

Banking Sector Reform In Nigeria: A Regulatory Imperative For A Sustainable Banking Industry

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Abstract

The focuses on banking reform in Nigeria: A regulatory imperative for a sustainable banking industry. It is the aim of this research to critically appraise the Nigerian banking sector against the back-drop of its strategic role in national economic development. The research design adopted in this study falls within the paradigm of an Ex-post facto design type. Data were collected mainly from secondary records and analyzed using ordinary least square method. 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 study also reveals that huge bad debts profile or poor asset quality has a negative contribution to bank performance and was statistically significant. Interest rate had a positive effect and a significant effect on bank performance. On the whole, the incorporated variables (BCAP, INTR) contributed positively to the growth of Nigerian banks, and the economy at large. Based on the findings above, it is concluded that effective banking sector reforms is a regulatory imperative for a sustainable banking industry in Nigeria. This study recommends periodic increase in the banks' capitalization especially since the hyper-inflationary rate in our economy is not showing any sign of abating. This will afford the banks the financial leverage to perform some of its strategic developmental roles especially in the real sector of the economy to bring about the much-desired national economic development. They study strongly recommends the strict implementation of the risk-focused and rule-based regulatory framework by the regulators. This it is believed will reduce the high incidence of huge bad debts profile of banks and consequently improve the assets quality of banks for better performance.

Keywords: Bank profit, Bank capitalization, Bank bad debts, Bank interest rate, Good corporate governance

1.0 INTRODUCTION

1.1 Background to the Study

Generally, the financial system is more than being just institutions that facilitate payments and extend credit. It encompasses all functions that direct real resources to their ultimate users. Financial institutions play the critical role of mobilizing savings from the surplus economic units and directing same to the deficit economic units for investment purposes. The financial system is the central nervous system of every economy, especially, a market economy. It comprises a number of separate but inter-related components all of which are essential to its effective and efficient functioning. The three main inter-related components include: Financial intermediaries (institutions) such as banks and insurance companies, which act as principal agents for assuming liabilities and acquiring claims (i.e accept deposits and make payments); the financial market in which financial assets are exchanged; and, the financial instruments which is necessary for the effective interaction of the intermediaries in the markets.

These three components are inextricably intertwined. Banks need the payment system infrastructures (instruments) to exchange claims securely; and markets to provide the avenue for their intermediation activities. The banking system therefore functions more effectively and efficiently only when these three components are present and indeed robust. It is therefore against this back-drop of the very critical and strategic role which the banking system play in national economic development that makes the issue of banking reforms imperative although the reforms most times have been reactive rather than proactive, especially in Nigeria and other developing economies.

Conceptually, economic reforms are undertaken to ensure that every part of the economy functions efficiently in order to achieve the macroeconomic goals of price stability, full employment, enhanced economic growth and development exemplified in high per capita income, improved standard of living, increased gross domestic product, and favourable balance of payment position. 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 becoming one of the 20 largest economies by the year 2020. The 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.

The four pillars of the Nigerian banking sector reforms include: To enhance 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. By the time these four cardinal reform objectives are attained, the Nigerian banking system would have been positioned to deliver superior results and compete favourably with its peers globally.

1.2 Statement of the Problem

The fact that the banking sector has contributed in no small measure to the development of the national economy through its financial intermediation and other developmental roles is undisputed. This is evidenced by the sprawling number of branches of deposit-taking banks which rose from 3,247 to 5,837 and 6,605 in 2003, 2010 and 2011 respectively. Also, employment in the sector rose from 50,836 in 2005 to 71,876 in 2010 (Sanusi, 2011; Sanusi 2012).

However, despite this seeming positive position, a clean bill of health could hardly be given to the banking sector as many of its constituent members (banks) were merely gasping for breath and in dire need of a life-line due to technical insolvency, illiquidity, inept management, weak capital base, poor corporate governance, poor assets quality, among other corporate malaise. Not surprising therefore, the hitherto bloated banking sector with 89 member-banks prior to the 2004 banking sector reforms, flattened to the present 24 member banks, the latter of which emerged from mergers and acquisitions during the recent banking sector reforms and consolidation exercise.

Also, to buttress further the uneasy calm in the banking sector, and the imperative for reforms, is the current high level of financial exclusion in the Nigerian financial system, and the low ratio of bank branch to total population. For instance, the ratio of bank branch to total population stood at 1:24,224 as at 2011. Equally, Nigeria's population in 2005 was financially excluded to as high as 65percent (Central Bank of Nigeria, 2005*)* and 46 percent in 2010, compared to South Africa, Kenya, and Botswana with 26.0 percent, 32.7and 33.0 percent financial exclusion rates, respectively (Sanusi, 2012).

The dwindling public confidence in the sector due to incessant banking failures, which situation was further accentuated by the recent global financial crises and the need to reposition and strengthen the banks to play their critical and strategic roles as well as attain global competitiveness, all make continuous banking reforms a 'sine qua non'.

1.3 Objectives of the study:

The general objective of the study is to critically appraise the Nigerian banking sector against the back-drop of its strategic role in national economic development. The specific objectives of the research include:

1. To identify the factors that incapacitate the Nigerian banks from performing efficiently;
2. To determine how these factors impact positively, or otherwise, on the growth, stability and sustainability of the banking sector;

3. To determine the relationship; if any, of these factors, with each other, or if they are mutually exclusive;
4. To enunciate the critical functions of the Nigerian banks, and find out to what extent the banks have fulfilled these strategic roles.

1.4 Research Questions

1. Does adequate capitalization contribute positively to efficient performance of Nigerian banks?
2. Does poor asset quality negatively affect performance of banks?
3. Does restricted interest rate regime have any negative nexus with effective performance of banks?

1.5 Research Hypotheses:

$H0_1$: Capitalization does not have a significant effect on bank performance.
$H0_2$: Asset quality does not have a significant effect on bank performance.
$H0_3$: Restricted interest rate does not have a significant effect on bank performance.

2.0 LITERATURE REVIEW AND THEORETICAL FRAMEWORK

2.1 Theoretical Underpinnings

The theoretical underpinning of this research is anchored on the nexus that subsist between financial intermediation and the financial system on the one hand and economic development (proxy by sustainable banking industry) on the other hand.

The origin of the Finance and Growth nexus is traced to the works of Schumpeter (1912) who argued that financial services are paramount in economic growth. According to Schumpeter, 'it takes credit for production to materialize and one can only be an entrepreneur by previously becoming a debtor…What (the entrepreneur) first wants is credit. Before he acquires any goods whatsoever, he requires purchasing power. He is the typical debtor in a capitalist society'. In this process, continued Schumpeter, 'the banker is the key agent. The banker is not so much primarily the middleman in the commodity purchasing power as a producer of this commodity- money. He is the ephod of the exchange economy' (Schumpeter 1912).

Literature on the role of financial intermediation and the financial system in economic development was rekindled by Mckinnon (1973) and Shaw (1973). In the enunciations of this duo, the functions of financial institutions in the savings-investment process were underscored as being an effective conduit for the mobilisation and allocation of capital by equilibrating the supply of loanable funds with the demand for investment funds, and the transformation and distribution of risks and maturities. They further enunciated the 'financial liberalization' theory which they argued that government restrictions on the banking system restrain the quality and quantum of investment.

Apart, there is a theoretical relationship between financial policy reforms and money market operations. We already know that the banking system falls directly within the circumference of the money market. Hence, in the traditional Keynesian theory, the impact of monetary policy can be transmitted to the rest of the economy through the monetary system. There is an assumption that in the presence of an efficient money market, interest rate elasticity brings about the allocation of funds among competing uses in an efficient way. The liberalization of interest rate coupled with price competitiveness in the banking system will stimulate the rate of savings in a given level of income and this will finally lead to the supply of domestic capital. (Ndekwu1991).

Arguing further in support of this, Pagano (1993) noted that financial intermediation has a positive effect on national economic growth, and that government intervention or restriction in the financial system has a negative effect on the equilibrium growth rate, also opined by King and Levine, (1973).

Suffice it to reiterate here that among the critical policies that influence the financial system is the deregulation of the interest rate. According to Terriba (1986), this often results in greater competition involving the use of both price and non-price variables. Equally, government restrictions in the financial sector has the possibility to slow down the pace of financial development and consequently, economic growth and development (Schumpeter 1934).

In another theorization, it is asserted that expanded financial intermediation between savers and investors under ideal situations, increases incentives to save as well as invest, and equally raises the average efficiency of investment. More so, it also raises real returns to savers while also lower real cost to investors by accommodating liquidity preferences (Shaw 1973). It could also lead to reducing risk through diversification, giving room to the benefit of economies of scale in lending, increasing operational efficiency and lowering information costs both to savers and lenders through specialization and division of labour (Nissanke 1991).

