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BANK CAPITALIZATION REFORMS AND FINANCIAL PERFORMANCE OF NIGERIAN DEPOSIT MONEY BANKS: 2004-2020

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ABSTRACT

The study examined the effect of bank capitalization reforms on financial performance of Nigeria deposit money banks. Ex Post Facto research design was adopted for the study. Data were extracted from audited annual accounts and CBN statistical bulletin from 2004 to 2020. Regression analysis was used to analyze the data and tested the hypothesis. The findings revealed that minimum capital requirements have a significant effect on the financial performance of deposit money banks in Nigeria. It was recommended among others that Deposit money bank should invest in liquid short term guilt edge financial asset such as treasury bills to ensure adequate liquidity.

***Keywords**: Minimum capital requirements, Total assets and banks profitability*

1. INTRODUCTION

The world can be considered as a global village due to technological advancement and its impact on the economy. Banking systems' in any given economy in the world carries out vital functions that facilitate growth and development of the economy, especially in market economies (Okotori & Ayunku, 2020). In a developing country like Nigeria, banks play important and sensitive roles hence their performance directly affects the growth, efficiency and stability of the economy (Oladejo & Oladipupo, 2011). But for more than two decades after independence, the Nigeria financial system was repressed, as evidenced by ceiling on interest rates and credits expansion, selective credit policies, high reserve requirement, and restriction on entry into the banking industry. It is a fact that, macroeconomic variables fluctuate due to external shocks to which no country seem to claim immunity from (Gajic, 2012; Okotori, 2019).

Reforms in the Nigerian banking sector have always been aimed at repositioning and deepening the financial system in order to ensure the desired growth of the Nigerian economy and favorable competition at the global financial arena in accordance with established national, regional and international standards and best practices (Offiong, Riman , James, Okon & Ogar, 2020). According to Ajayi (2005) as cited in Adegbaju and Olokoyo (2008), the main thrust of reforming the banking sector is centered on addressing operational inefficiencies, poor governance and poor risk management that sought to hinder the health and soundness of the banking system at large, while the Nigerian banking industry has undergone a series of recapitalization policies aimed at strengthening the sector and ensuring better participation in the economy.

The reforms according to Oluyemi (2006) had in turn prompted a regulatory induced restructuring in the form of consolidation that would engender the alignment of banks group in determined moves expected to translate into the merge of some banks and the acquisition of others. The emergence of mega banks no doubt would expose banks to new challenges, which if not properly addressed could adversely affect the operation of the payment system and its credibility. The banking sector reforms have been acclaimed to be necessary but the question is whether they yield anticipation result. Soludo's reforms started soon after he was appointed Governor of the central bank of Nigeria in May 2004, when he moved to consolidate the country's creaking banking system. The banking sector was an obvious place to begin his reforms, Sanusi Lamido, another former CBN Governor equally made a major impact towards creating a sustainable banking system.

The Nigeria deposit money banks have undergone rapid changes over the years in terms of the number of institutions, ownership structure, as well as operations. These changes have been influenced by challenges posed by deregulation of the financial sector, globalization of operations, technological innovations and adoption of supervisory and prudential requirements that conform to international standard. The rate of bank failures in Nigeria has constituted a problem because it has risen sharply in recent years, confidence and credibility were gradually and steadily being eroded and the picture had never been more gloomy and the impending consequences more alarming. The fundamental problems of the unsound banks have been identified to include persistent illiquidity, poor assets quality and unprofitable operations including weak capital base. It is against this backdrops that this study evaluates the effect of banking reforms on financial performance of Nigerian deposit money banks, this time the country is witnessing obvious economic recession which the government itself acknowledged.

Unfortunately, the hopes and prospects of the recapitalized banking system in Nigeria became short lived as a result of these interdependent factors such as macroeconomic instability resulting from the sudden influx of huge inflow of capital funds, poor corporate governance stance in these banks, lack of transparency in the disclosure of the banks' financial standings, the continuous wide gaps in financial regulations and laws, unstructured management processes and governance by the apex bank, and the weak operating environment for banks. On this note, this study evaluates the effect of minimum capital requirements on profit before tax of Nigerian deposit money banks.

