure better performance of new loans. Non-performing loans provisions to capital declined from 90.0% in December 2004 to 23.4% in June 2007.

In terms of earning and profitability return on assets (ROA) and return on equity (ROE) were 3.1% and 27.4% in 2004, but almost halved by June 2007 to 1.8% and 13.8% respectively. The decline in profitability indices can be attributed to the increase in shareholder funds that were used to information technology (IT) and other facilities such as new braches, to ensure competitive edge. Some banks were focused on addressing administrative challenges rather than improving on profitability. Liquidity ratio on the average increased from 61.1% at end December 2005 to 62.2% at June 2007. Customer deposit to total loans 77.4% at December 2005, but decline to 67.3% at June 2007.

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Table 4 Financial Soundness Indicators for the Banking Sector, 2004–07 (Percent, unless otherwise indicated)

	Dec-04	Dec-05	Dec-06	Jun-07
Capital Adequacy				
Regulatory capital to risk-weighted assets[1]	14.7	17.8	22.6	18.6
Regulatory Tier I capital to risk-weighted assets[1]	13.4	16.5	21.8	17.5
Capital (net worth) to assets	9.9	12.4	14.7	13.3
Asset quality and composition				
NPLs to gross loans[1]	21.6	18.1	8.8	7.7
NPLs net of provisions to capital[1]	90.0	64.4	21.3	23.4
Sectoral distribution of loans[1]				
Manufacturing	22.5	18.6	16.9	13.6
Trade and services	23.6	21.1	22.0	19.4
Energy and minerals	9.4	8.9	10.1	11.9
Agriculture	4.9	3.9	2.3	1.9
Construction and property	7.6	7.5	6.2	5.6
Households				
Government	4.2	4.6	7.6	1.9
Other	29.4	35.8	38.0	41.3
Earnings and profitability				
ROA[1]	3.1	0.9	1.6	1.8
ROE [1]	27.4	7.1	10.4	13.8
Interest margin to gross income[1]	37.6	38.1	39.6	43.9
Noninterest expenses to gross income[1]	53.9	59.2	52.7	47.0
Personnel expenses to noninterest expenses	0.0	37.3	42.7	39.0
Trading and fee income to total income	45.1	31.7	33.3	32.4
Liquidity				
Liquid assets to total assets[1]	…	…	61.1	62.2
Liquid assets to short term liabilities[1]	…	…	…	…
Customer deposits to total (non-interbank) loans	…	77.4	73.6	67.3
Foreign exchange liabilities to total liabilities	…	5.9	12.5	6.7

Source: Central Bank of Nigeria (CBN). 1 Included in the "core set" of financial soundness indicators. NPL - None performing loans; ROA - return on assets; ROE - return on equities.

Table 5 Comparator Countries: Financial Soundness Indicators, 2007 (Percent, unless otherwise indicated)

	CAR	Non Performing Loans (NPL)[1]	Return on Assets (ROA)	Return on Equities (ROE)
Brazil[2]	17.4	4.4	2.3	24.5
Indonesia[3]	19.2	16	2.6	28
Malaysia[4]	12.7	8.7	1.3	14.1
Nigeria	18.6	7.7	1.8	13.8
South Africa[5]	12.7	1.1	1.4	18.6

Sources: Central Bank of Nigeria (CBN), and IMF, GFSR. [1]NPLs to gross loans for Nigeria and Malaysia NPLs to total loans for all others. [2]CAR , NPL for 2005, ROA and ROE for March 2006., [3]CAR Sept. 2006; NPLs include compromised assets ratio, restructured loans, and foreclosed assets., For the largest 16 banks. ROE is based on the largest 12 banks. [4]ROA is before tax. [5]All entries are for March 2007.

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In terms of sectoral distribution of loans energy and minerals sector is getting an average increase in loans from the consolidated banks , it increased from 9.4% at December 2004 to 11.9% at June 2007.Loan to manufacturing trade and services, agriculture, construction and property and the government sector has been decreasing since 2004.

Table 5 shows that in 2007, Nigeria, compared to other countries in similar stage of financial development has capital adequacy ratio of 18.6%. This is considerably above those of South-Africa, Malaysia and Brazil and slightly below that of Indonesia. Nonperforming loans to gross loans is 7.7% better than that of Indonesia and Malaysia. Return on assets (ROA) is 1.8% better than that of South Africa and Malaysia.

The deposit growth structure also grew from 2,000b Naira in 2005 to almost 4,000b Naira at September 2007.Demand deposit, time deposit and savings deposits and even foreign currency deposits grew considerably during the period December 2005 to September 2007.

Conclusion

The consolidation of the banking system has transformed Nigeria's financial system and created opportunities for financial institutions and market participants. Strong and big banks could increase competition. This development could facilitate the monetary policy transmission and support private sector growth. These benefits, however, will materialize only if the authorities work diligently to ensure that past weaknesses do not continue in post consolidated era. Efforts must therefore be stepped up to strengthen supervision and regulatory intervention.

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