In the postulations of Adam and Mistry (1990), economic and social development can be accelerated by an efficient financial sector. This however requires a large population of savers and financial intermediaries as well as a wide range of financial instruments that will provide the necessary financial infrastructures that will warrant the heightened activities in the financial market.

However, Robinson (1952) argued that financial development follows growth, and articulated this causality by suggesting that where enterprise leads, finance follows. Robinson (1952), Keynes (1936) further argued that although growth may be constrained by credit creation in less developed countries, however, in more developed economies, finance is viewed as endogenous responding to demand requirements (Ujunwa and Salami 2010). Chick (1983) earlier opined following this frame of thought that the more developed a financial system is, the higher the likelihood of growth causing finance.

These controversies, according to Ujunwa and Salami (2010) motivated further empirical studies which brought out this causality relationship in three ways:

(a) Financial deepening stimulates economic growth
(b) Economic growth promotes the development of the financial system
(c) A circular relationship that financial development and economic growth stimulates each other (bi-directional relationship) (Arestis and Demetriaades 1993).

Again Ujunwa and Salami (2010) refer to the 'circular relationship' of Arestis and Demetriaades (1993) as the Reciprocal Relationship Theory. According to this duo, this theoretical view stresses the reciprocal relationship between financial development and economic growth. Enunciating further, they asserted that economic growth makes the development of financial intermediation profitable while the establishment of an efficient financial system permits faster economic growth. They also noted that by specializing in the pooling of funds, risk diversification, liquidity management, project evaluation and monetary policy, the financial system improves the efficiency of capital allocation and increases the productive capacity of the real sector. At the same time, the technological efficiency of the financial sector increases in size. Thus, both the financial sector, and the real sector seem to have a positive influence on each other, which is the crux of the Reciprocal Relationship Theory of Arestis and Demetriaades (1993) to the effect that financial development and economic growth positively influence each other in the process of development.

Fadare (2010:150-151) leaning towards the 'assumptions of the neo-classical economic theory' opined that 'the long-run rate of economic growth is dependent only on the rate of technological progress and the rate of labour force growth, and that capital is always subject to diminishing returns.' Thus, given a fixed stock of labour, the impact on output of the last unit of capital accumulated will always be less than the one before. Assuming for simplicity, no technological progress or labour force growth, diminishing returns implies that at some point, the amount of new capital produced is only just enough to make up for the amount of existing capital lost due to depreciation. (Solow 1956)

Fadare (2010) went further to assert that recent endogenous growth theory suggest that a strong banking sector promotes economic growth and holds that policy measures can have an impact on the long-run growth rate of an economy. Buttressing his point, he cited Schumpeter (1934) argument that the banking sector plays a crucial role in the market in channeling finance and investment to productive agents within the economy and thus acts as a catalyst of economic growth.

The main implication of this theory, according to Fadare (2010), is that banking policies which embrace openness, competition, change and innovation will promote economic growth. Conversely, policies which have the effect of restricting or slowing banking reforms by protecting or favoring particular industries or firms, are likely, over time, to experience unsustainable economic growth.

'Sustained economic growth-even if one narrowly defines it as sustained growth in income per person-is everywhere and always a process of continual transformation.' The economic progress that rich nations have enjoyed since the industrial revolution would not have been possible had people not undergone wrenching changes. Economies that cease to transform themselves are destined to fall off the path of economic growth. The countries that most deserve the title of 'developing' are not the poorest of the world, but the richest. To stay rich, countries….must engage in a never-ending process of economic development and transformation', concluded Fadare (2010).

2.2 Review of Empirical Literatures

2.2.1 Need for Reforms

Conceptually, economic reforms are undertaken to ensure that every part of the economy functions efficiently in order to ensure the achievement of macroeconomic goals of price stability, full employment, high economic growth and development manifested in high per capita income, improved standard of living, increased gross domestic products and favourable balance of payment position. Thus, banking reforms in Nigeria is an integral part of the country-wide reform programme undertaken to reposition the Nigeria economy to achieve the objective of becoming one of the 20 largest economies by the year 2020, making the system more effective and strengthening its growth potentials. Also, there is a need for periodic reforms in order to foster financial stability and confidence in the system (Sanusi 2012).

Reforms are predicated upon the need for re-orientation and re-positioning of existing status quo in order to attain an effective and efficient state (Ajayi 2005). Also, policy reforms mean a re-negotiation of contracts that entails direct government involvement in production towards more efficient market-oriented ones (Compos and Esfahani, 1996)

According to Okeke (2007), reforms are deliberate actions by the government to fast-track, jump-start and consolidate specified sectors of the economy to achieve desired objectives. For Ebong (2006), financial reforms are deliberate policy response to correct perceived or impending financial crises and subsequent failure. Reforms in the financial industry are aimed at addressing issues such as governance, risks management and operational ineffiencies. The vortex of most financial reforms is around firming up capitalization. Specifically, financial reforms are primarily up by the need to achieve the objectives of consolidation, competition and convergence in the financial architecture (Deccan 2004).

Financial reforms and attendant policy prescriptions are age long phenomena. They represent the various transformations and policy adjustments and overhaul that are directed at the art, practice and activities of financial institutions and market overtime in response to nominal need for operational improvement and growth of both the institutions and economy as a whole. They could be internal or external reflecting critical comprehensive amendments, re-structuring and/or additions to the existing body of laws, guidelines and policies (Chinedu Muogbalu 2004).

In Nigeria, the ability of the financial sub-sector to play its role has been periodically punctured by its vulnerability to systematic distress and macro-economic volatility and policy fine tuning inevitability (Kama 2006). Consequently, the financial reforms were focused on further liberalization of banking business, ensuring competition and safety of the system and proactively positioning their interrelation with the capital market to boost financial intermediation with the hope to serve as a catalyst to economic growth and development. In many emerging markets including Argentina, Brazil and Korea, financial reforms have also become prominent as banks strive to become more competitive and resilient to shocks as well as reposition their operations to cope with the challenges of the increasing globalised banking system (Oke, M O and Adeusi, S O. 2012).

Like other emerging economies, Nigeria has been involved in financial reforms on a regular basis aimed at responding to the challenges posed by some factors or developments such as systemic crisis, deregulation, globalization and technological innovations, or act proactively both to strengthen the financial system and prevent systemic problems as in the case in the current reforms (Imala 2005).

The reforms of the financial sector with particular reference to the Structural Adjustment Programme (SAP) of 1986, was aimed at increasing the efficiency of the financial sector, among others (Iganiga 2010). The financial sub-sector needs to be reformed in order to enhance its competitiveness and capacity to play its fundamental role of financial investment. Financial sector reforms are propelled by the need to deepen the financial sector and reposition it for growth to become integrated into the global financial architecture and evolve a banking sector that is consistent with regional integration requirements, savings mobilisation, and the requirement of international best practices (Nnanna Englana and Odoko 2004).

For Lemo, T (2005), the primary objective of the reforms was to guarantee an efficient and sound financial sector. He went on to state that the Nigerian financial reforms were designed to enable the banking industry develop the required resilience to support the economic development of the nation by efficiently performing its functions of financial intermediation, adding that a fundamental objective of the programme was to ensure the safety of depositors' money, position banks to play active developmental roles in the Nigerian economy and become major players in the sub-region, regional and global financial markets.

Referring to the 2004-2005 banking consolidation and reforms in Nigeria, Okonjo-Iweala and Osafo- Kwaako (2007:15) stated that "in order to strengthen the financial sector and improve availability of domestic credit to the private sector, a bank consolidation exercise was launched in mid 2004. The Central Bank of Nigeria requested all deposit-taking banks to raise their minimum capital base from about US$192 million by the end of 2005… In the process of meeting the new capital requirement, banks raised the equivalent of about $3 billion from domestic capital markets and attracted about $652 million Foreign Direct Investment (FDI) into the Nigerian banking sector."

According to Sanusi (2011) "banking reforms the world over is predicated on the need to increase risk management procedures and enhance corporate governance in order to strengthen and reposition the banking industry to enable it contribute effectively to the development of the real sector through its intermediation process…….a comprehensive process of substantially improving the regulatory and surveillance framework, fostering healthy competition in banking operations, ensuring an efficient framework for monetary management, expansion of savings mobilization base, enforcement of capital adequacy, promotion of investment and growth through market-based interest rates, increasing sophistication of the global financial products, and even the recent global financial crisis, all make the need for banking sector reforms a "sine qua non."