2. CONCEPTUAL REVIEW

The word "reform" is simply viewed as alteration of defects/lapses to achieve better performance/improve an existing institution/system. Reform is a mechanism used to drive a desired change; a shift from one normative course of action to another in a social or economic system so as to control the operations and operators of the system and enhance system performance (Alajekwu & Obialor, 2014). Bank restructuring or reform is an inevitable process when the existing structure of banks cannot fulfill the desired level of economies of scale in operation. However, lack of any one or all the prerequisites would not only bring disaster for banking and financial system, it sometimes might cost the real sector severely (Islam, 2013). Okotori and Ayunku (2020) documented that reforms can be seen as the major adjustments in the regulations guiding the operations of the banking industry, the purpose being to make the conditions for individual banks and the industry to perform better.

According to Alajekwu and Obialor (2014), banking reform can be categorized into systemic and big-bang banking reform; the systemic banking reforms refer to a reform designed to resolve a combination of banking sector or economy wide problem while the big-bang reform is targeted to achieve a particular course (for example: increase capital base of banks). Thus, the reforms were 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-regional, regional and global financial markets (Owolabi & Ogunlalu, 2013).

The ability of the financial system to engender economic growth hinges largely on the health, soundness, efficiency and stability of the banking system. It involves a comprehensive process of substantially improving the regulatory and surveillance framework fostering healthy competition in operation, 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.(corporate guide, 2011)

The theoretical argument linking bank reforms to growth is that a well-developed financial system enhances the efficiency of intermediation by reducing information, transaction, and monitoring costs. On the one hand, it broadens the deposit base of the economy and also it promotes investment by identifying and funding good business opportunities, facilitating the exchange of goods and services and also hedging and diversifying risk (Sanusl, 2012).

Ultimately, bank reforms are aimed at ensuring financial deepening which implies the ability of financial institutions to effectively mobilize savings for investment purposes. The growth of domestic saving provides the real structure for the creation of diversified financial claims. It also presupposes active participation of financial institutions in financial markets, which in turn entail the supply of quality financial services in financial institution (Odedokun, 1989) cited in (Okagbue & Aliko ,2004). According to Obuobi, Nketiah, Awuah, and Amadi (2020a), recapitalization is a process seeking to boost, stabilize or overhaul the financial position or structure of a bank by swapping around various financing options. In their study of the Ghanaian banking sector, these authors concluded that recapitalization had the potential to improve banking system, especially in the long run.

3. BANK REFORMS IN NIGERIA

At a macroeconomic level, banking structure refers to the mix and interrelationships among institutions authorized to undertake banking business by the extant banking legislation(s) of a country. The Nigeria Banking system has undergone a lot of banking reforms which have resulted in the current state of Nigeria banking system. The reforms in the Nigeria banking system, for the purpose of this study are grouped into seven (7) distinct stages.