Commenting specifically on the 2004 banking reforms in Nigeria, Sanusi (2011) again explained that the thrust of the policy was to grow the banks and position them to play pivotal roles in driving development in other sectors of the economy, as well as induce improvements in their own operational efficiency…..the need to recapitalize the banks and ensuring minimum reliance on public sector for funds, the adoption of risk- focused and rule-based regulatory framework, the adoption of zero tolerance in regulatory framework in data/information rendition/reporting and infractions, the need for strict enforcement of corporate governance principles in banking, expeditious process for rendition of returns for banks and other financial institutions through e-FASS, revision and updating of dormant laws and ensuring greater transparency and accountability in the implementation of banking laws and regulations.

Further enunciating on the need for financial sector reforms, Sanusi (2011) again said it involves the movement from an initial situation of controlled interest rates, poorly-developed money and securities market and under-developed banking system, towards a situation of flexible interest rates, an expanded role for market forces in resource allocation, and a deepening of the money and capital markets.

Still, according to Sanusi (2011), good reforms will engender clear market entry and exit conditions, ensure the ability of banks to function according to market principles without state intervention in their decision-making, establish stronger banking oversight. Explaining further, he said that reforms in the domestic financial system will comprise three key policy actions, namely:

a) The removal of price restrictions: this refers to the ceilings on deposits interest rates and restrictions on lending interest rates.

b) The removal of quantity restrictions: this refers to the removal of direct credit allocation mechanisms, relaxation of reserve requirements and removal of restrictions on foreign currency deposits.

c) The removal of entry barriers in the financial system.

All these actions, according to Sanusi (2011), aim at promoting strong competition in the financial system which improves the efficiency of intermediation through the dismantling of monopolies in the financial system.

According to Abdullahi (2007), banking sector reforms and its sub-component, bank consolidation, has resulted from deliberate policy response to correct perceived or impending banking sector crises and subsequent failures. A banking crisis can be triggered by the preponderance of weak banks characterized by persistent illiquidity, insolvency, under capitalization, high level of non-performing loans and weak corporate governance, among others (Uchendu 2005).

Based on the above, Ajayi (2005) posited that banking reforms aimed at ensuring a healthy audience encompasses reforming the regulatory and supervisory framework, the safety net arrangements, crisis resolution mechanisms, shareholding structure, structure of the banking industry, and enthronement of good governance.

Added Abdullahi (2007), reform of the regulatory and supervisory framework is aimed at aligning the institutional framework governing the regulation and supervision of financial institution to the needs of a growing and complex financial system.

It involves issues of regulating independence, risk-focused and rule-based supervision while safety arrangements in reforms embrace the traditional lender of last resort role, deposit insurance arrangement which cater for prudential regulation and supervision. Reforms relating to corporate governance evolve in order to provide a well-established governance structure and oversight process. This is essential in order to engender proper evaluation, understanding, mitigation of risk as well as permit banks to strengthen the stability of their operations and instill accountability.

Odufu (2005) enumerated the under listed deficiencies which according to him were the rationales behind the banking reforms and bank consolidation in Nigeria:

a) **Low Capital Base:** The average capital base of Nigerian banks prior to consolidation was $10million which was very low compared to banks in other developing economies like Malaysia where the capital base of the smallest bank is $526million. In the same vein, the aggregate capitalization of the Nigerian banking system stood at #311billion ($24million) which is grossly low in relation to the size of the Nigerian economy, and in relation to the capital base of $688billion for a single banking group in France and $541billion for a bank in Germany.

b) **A Large Number of Small Banks with Relatively few Branches:** For instance, the 89 banks in Nigeria prior to the consolidation had a total of 3,382 branches only, whereas the 8 banks in South Korea had about 45,000 branches, as at the time.

c) **The Dominance of a few Banks:** The top 10 banks controlled about 50.8 percent of the aggregate assets, 51.7 percent of total deposit liabilities and 45 percent of the aggregate credit.

d) **Poor Rating of a Number of Banks:** Although on the average, the Nigerian banking system was rated satisfactory, a detailed analysis of the health of individual banks as at December 2004 revealed that no bank was rated very sound, only 10 were adjudged sound, 51 satisfactory, 16 marginal and 10 unsound.

e) **Weak Corporate Governance:** Inaccurate reporting and non-compliance with regulatory requirements, declining ethical behaviours and gross insider abuse, a situation which resulted in huge non-performing insider- related credits.

f) **Insolvency**: This was evidenced by negative capital adequacy ratio of many banks and completely eroded shareholders' funds occasioned by operating losses.

g) **Over-dependence on Public Sector Funds and Foreign Exchange Trading at a Neglect of Small and Medium Term Private Sector Savers:** It is obvious that the performance of the Nigerian banking system plays a marginal role in the development of the real sectors, therefore not in a position to meet the nation's ideal of a strong, competitive and reliable banking system which depositors can in turn trust, rely upon and the nation can depend upon to facilitate its growth and development. These therefore suggested the strong and urgent need for fundamental restructuring and refocusing.

Accordingly, confirmed Abdullahi (2007), the objectives of the banking sector reforms as announced by the Governor of Central Bank of Nigeria on July 6, 2004 were as follows:

a) Requirement that the minimum capitalization for banks should be N25billion with full compliance before end of December 2005.
b) Phased withdrawal of Public sector funds from banks, starting in July 2004.
c) Consolidation of banking institutions through mergers and acquisitions.
d) Adoption of a risk focused and rule-based regulatory framework.
e) Adoption of zero tolerance in the regulatory framework, especially in the area of data/information rendition/reporting. All returns by banks must now be signed by the managing directors of banks.
f) The automation process of rendition of returns by banks and other financial institutions through the electronic financial analysis and surveillance system (e-FASS).
g) Establishment of a hotline, confidential internet address (Governor@centralbank.org) for all Nigerians wishing to share any confidential information with the Governor of Central Bank of Nigeria on the operations of any bank or the financial system. Only the Governor has access to this address.
h) Strict enforcement of the contingency planning framework for systemic banking distress.
i) The establishment of an Asset Management Company as an important element of distress resolution.
j) Promotion of the enforcement of dormant laws, especially those relating to the vicarious liability of Boards of banks in cases of bank failures.
k) Revision and updating of relevant laws and drafting of new ones relating to the effective operations of the banking system.
l) Closer collaboration with the Economic and Financial Crimes Commission (EFCC) and the Financial Intelligence Unit (FIU) in the enforcement of the anti-money laundering and other economic crimes measures.
m) Rehabilitation and effective management of the mint to meet the security printing needs of Nigeria.

Ebong (2006) without much differing view with other empirical works observed that the Nigerian banking industry before the recent reforms was characterized by small-sized, marginal players with very high over-head costs which impacted negatively on the costs of intermediation. According to him, other challenges that the reform was designed to address included heavy reliance by banks on government patronage or public sector funds, weak corporate governance as well as unethical and unprofessional practices.

Enunciating further, Ebong (2006) noted that as at July 2004, public sector accounted for over 20 percent of aggregate deposits in the industry, adding that the dependency ratio of some banks was as high as 50 percent. This situation, he noted, was not a healthy development from the perspective of long-term planning and investment given the volatile nature of these deposits. He concluded that the inability of banks to plough these volatile public sector funds which constituted the larger chunk of their aggregate deposits into long term investment could therefore explain the non-correlation of the growth vortex witnessed in the banking sector with a corresponding decrease (against what would be expected) in economic activities in the real sector.

Explaining further the need and rationale for reforms in the Nigerian banking sector, Central Bank of Nigeria in its Banking Supervision Annual Report (2005:16) again puts it thus: 'Reforms….are usually introduced either in response to the challenges posed by factors and developments such as systemic crisis, deregulation, globalization and technological innovations, or as proactive measures both to strengthen the banking system and prevent systemic crisis, as is the case in the current reforms'.

Continuing the report, "A sound banking system must, inter alia, be able to facilitate economic development, provide a platform for sound monetary policy implementation as well as ensure price stability. However, the structure of the Nigerian banking system, prior to consolidation, inhibited its effective performance as it was characterized by a number of structural and operational inadequacies. The desire to remedy these inadequacies provided the *raison d'etre* and the impetus for the current reforms. The inadequacies included low capital base, large number of small banks with relatively few branches, poor rating of some of the Nigerian banks, weak corporate governance including inaccurate reporting and non-compliance with regulatory requirements, declining ethics and huge non-performing insider-related credits. Others included over-dependence on public sector deposits and foreign exchange trading as well as the neglect of small and medium scale enterprises. Thus handicapped, the Nigerian banking system was not in a position to meet the nation's ideal of a strong, competitive and stable banking system".

2.2.2 History and Nature of Banking Reforms in Nigeria

Banks promote economic growth primarily by mediating between surplus economic units and deficit economic units. In the process, banks facilitate capital formation and lubricate the process of production. This intermediation function is important because, in the absence of banks, savings would have been fragmented in small pockets, but by pooling together such savings banks are able to attain economies of scale with beneficial effects for their credit customers.

For banks to perform efficiently and discharge above core functions, it is imperative that the banks are viable and healthy and that the entire industry is stable and sound. It is against this background that the industry globally is heavily regulated, and most times either proactively or in response to certain industry inefficiencies, embarks on reforms to reposition the industry in order to meet desired objectives (Ebong 2006).

The first attempt at banking reforms in Nigeria which also doubled for the premier attempt to regulate the industry in the country was the enactment of the Banking Ordinance of 1952. According to Akpan in Mbat (2011), the high rate of (banking) failure and the need to maintain bank customers' confidence brought about the appointment of Mr. P. Paton by the colonial administration to enquire into the conduct and performance of banking business in Nigeria. An attempt to actualize Mr. Paton's report led to the enactment of the 1952 Banking Ordinance. The Ordinance stipulated the conditions for the establishment and operation of banks in Nigeria as against the hitherto unregulated scenario which precipitated the incessant banking failures.

2.2.2.1 The 1952 Banking Ordinance Era:

According to Adekanye (1986) this initial attempt at banking reforms stipulated the following conditions, among others.

(a) **Licensing**: All banks were to be licensed under the Ordinance, of course, after meeting other basic statutory requirements.

(b) **Capital and Reserve**: Under this dispensation, the capital of both indigenous and expatriate banks was fixed at \$50,000 and \$200,000 respectively.

(c) **Liquidity**: The Ordinance specified the liquidity and cash ratios which all banks had to hold. This was to ensure that all banks held adequate and reasonable liquidity to meet their clients' cash needs at any given time.

(d) **Limits to Lending Operations**: This was fixed to check unbridled, excess and unauthorized lending by banks so as to curtail the risk of unnecessary credit exposures and consequent loan losses.

2.2.2.2 The Era of Banking Regulation (1958-1985)

According to Akpan, in Mbat (2011), the government before this time could do only little to check the incessant malpractices in the banking system since there was no apex regulatory body. Hence, the setting up of Loynes Commission in 1958 led to the establishment of the Central Bank of Nigeria in 1959 to provide leadership for the banking system. Apart from the establishment of the apex bank which was a major characteristic of this era, other major features were the various amendments to the Banking Ordinance and regulations. These included the following:

(a) Under the 1958 Ordinance (Amended), while £12,500 was retained as paid-up capital for indigenous banks, it was raised for expatriate banks, profit transferable to reserve fund was also increased from 20 percent to 25 percent. Equally under this amendment, banks were restricted from owning real estate except where absolutely necessary.

(b) Under the 1961 Amendment, a receiver and liquidator was appointed for liquidation of banks whenever necessary.

(c) Under the 1962 Amendment, the minimum paid-up capital of existing indigenous banks was raised from £12,500 to £25,000 with seven years compliance period allowed the affected banks. Expatriate banks were to keep within Nigeria assets valued not less than £25,000. Banks were allowed to write-off losses before affecting the transfer of profits to reserve fund. The Central Bank of Nigeria was authorized to adopt some flexibility in applying the definition of liquidity when computing liquidity ratio. Banks were also now allowed, for expansionary reasons, to own real estates.

(d) The 1968 Companies Act provided that foreign banks operating in the country was required to be incorporated in Nigeria.

(e) The 1969 Banking Act provided that the adjusted capital requirement (minimum paid-up capital) of indigenous and expatriate banks be part of £300,000 and £750,000 respectively, for the first time, capital to deposit ratio of between 10 and 30 percent, and capital to loan ratio of between 25 and 33.3 percent.

The apex bank, under these amendments was empowered to monitor and vet advertisement by banks, authorize bank amalgamations, approve the opening or closure of new branches. Notable among the achievements of the banking reforms of this period included the promulgation of the Treasury Bill Ordinance of 1959, the apparent stability and consequent establishment of more commercial banks, the development of the money and capital markets, and the consequent establishment of the Lagos Stock Exchange in 1961(Ofanson, Aigbokhaevbolo and Enabulu 2010).

Enunciating further, Ofanson et al observe that this era also witnessed the promulgation of the Indigenization Decree of 1972 as later amended in 1977. According to the trio, this decree empowered Nigerians to demonstrate the ownership, management and control of all sectors of the indigenous economy. And pursuant to this policy therefore, the Federal Government acquired controlling interests in the then existing three expatriate banks viz: First Bank, Union Bank and United Bank for Africa, set up a Financial System Review Commission (the Pius Okigbo Commission) to explore means of strengthening the operational efficiency of the financial system, established Federal Government wholly owned banks in order to accelerate the pace of economic development - the Nigerian Agriculture and Cooperative Bank, the Nigerian Bank for Commerce and Industry, and the reconstitution of the Nigerian Building Society as the Federal Mortgage Bank of Nigeria, established State Governments owned banks, intensive public sector intervention by way of direct credit, selective credit controls imposed on the size of lending to private sector, sustained increase in the paid-up capital of new entrants and strict control of interest rates, identification of preferred sectors such as agriculture and manufacturing in terms of allocation of credit and interest rates, stricter foreign exchange control practices in 1982 (import licensing) supported by other trade restrictions.

The policy reforms of these period was characterized as 'financial repression' in the sense that it encapsulated widespread control and regulation of the financial sector apart from government direct participation in commercial and merchant banking. The traditional instruments used for the regulation of the financial activities included liquidity ratios, special deposits, cash reserve requirements, direct regulation of interest rates, stabilization securities, direct credit control and moral suasion (Ofanson, Aigbokhaevbolo and Enabulu 2010).

2.2.2.3 The Era of De-regulation (1986-1992)

One key feature of this era was the Structural Adjustment Programme (SAP) introduced in 1986 by the then Federal Government. The key objectives of SAP included achieving balance of payment viability in the short and medium terms, laying foundation for sustainable non-inflationary growth, and improving the efficiency of public and private sector. The policy measures adopted to achieve these objectives included the introduction of a second-tier foreign exchange market (SFEM), adoption of appropriate fiscal and monetary policies, dismantling of price controls, trade and exchange regulations, revision of tariff structures, elimination of petroleum subsidy, commercialization and privatization of public enterprises, and overhauling of administrative structures (Ofanson, Aigbokhaevbolo and Enabulu 2010).

The Structural Adjustment Programme macro-economic policy led to a major reform in the banking sector. It led to the liberalization or de-regulation of the banking sector. Among the major reform measures was the free or relaxed entry into the banking system such that as at 1992 there were 121 banks (66 commercial and 55 merchant banks) as against 28 banks which operated in 1985 (Akpan in Mbat 2011, and Ofanson et al 2010).

Other reform measures during this era had to do with strengthening the regulatory framework in the sector. This included the promulgation of the Central Bank of Nigeria Decree No 24 of 1991 (as amended) to give more teeth to Central Bank Nigeria to bite erring financial institutions and operators, Banks and Other Financial Institutions Decree (BOFID) No 25 of 1991 to effectively control the industry and ensure soundness. Nigeria Deposit Insurance Corporation (NDIC) Decree No 22 of 1988 to insure the deposit liabilities of licensed banks and to provide technical and financial assistance to banks by way of complementing the efforts of Central Bank of Nigeria in its regulatory and over sight functions of the industry. Two other major elements of the reform during this era was the bifurcation of the policy thrust into credit and interest rate (Ofanson, Aigbokhaevbolo and Enabulu 2010)

According to this trio, apart from strengthening the regulatory capacity of the regulators, other policy focus concerned interest rate regime and credit. For instance, continued Ofanson et al (2010) during this de-regulation period, all controls of interest rates were removed with Central Bank of Nigeria fixing its minimum rediscount rate (MRR) to indicate its desired direction of interest rates. Equally, the prudential regulations (Prudential Guidelines) were introduced in 1991 to check the quality of risk assets.

Another major element of the reforms of this era in the industry was the prominence which the 'Gap Thesis' gained. The gap thesis explain the financial exclusion which existed (and still exists though gradually being bridged) in the industry. Hence this brought about the introduction of the Peoples Banks and Community Banks to fill some noticeable gaps within the financial system (Akpan in Mbat 2011).