The first stage of banking reform in Nigeria banking system was the promulgation of the 1952 banking ordinance to tackle the banking failure witnessed within the free banking era: 1892 to 1952. Okaro (2009) reports that the ordinance prohibited banks from paying dividends before writing off capitalized expenditure and from banking loans" against security of its shares, it imposed a ceiling on unsecured loans to directors and to companies in which directors had interest. **The second stage is the era of banking legislation which opened with the operation of Central Bank of Nigeria on 1st July, 1959. The enabling act of Nigeria money and capital market was all put in motion by the 1959 banking ordinance. The third stage; indigenization era of 1970 to 1976 resulted in the government of Nigeria (both state and federal) acquiring stakes in foreign banks under the indigenous enterprises promotion decree of 1972. In addition, Nigeria Agricultural and Corporative Bank and Nigeria Bank for Commerce and Industry was established to pick up the pace of economic growth and development. The fourth stage, 1977 - 1986 which is the post Okigbo era, general reassess 3rd the focal point of the Nigeria banking system by introducing banking services in the rural areas of the country. The sixth stage termed the era of deregulation or universal banking saw the introduction of the Structural Adjustment Programme (SAP) 1986 - 2005 where banks were permitted to engage in other activities aside core banking practices. However, this was grossly abused by banks operating in the country leading to the then Governor of CBN Professor Charles Soludo banking reform of 2004 known as "era of banking consolidation/recapitalization" in Nigeria. This resulted in the closure of some banks as operating license revoked, and existing banks were forced to merge while some acquired by other banks to meet up with minimum capital requirement and stay in the business of banking. The several/final phase is the banking reform of Sanusi Lamido termed "Sanusi Era", who was appointed on 3rd June 2009 for a five year term but was suspended from office by Goodluck Jonathan on 20th February 2014 after claiming that a $20billion fraud was committed in the NNPC. He was a successful banker and formal Governor of Central Bank of Nigeria. The reform came as a result of the global financial meltdown that bedeviled Nigeria and exposed the weak corporate governance and risk management structure of banks top executives. This resulted in the sack of some banks' executive directors and merger and acquisition of some banks. For instance, during this 'era, Eco Bank transnational corporation and Access Bank acquired Oceanic Bank and Intercontinental Bank, Enterprise Bank Ltd acquired Spring Bank, Keystone Bank**

Ltd Acquired Platinum - Habib Bank, First City Movement Bank acquired First Inland Bank, Sterling Bank Pic acquired Equatorial Trust Bank, Mainstream Bank Ltd acquired Afri Bank Pic. (NDIC report 2015).

In the case of the banking supervision, the reform has somehow been very slow over the years, The CBN has retained exclusive authority over the regulation and supervision of main-line banking, within a short period however, the authority to regulate and supervise some specialized banks was vested in other regulators which are now defunct and can be seen as:

Community Banking: it was introduced in the Nigerian banking landscape in 1990,although the enabling act the community banks act no 46 was formally enacted in 1992 with retrospective effect in 1990. The federal mortgage bank act, which established the federal mortgage bank of Nigeria (FMB) vested the bank with primary responsibility of regulating and supervising the primary mortgage institutions (PMI"s) (corporate guide 2015).

Bank Performance :

Bank performance or efficiency refers to the bank's ability to generate revenue from a given amount of assets and to make profit from a given source of income (Abduraheem, Yahaya & Aliu, 2011). For Mohammed (2005), the reasons for non-performance of the banking sector is the personalization in ownership and management structure which makes the banks incapable to finance large scale and long term projects due to limited liquidity at their disposal. The banking sector with import financing rather than encouraging domestic growth in the economy will bring loss of public confidence due to fear of liquidation, customer dissatisfaction on banking services as well as some obnoxious, unprofessional and other sharp practices within the industry. All these can cause great distortion in the financial system resulting to financial inefficiency, which will make investors not to get constant and high dividends as a result of inefficiency in terms of gross earnings, profit after tax and net assets (Mohammed, 2005).

The concept of bank profitability is a means to ascertain bank performance. Tan and Anchor

(2016) saw profitability as being of a major consideration in the operation of commercial banks; there is also the place of stability, which is taken seriously by the banking regulatory authorities. There is a consideration of risk-taking behaviour, as well as links to the risk as regards DMB's efficiency (Tan & Floros, 2013). Many researchers and writers have offered a variety of models for measuring performance in banks.