2.2.2.4 The Era of Banking Distress (1992-1995)

Financial distress is the inability of banks to function effectively and contribute meaningfully to economic development (Ebhodaghe 1995). A review of this period shows that the banking industry witnessed cut-throat competition with many, especially the new entrants, adopting all kinds of strategies to outwit each other, ostensibly because of the proliferation of banks. For instance, branch network of banks increased astronomically: merchant bank branches increased from 26 in 1985 to 144 in 1994 while commercial bank branches increased from 1,297 to 2,541 during the same period (Ofanson, Aigbokhaevbolo and Enabulu 2010).

Enunciating further, this trio said many banks created risks assets at incredibly low interest rate with or without collateral or adequate cover, some banks generate liabilities (deposits) at incredibly high interest rates, insider abuse manifested in several dimensions (granting of credit to dummy individuals and organisations, high rate of loan repayment default especially by government and government parastatals, managerial incompetence, unbridled rate of bank frauds and forgeries, coupled with the general economic down-turn and adverse macro-economic conditions, inadequate regulatory and supervisory capacity, all of which led to the distress of many banks during this period. For instance, in 1995 the distress reached an epidemic proportion when 55 units of the 120 banks were distressed. To curb this financial menace, the Failed Banks (Recovery of Debts) and Financial Malpractices Decree of 1994 was established to restore sanity and confidence in the system (Ofanson, et al 2010, and Akpan in Mbat 2011).

2.2.2.5 Universal Banking Era (1996-2004)

Akpan in Mbat (2011) describes universal banking as a system of banking in which there is no restriction for performing commercial or merchant banking activities by banks. He also calls this mix or multi-purpose banking which system was introduced into the Nigerian banking architecture during this period. This banking model also allowed banks to diversify into non-bank financial businesses (Sanusi 2012)

Some major reform measures of this period included

1. The adoption of universal banking policy in 2001,
2. Upward review of the minimum paid-up capital of banks to #2 billion in 1997
3. Total de-regulation of interest rates in October1996
4. The re-introduction of Dutch Auction System (DAS) in July 2002 to realign the naira exchange rate, enhance transparency and curb capital flight from the country
5. Central Bank of Nigeria also rolled out guidelines for electronic banking (e-banking) in line with global trends in 2004 and banks were encouraged to install Automated Teller Machines (ATMs) for cash withdrawals
6. Central Bank of Nigeria also introduced guidelines for the use of electronic money (e-money) products such as credit cards, debit cards, digital cash, etc, in line with international best practices. The promotion of automated payment system by Central Bank of Nigeria was in order to reduce delays in clearing of payment instruments, reduce cash transactions and enhance monetary policy transmission mechanism.
7. Real Time Gross Settlement (RTGS) system was implemented to eliminate risk in large value payments and increase efficiency of the payment system. Under this arrangements, seven banks that met Central Bank of Nigeria requirements were appointed as Settlement Banks to perform clearing and settlement functions for other banks and National Savings Certificate
8. Variations of Cash Reserve Requirements (CRR) and the Minimum Re-discount Rate (MRR) were introduced to enhance liquidity management (Ofanson, Aigbokhaevbolo and Enabulu 2010).

Regarding the nexus between banking reforms and national development challenges, the National Economic Empowerment and Development Strategy (NEEDS) which is the government reform agenda identified the problems confronting the financial sector to include the inability of the sector to play a catalytic role in the real sector, shallowness of the capital market, dependence of the banking system on public sector funds as a significant source of deposit and foreign exchange trading. Also, inaccurate information, non-harmonization of monetary and fiscal policies, non-prompt repayment of bank loans (National Planning Commission 2004).

According to Ofanson et al (2010), in order to tackle the above identified problems, and hinging the success of NEEDS in part on effective financial intermediation in the economy, the following measures were to be incorporated into the monetary policy framework and adopted by the regulatory authorities. These include: Comprehensive reform process aimed at substantially improving the financial infrastructure (legal codes, information system); restructuring, strengthening and rationalizing the regulatory and supervisory framework in the financial sector; addressing low capitalization and poor governance practices, collaborating with banks and other financial institutions to work out a structural financing plan that ensures less expensive and more accessible credit to the real sector, and directing government policy towards financial deepening (establishing linkages between rural and urban, banking and non-banking and formal and non-formal financial system) and financial product diversification which requires filling the missing gap for financial services for small and medium size enterprises with new services based on best practice technologies for cash flow financing and leasing.

2.2.2.6 The Banking Consolidation-Era (2004-to date)

As a further step towards strengthening the financial system and in particular the banking sector, the Central Bank of Nigeria on July 6th 2004, read out what sounded like a 'riot act' to banks in Nigeria at a Banker's Committee Meeting. These were new reform measures which came in a thirteen point agenda:

(i) Increase in the minimum paid-up capital of banks (unimpaired by loan losses) from #2 billion to #25 billion with a full compliance deadline of 31st December, 2005;
(ii) Phased withdrawal of public sector funds from banks, starting in July 2004;
(iii) Consolidation of banking institutions through mergers and acquisition;
(iv) Adoption of a risk-focus and rule-based regulatory framework;
(v) Adoption of zero-tolerance for non-compliance especially in the area of data/information rendition and reporting;
(vi) Automating the process for the rendition of returns by banks and other financial institutions through the enhanced electronic Financial Analysis and Surveillance System (e-FASS);
(vii) Establishment of a hot line, confidential internet address (Governorcenbank.org) for all those wishing to share any confidential information with the Governor of Central Bank on the operations of banks or the financial system;
(viii) Strict enforcement on the contingency planning framework for systemic bank distress;
(ix) Establishment of Assets Management Company as an important element of distress resolution;
(x) Promotion of the enforcement of dormant laws, especially those relating to the issuance of dud cheques and the laws relating to the vicarious liability of the Boards of Directors of banks in cases of bank failure;
(xi) Revision and updating of relevant laws, and drafting of new ones relating to effective operations of the banking system;
(xii) Closer collaboration with the Economic and Financial Crimes Commission(EFCC) in the establishment of Financial Intelligence Unit (FIU) and the enforcement of the anti-money laundering and other economic crime measures; and
(xiii) Rehabilitation and effective management of the Nigerian Security Printing and Minting Company (NSPMC) PLC, to meet the security printing needs of Nigeria, including the banking system which constitutes over 90 percent of the NSPMC's business (Ofanson, Aigbokhaevbolo and Enabulu 2010, Akpan in Mbat 2011, Abdullahi 2007, and Ebong 2006).

Corroborating the above stringent financial reform measures of the Central Bank of Nigeria, Ofanson et al, further opined that the operational performance of the banking industry was not in the best of state prior to the reforms. According to the trio, comparing Nigeria with advanced economies like USA where there had been over 700 cases of bank mergers since 1980, UK which followed similar trend with 203 mergers and acquisitions between 1997 and 1998, developing countries of Korea with only 8 banks after consolidation, and Malaysia that almost flattened her bank size from 80 to 20 banks within one year, both in terms of capitalization, total assets, global competitiveness and so on, Central Bank of Nigeria considered a major overhaul in the banking industry to make it globally competitive as well as help in the development of the domestic economy.

Furthermore, Table 1 below shows the rating of licensed banks by Central Bank of Nigeria using the capital adequacy, asset quality, management proficiency, earnings and liquidity (**CAMEL**) parameters.

TABLE 2.1
Rating of Nigerian Banks using the CAMEL Parameters

Category	2001	2002	2003	2004	2005	2006	2007	2008	2009
Sound	10	13	11	10	5	10	4	3	1
Satisfactory	63	54	53	51	47	12	17	18	11
Marginal	8	13	14	16	16	3	2	2	3
Unsound	9	14	9	10	18	-	1	1	9
Total	90	90	87	87	86	25	24	24	24

Sources:
1. Central Bank of Nigeria: Annual Report and Statement of Accounts (2009).
2. NDIC Annual Report (2007)

According to the above table, the number of banks in Nigeria reduced from its 2001 figure of 90 to 24 in 2009. Also, in 2007, 2008, 2009, the number of banks rated as “sound” was as low as 4, 3 and 1, bank respectively. Of course it must be noted that banks under the ‘satisfactory’, ‘marginal’ and ‘unsound’ categories offer no guarantee of meaningful contribution to the sector or even the overall economy.

2.2.3. Post Consolidation Structure of Nigerian Banks: Benefits and Challenges

2.2.3.1 Benefits of Banking Reforms in Nigeria

The Central Bank of Nigeria Banking Supervision Annual Report (2005:36) highlights the following post consolidation immediate and anticipated benefits of the reforms to the Nigerian banking sector, and by implication the overall national economy:

On a general note, as at 31st December, 2005, 25 out of 89 banks emerged from the consolidation exercise. The 25 banks were the only ones that could pass the Central Bank of Nigeria ‘litmus test’, i.e, meeting the stringent conditions under the reforms. This number later further reduced to 24. This also meant these were the only banks that could be issued a clean bill of health by the apex bank, and worthy to enjoy the confidence of the Nigerian banking public. The positive implications of this are indeed manifold enormous. Accordingly, the specific benefits of the 2004 banking sector reforms comprise, among others, the following:

a) Increase in Bank Capitalization

At the level of the individual banks, each emerging bank increased its paid-up capital un-impaired by loan losses from #2billion to a minimum of #25billion, mandatorily. Consequently, at the end of the consolidation exercise, the total capitalization of the 25 successful banks came to #755billionas against #324billion before the commencement of the 2004 banking sector reforms. The enormous positive implications that this new capital structure portend for the banking industry in its financial intermediation process can only be imagined than described: superior returns on savings, availability of bank funds for higher ticket transactions, possible spread of risks and investments, employment creation and wealth generation, the much desired financial inclusiveness, among numerous other benefits. Also, the now increased capital capacity of banks by implication expands the banks’ single obligo limits thereby enabling them also expand their lending scope to sectors which they could not, hitherto, such as the real sector of the economy. Finally, the injection of additional capital into the sector would address the rampant cases of weak capital base and its attendant crises of confidence in the sector, but now enables banks to play more effective developmental roles in the economy.

b) Dilution of Ownership of Banks

Most banks that were hitherto family businesses with parochial controls now had to open their boardrooms to other non-family members to invest. This greatly improved on the corporate governance of such banks and by implication their efficiency.

c) Reduction of Public Sector Deposits or Government Funds to a Maximum 10 percent in Banks

This now made banks to sit up and fully explore the financial market for the benefit of all concerned- savers, investors, operators, regulators, etc.

d) Arising from the Reforms, Virtually all the Banks are now Quoted on the Nigerian Stock Exchange

This has also resulted in increased and expanded supervisory and regulatory oversight of the operations of these banks by the Securities and Exchange Commission (SEC) and the Nigerian Stock Exchange (NSE), in addition to regulatory oversight by other regulatory agencies such as Central Bank of Nigeria and the Nigeria Deposit Insurance Corporation.

e) Deepened Activities of the Capital Market

The quoting of the banks on the floor of the Nigerian Stock Exchange has deepened the activities and increased the fluidity in terms of the liquidity of the capital market through the activities in the stocks and shares of banks. This has increased the operational capacity and propensity of our capital market making it globally competitive.

f) Global Ratings and Competitiveness

The post consolidation banks in the country will become more globally compliant in terms of international ratings and competitiveness, and able to attract foreign financial assistance in form of access to credit lines and foreign direct investments (FDIs). This will ultimately lead to a robust local economy with the attendant benefits of overall optimization of factors of production and the resultant improved standard of living of the citizenry.

2.2.3.2 Post Consolidation Challenges of Banking Reforms in Nigeria

Much as the reforms would bring about the above enumerated benefits, among others, there are also attendant challenges of the exercise, even though the challenges are not enough to obliterate the benefits.

According to Central Bank of Nigeria Banking Supervision Annual Report (2005), the banking sector will face the challenges of the sustenance of the growth in the system, compliance with international standards of operations, effects of exposure of our volatile financial institutions to a sophisticated globalised business environment and the use of new devices by money launderers which are likely to manifest in the post consolidation era.

The post consolidation era, continued the Central Bank Nigeria report, would also witness the challenge of integrating the merging banks' operations, customers, products and service offerings. The integration process will also involve careful staff selection and synchronization of operational procedures.

Still, the operators have to contend with the alignment of goals, policies, management of different corporate cultures, staff turnover and poaching, and increased competition, among others.

Continuing the report, another great challenge in the post consolidation era would be the issue of corporate governance where the boards and top management of banks will have to exhibit the necessary discipline and oversight in the discharge of their fiduciary functions. In order to ensure this, Central Bank of Nigeria has issued an exposure draft of the corporate governance code that would guarantee best practices in the boards and top management of the banks, the report also hinted.

Another major challenge for the banks is the issue of capacity building to cope with the management of the increase in their risk profiles. This challenge is equally applicable to the regulators who will also be required to shore up their technical knowhow and overall capacity to cope with the changes which the reforms have thrown up, especially as emphasis is now shifted to risk-based approach to supervision.

Still continuing the Central Bank of Nigeria annual report (2005), the ability to detect and prevent the misuse of wire transfer system by money launderers, terrorists and other related criminals poses a serious challenge to the banking system. The report added that while these challenges will further task the regulatory capabilities in the post consolidation era, individual banks are expected to ensure strict compliance with the "Know Your Customer (KYC)" principles and other anti-money laundering measures already in place.

Worthy of specific mention also is the challenge of lay-offs, down-sizing and or rationalization of staff which the resultant mergers and acquisitions would very likely throw up in the banking sector arising from the banking sector consolidation.

Again, the report highlighted the strong need for a consolidated supervision framework in the industry arising from the recent banking sector reforms. The Central Bank of Nigeria report (2005) observed that the reforms led to the emergence of financial conglomerates and 'mega banks' covering money, capital and insurance markets. Consolidated supervision becomes desirable in group relationships because there may be risks to a regulated firm as a result of its membership of a group.

The primary objective of consolidated supervision is to evaluate the strength of an entire group taking into account all the risks (including those arising from the operations of related entities) that may affect the supervised entity in the group. The main rationale for consolidated supervision is that it provides information on the integrity and adequacy of the capital of the firm and on concentration of risks across different members of the group. Such risks as:

a) The risks taken by other members of the group which may undermine the group as a whole;
b) The financial risks caused by financial linkages with other members of the group (for example, intra-group lending or intra-group guarantees).
c) The reputation risks arising from losses or problems of the activities of other group members.

Concluding the Central Bank of Nigeria Annual Report (2005), another major challenge to the financial regulators is ensuring that banks are more transparent especially in the rendition of timely and accurate returns. The adoption and strict implementation by the Central Bank of the Zero Tolerance policy for incomplete, inaccurate returns and misreporting, as well as the implementation of the newly introduced electronic financial analysis surveillance system (e-FASS) would, however, go a long way in getting banks live up to expectation in this regard.

The report finally noted that despite these teething challenges, a close collaboration and cooperation between the banks and the regulators will help consolidate the gains of the reforms and overcome whatever challenges that may ensue.

2.2.4 Interest Rate Management and its Effects on the Banking Sector and the Macro-economy

2.2.4.1 The Role of Interest Rates

The primary role of interest rates is to help in the mobilisation of financial resources and to ensure the efficient utilization of such resources in the promotion of economic growth and development. Interest rates affect the level of consumption on the one hand and the level of investments, on the other. They are crucial in the financial intermediation, which involves transferring funds from surplus units in the economy to deficit units. In general, interest rates are useful in gauging financial market conditions and they are a major tool of monetary policy. Usually, when the structure of interest rates is changed, the resulting relative rates of return will induce shifts in the asset portfolio of both the banks and non-bank public. Hence the direction and magnitude of changes in the market rates are of primary importance to economic agents and policy makers, (CBN Briefs Series NO 2008-2009/04).

2.2.4.2. The Structure of Interest Rates

There are various rates of interest in the financial system. These are generally classified into two: deposit and lending rates. Deposit rates are paid on savings and time deposits of different maturities. Examples of such rates include one-month and fixed deposit rates. Lending rates are interest rates charged on loans to customers, and they vary according to perceived risks, the duration of the loans, the cost of loanable funds, lending margins, etc.

The main lending rates in the financial sector are prime, maximum and inter-bank rates. The prime lending rate is the interest rate charged on customer loans considered to be least risky and is usually the minimum lending rate for an institution. The maximum lending rate is the rate charged to customers with relatively high credit risks. The inter-bank rate is the rate that applies to transactions between banks involving mainly over-night and other short-term funds.

Other rates of interest in the financial system include the Treasury bill, inter-bank and minimum rediscount rates. The Treasury bill rate is the discount offered by government to savers who purchase treasury bills issued to cover its short-term borrowing needs. Similarly, the inter-bank rate is the rate paid in the inter-bank market when banks borrow from and lend to one another in order to adjust their liquidity positions. The minimum rediscount rate (MRR) refers to the amount that is charged by a central bank for lending to banks in performance of its function of lender of last resort.

Due however to its non-responsiveness to the developments in the money market, the MRR was replaced in December 2006 with the monetary policy rate (MPR), which defines the central point of a standing facility introduced to steer market interest rates. This involve an interest rate corridor with the upper band representing the Central Bank Nigeria lending rate to the deposit money banks (DMBs) overnight under the standing lending facility, while the lower band represents the deposit rate at which the Central Bank of N accepts deposits from the deposit money banks (DMBs) overnight under the standing deposit facility (CBN Briefs Series NO 2008-2009/04).

2.2.4.3 Factors Influencing Interest Rates

A number of factors influence the behaviour of interest rates in an economy. Prominent among these are savings, investment, inflation, government spending, monetary policy, taxation, etc. It is generally agreed that the price of any factor of production (land, labour, and capital) in a market system is determined by the forces of demand and supply. Savings constitute the major source (supply) of credit while investment represents the main demand for credit. Consequently, the amount of savings by individuals, businesses and government partly determines the level of interest rate. For instance, a decrease in the accumulation of loanable funds/savings is likely to exert an upward pressure on interest rates just as a reverse situation would tend to have a moderating effect.

Inflation is another factor which affects the level of interest rates. The nominal interest rate is a function of the real interest rate and the inflationary expectation. Expectations about inflation influence interest rate movements even though the demand and supply for capital remains constant.

Government activities influence interest rates on both the demand and supply sides of the credit market. When government actions result in the supply, it may increase the level of money stock which is most likely to influence a downward movement in interest rates. The reverse is true, when government demands credit.

Monetary policy through expansion and contractions in money stock can influence interest rates. For instance, if money supply is increased with the demand of money remaining unchanged, short-term interest rates may decline. Restrictive monetary policy may lead to a rise in interest rates while an expansionary policy may result in lower interest rates.

Also, income tax consideration has some influence on market interest rates. For example, when borrowers are allowed to deduct interest payments in deriving taxable income, the after tax cost of funds would be lower than the prescribed rates. The effect is that the demand for credit is larger than would have been the case in the absence of tax provisions and thus lead to increase in the short-term interest rates. On the other hand, since lenders are expected to include interest received as taxable income, the after-tax return would be less than the contract rate, reducing, as it were, the supply of loanable funds which would also lead to a rise in short-term interest rates. In general, the effect of taxes is to raise the market rate of interest.

Finally, the term of maturity of financial assets also affects interest rates. Long-term funds tend to attract higher interest rates than short-term funds because of future uncertainties. This is however without prejudice to the concept of 'an inverse yield curve' which explains a situation in which long-term securities may attract lower rates of returns than short-term ones. Such a situation may arise when there is acute shortage of funds in the financial system or when the rate of inflation is rising. Hence, related to the term of maturity is the yield curve, which indicates the relationship between the rate and time of maturity of different financial assets.

Other factors that may affect interest rates include: speculation, expected changes in exchange rates, and differentials between domestic and international rates (CBN briefs series NO. 2008-2009/04).

2.2.4.4. Effects of Interest Rates Changes on the Macro-economy

Interest rate movement can have significant effects on the macro-economy. The banking sector being not just an integral part but the nerve centre of the economy will of course be the most vulnerable to such changes. The effects of an increase in interest rate, other things being equal, will lead to a decline in aggregate demand partly because this will encourage savings to earn higher returns. On the other hand, a situation where the interest payments form a significant portion of the production costs, increased interest rates could result in reduced capital spending, investment, output and employment.

A rise in interest rate could result in the deterioration of the current account position of the balance of payments arising from increased capital inflows from abroad, pressure on the domestic currency and reduced demand for locally produced goods and services. Both output and employment in the domestic economy would be adversely affected (CBN briefs series NO. 2008-2009/04).

2.2.4.5 Management of Interest Rates in Nigeria and its Effects on the Banking Sector

The management of interest rates involves two approaches, namely, the administrative fixing (or restricted interest rate regime), and free market determination of the interest rates.

a) Management Prior to 1986

Prior to the Structural Adjustment Programme of 1986, the level and structure of interest rate were administratively determined by the Central Bank of Nigeria. Both deposit and lending rates were fixed by the apex bank based on policy decisions. At that time the major reasons for administering interest rates were the desire to obtain the social optimum in resource allocation, promote growth of the financial market, combat inflation and lessen the burden of internal debt servicing on the government.

In implementing credit policy, the sectors of the economy were classified into three categories, namely, preferred, less preferred and others. The preferred sector included agriculture, manufacturing, and residential housing, while the less preferred sector consisted of import and general commerce. The group of "others" comprised credit and finance institutions, government, and 'personal and professional' groups.

Such classification enabled government to direct financial resources at concessionary interest rates to sectors considered as priority areas. The concessionary rates were typically below the minimum rediscount rate which was itself quite low, averaging about 7.25 percent between 1978 and 1985. The prevailing rates were unable to keep pace with inflation, resulting in negative interest rates. Moreover the demand for credit soon exceeded savings and a large portion of government borrowing had to be financed by Central Bank. Other implication of the low interest rate policy was that even the "preferred sectors" could not access fund partly because financial institutions were unable to raise sufficient loanable funds through savings or from the money market at the favoured concessionary rates of interest. A case in point was the directive given to banks to lend to agricultural sector at 7.0 percent in 1984 when average savings deposit rate was 9.5 percent. Overall, the low interest rate regime resulted in inefficient production and excessive demand for credit (CBN briefs series NO. 2008-2009/04).

b) Management of Interest Rates Since 1986

According to the CBN Briefs (2008-2009/04), within the general framework of regulating the economy to enhance competition and efficient allocation of resources, the Central Bank of Nigeria introduced a market-based interest rate policy in August 1987. While it generally agreed that low interest rates did not encourage savings, it was feared that high interest rates, which were likely to accompany deregulation, might stifle investment. The deregulation of interest rates allowed banks to determine the deposit and lending rates according to market conditions through negotiations with customers. However, the minimum rediscount rate which influences other rates continued to be determined by the Central Bank in line with changes in overall economic conditions. The MRR which was 15 percent in August 1987 was reduced to 12.75 percent in December 1987 with the objective of stimulating investment and growth in the economy. During the same period, the savings deposit rate of commercial banks on the average was 11.5 percent and the interest rate paid by merchant banks on 90days funds was 15.0 percent.

The prime lending rates of commercial and merchant banks were on the average 18.0 and 20.5 percent respectively, while their corresponding maximum lending rates were 19.2 and 22.0 percent, respectively. Following the need to moderate monetary expansion in 1989, the MRR was raised to 13.25 percent. It was observed that there were wide disparities in the interest rates of various banks. The deposit rates offered by the newly licensed banks were higher than those of the older and established banks. However, the lending rates charged by both categories of banks were a lot closer. It was also observed that while banks were willing to raise their lending rates, deposit rates were deliberately kept low resulting in a wide spread between lending and deposit rates. In a bid to remove distortions in the structure of interest rates, the Central Bank of Nigeria reached an accord with the banks towards the end of 1989 on margins between their deposit and lending rates. Consequently, the spread between the savings deposit and lending rates was fixed at 7.0 percent. Also, the margin between the prime and maximum lending rates for each bank was fixed at 4.0 percent, while inter-bank rates were to be at least 1.0 percent below the prime lending rate (CBN briefs NO. 2008-2009/04).

Above renditions clearly explains the effects of restricted interest rate regime on the banking sector and ultimately, the entire economy.

3.0 RESEARCH METHODOLOGY

The research design adopted in this study falls within the paradigm of an Ex-post facto design type. The reason is that the events observed, in this case banking reforms in Nigeria, have already taken place. Hence, the study is intended to review and evaluate the reforms with the view to ascertaining their effectiveness in meeting desired objectives, and making possible recommendations for improvement to make the Nigerian banking industry globally competitive and relevant. The population of this study comprises the 89 conventional banks that constituted the Nigerian banking system prior to the 2004 banking sector reforms. Also, since it is not possible due to paucity of time to review all the reforms that have taken place in the Nigerian banking system, the study is restricted to the 2004 banking reforms and consolidation exercise.

Multiple Regression Analysis is used in this study to measure the effect of changes in the Dependent Variable (BPROF) as a result of changes in the Independent Variables (BCAP, BBDT, BINTR, GCGOV, BSRFR).

BPROF= f(BPROF=BCAP, BBDT, BINTR, GCGOV, BRSFR)

Where:

BPROF = Bank profit
BCAP = Bank capitalization

BBDT = Bank bad debts
BINTR = Bank interest rate
GCGOV = Good corporate governance
BSRFR = Bank regulatory and supervisory framework

Therefore, Effective Bank Performance (Y), proxy by Bank Profit (BPROF), is dependent on or a function of adequate Capitalization of the banks (BCAP), good Corporate Governance (GCGOV), good assets quality exemplified in low Bank Bad Debts ratio (BBDT), up and doing Regulatory and Supervisory framework and agencies (BRSFR), and finally, market-driven Interest Rate regime (BINTR).

4.1 Data Presentation

TABLE 4.1
Nigeria's Macroeconomic Variables

YEAR	BPROF	BCAP	BDT	INTR
1986	159190.8	1298.7	14808.3	9.5
1987	226162.8	1545.1	16525.7	14
1988	295141.8	1932.4	19461.1	14.5
1989	385141.8	2692.4	21334	16.4
1990	458777.8	3712.7	25200.3	18.8
1991	584375	4300.8	29891.3	14.29
1992	694615	3769.3	38834.2	16.1
1993	1070019	4420.2	42580.2	16.66
1994	1568829	5447.7	84745.5	13.5
1995	2247040	6530.6	122833.7	12.61
1996	2766880	8730.5	153158.4	11.69
1997	3047856	17666.5	214762.4	4.8
1998	3753278	25634.8	244656.2	5.49
1999	4515117	31453.3	311670.2	5.33
2000	5258192	44205.7	429341.8	5.29
2001	8009743	75170.6	714473.2	5.49
2002	6664949	101276.5	805309.5	4.15
2003	7472932	122735.9	1012365	4.11
2004	7570502	142324.5	1278645	4.19

2005	8780050	172321.5	1584519	3.83
2006	10409066	170494.9	2096270	3.14
2007	10981893	152954.1	3861541	3.55
2008	1124356	210936.3	6051684	2.84
2009	1111269	219510	7385759	2.68
2010	1117812	249714.6	6359621	1.49
2011	1114540	220208.2	6098514	1.41

Source: Central Bank of Nigeria, 2011

4.2 Data analysis and interpretation

The regression results of effective Banking Sector Reforms in Nigeria

TABLE 4.2
Regression Results

Dependent Variable: LBPROF

Variable	Coefficient	Std. error	t-stat	Prob
LBCAP	1.730415	0.401542	4.309424	0.3944
LDBT	-0.668762	0.385053	-1.736804	0.0003
LINTR	1.282321	0.546196	2.347733	0.0964
C	3.030976	3.489546	0.868587	0.0283

Significant at one percent level, significant at five percent level, significant at ten percent level

$R^2 = 0.699886$; R^2 (adj) = 0.658961; SER = 0.747729; F-STAT = 17.10183; DW = 0.659153

The "goodness of fit" of the model as indicated by the adjusted R-Squared, shows a good fit of the model. An adjusted R-Squared value of 0.699886 or 70 percent indicated that the model fits the data well; the total variation in the observed behaviour of Bank profitability (BPROF), used as a measure of banks performance, is jointly explained by variation in Bank Capital, Bad Debts and interest rate up to 70 percent . The remaining 30 percent is accounted for the stochastic error term. To test for the overall significance of the model, the ANOVA on the f-statistic is used.

To test for the individual statistical significance of the parameters, the t-statistic of the respective variables were considered. Considering their probability values, which were automatically generated during the computation process by the computer software, the constant term is insignificant, Bank Capital is significant at one percent Bad debt is significant at ten percent while Interest Rate is significant at five percent. The a priori expectations about the signs of the parameter estimates are confirmation to economic theory. Here, both Bank Capitalization and Interest Rate entered the model with a positive sign. By interpretation, a one percent increase in BCAP to the economy will increase growth by the amount of the coefficient of BCAP i.e 1.73 percent, all things being equal. For interest rate, an increase in interest rate will increase banks performance by 1.28 percent, ceteris paribus.

As an addendum, Bad debts had a negative contribution to banks performance and appeared with -0.66% meaning that a one percent decrease will lead to a decrease in banks performance.

The robustness of the BCAP and INTR variables in the growth equation indicates their performance on growth of the Banking industry, given the data set.

One also tests for autocorrelation in the residual. Here, the reported DW Statistic is used to compare with the table DW values. The decision rule for "no autocorrelation" in the residuals of the model is that the calculated DW Value must lie between the du and 4-du (ie du <dw<4-du) since $K^1=3$ variable and n=26 years, then reading up from the DW table, it is shown that du=1.65 and 4-du=2.35; dl=1.14 and 4-dl=2.86

Since the calculated DW (i.e. 0.659153) lies outside du and 4-du (ie it lies outside 1.65 and 2.35), then one could report that the model is not free from serial correlation of residuals. Therefore the estimates should be taken with caution.

4.3 Discussion of Findings

Hypothesis one was tested and the result showed that there is a significant relationship between bank capitalization and bank profitability. The hypothesis was tested using the Multi Regression Analysis, at one percent level of significance. Also, since the Decision Rule in the Test of Hypotheses states that if t-calculated is greater than t-tabulated, the alternative hypothesis should be accepted, and vice versa; hypotheses one revealed a t-calculated value of 4.309 and t-tabulated value of 2.807, the alternative hypothesis was accepted and null hypothesis rejected. This implies that there is a significant relationship between bank capitalization and bank profitability. This finding is corroborated by Fadare (2010) and Odufu (2005) who asserted that strong banking sector exemplified by adequate capitalization promotes profitability, growth and sustainability of banks, and indeed the economy.

In hypothesis two, using the Multi Regression Analysis, at ten percent level of significance, and at a t-calculated value of 1.736 and t-tabulated value of 1.714, following the Decision Rule, the findings revealed that there is a significant relationship between asset quality and bank performance. The alternative hypothesis was therefore accepted and the null hypothesis rejected. This is in line with the findings of Ebong (2006) who asserted that prior to the banking sector reforms of 2004, most Nigerian Banks were characterized by poor asset quality occasioned by unethical and unprofessional practices due to weak corporate governance.

In hypothesis three, using the Multi Regression Analysis, the findings showed that interest rate was significant at five percent level, t-calculated value of 2.348 and t-tabulated value of 2.069. Based on the Decision Rule therefore, the findings showed that there is a significant relationship between interest rate and bank profitability, growth and sustainability. Accordingly, the alternative hypothesis was accepted while the null hypothesis rejected. This finding is supported by the works of Sanusi (2011) who asserted that "banking sector reforms the world over is predicated on the need to ensuring the expansion of savings mobilization base, promotion of investment and growth through market-based interest rate. This could be described as being the movement from an initial situation of controlled interest rate towards a situation of flexible interest rate.

Terriba (1986) also corroborate this finding when he asserted that among the critical policies that influence the financial system is the deregulation of the interest rate which according to him results in greater and healthier competition among banks, ultimately resulting in growth. This is not far from an earlier assertion by Schumpeter (1934) who posited that government restrictions in the financial sector has the possibility to slow down the pace of financial development and consequently economic growth and development

5.0 CONCLUSION/RECOMMENDATIONS

Based on the findings above, it is concluded that effective banking sector reforms is a regulatory imperative for a sustainable banking industry in Nigeria. The study brought to the fore, those variables which could be termed as growth-induced variables such as adequate capitalization of banks, market-driven interest rates, and such non-growth variables as poor assets quality exemplified by huge bad debts profile of banks, poor corporate governance as well as weak regulatory and supervisory framework. From the results of these findings, the banking regulators will be better equipped to direct their regulatory searchlight towards enhancing and strengthening regulations that will foster the growth - induce variables of banks and overturning the non-growth variables. The end result of this will be not just profitable banking organization, but much more, a sustainable banking industry that will be the pride of all stakeholders.

The following recommendations are made based on the findings and conclusions:

1. This study recommends periodic increase in the banks' capitalization especially since the hyper-inflationary rate in our economy is not showing any sign of abating. This will afford the banks the financial leverage to perform some of its strategic developmental roles especially in the real sector of the economy to bring about the much-desired national economic development.
2. One of the findings which this study revealed was the dearth of capacity for operators as well as regulators and supervisor in the post consolidation era. Much as the operators need to develop adequate and appropriate capacity to cope with the post consolidation challenges, regulators and supervisors themselves need also to shore up their capacity to meet the challenges of supervising mega banks which they were not exposed to, before.
3. They study strongly recommends the strict implementation of the risk-focused and rule-based regulatory framework by the regulators. This it is believed will reduce the high incidence of huge bad debts profile of banks and consequently improve the assets quality of banks for better performance.
4. Finally, there should be strict enforcement of corporate governance principles to reduce the increasing incidence of insider abuse by executive management and directors of banks.

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