Information about the return (or profit) a firm earns on its past investments to the point of the calculation enables shareholders to assess the performance of the company's management; Users will want to know how well companies are doing and also to know if it can be improved in the foreseeable future. This is the reason why the use and interpretation of a firm's financial results must be done with utmost care and desirable professional expertise. Besides, it obviously provides a basis for assessing the internal and external performances of the firm (Lucey, 2003)

Empirical Literature:

Okotori and Ayunku (2020) examined how banking reforms have enhanced or inhibited Deposit Money Banks (DMB's) profitability in Nigeria. The data set comprising 12 of the 22 banks that have national and international authorization was annual data that covered the period 2006 to 2018 and were analyzed by adopting a dynamic GMM econometric methodology for the derived panel data. The conclusions from the study was that bank credit risk exposure, the inflation rate, and the exchange rate were significant indicators of profitability of DMB'S in Nigeria. Offiong, Riman, James, Okon, and Ogar (2020) evaluated how adequate is capital? The study used descriptive statistics and Levene's test for equality of variance, as well as an independent sample t-test to look at the (10) ten various performance parameters for both pre- and post-recapitalization periods. From the results of the analysis, most of the performance parameters did not improve after post-recapitalization. This answers the question posed by the study that capital is not adequate in the Nigerian banking sector.

Batten and Vo (2019) did inquire into the factors that impact on bank profitability in Vietnam for the period that spanned from 2006 to 2014. The study adopted a number of econometric methods to evaluate the sourced data; the findings of the study shows that, the size of the bank, capital adequacy, risks, expenses, had impact on profitability. The findings also show that the characteristics of the banking sector and the non bank-specific variables affect bank profitability. But the direction of causal links; where similar when assessed based on profitability measures that were examined.

Yüksel, Muktharov, Mammadov, and Ozsan.(2018) carried out research to isolate the determinants of the profitability of banks in 13 countries from the former Soviet Union. The annual data that spanned the period from 1996 to 2016 was examined by considering panel regression using GMM. The study found that the value of loan, NIM and output growth were significant factors impacting on profitability. The findings show that, the NIM and economic growth had a strong positive link with profitability. The study made recommendation that post-Soviet countries banks' need to consider means by which their banks NIM can be increased. Muraina (2018) examined the variables that influenced profitability of DMB's in Nigeria from 2008-2016. Data for the analysis was sourced from fourteen DMB's that were quoted in the NSE. The study adopted ROA as the proxy for profitability, while the regressor variables where; capital adequacy, credit risk, and inflation. The findings from the study show that while CAD had a positive, but significant effect on profitability, credit risk had a negative significant impact on profitability. Djalilov and Piesse (2016) in their study saw a significant link connecting capitalization and profitability for firms from countries that transited early from command economy to free market after the collapse of the Iron curtain in Eastern Europe and that for those countries that are late transition countries the nexus is insignificant. Alhassan (2015) estimated the impact of scores on cost and profit efficiency of a total of 26 banks in Ghana from 2003 to 2011. This research discovered that in large banks, there is high cost as well as profit efficiency than in smaller banks.. Okorie and Agu "(2015) evaluated the impact of Nigerian banking sector reforms on Nigerian banks' performance and efficiency in two time periods - pre -consolidation period and post consolidation period. The researchers adopted a non-parametric (Data Envelopment Analysis) approach, and the factors that determine efficiency were examined. The finding of the study revealed varying levels of efficiency in both periods. Although some banks still remained inefficient, there was a general improvement in efficiency in the post-consolidation period. This improvement was not entirely attributed to the consolidation policy as two immediate years after the consolidation exercise still recorded poor levels of efficiency among many banks. Further investigation reveals some effects of the recent financial crisis on the overall efficiency of Nigerian banking sector. Owolabi and Ogunlalu (2013) analyzed financial performances of pre and post consolidation program in order to determine whether there is significant difference between the two periods. The study employed the use of secondary data gathered from the audited financial reports of selected banks. Descriptive analysis was employed through the use of tables and charts; then the regression is used to determine the relationships while t-test statistics is used to find out whether there is statistical difference between the means of consolidation variables and financial performance variables. It was discovered that it is not all the time that consolidation transforms into good financial performance of banks and it is not only capital that makes for good performance of banks. Olokoyo (2012) assessed the areas that have been deregulated in the banking sector and how it has affected bank performance. The study analyzed secondary data' collected from CBN statistical bulletin by employing the Ordinary Least Square (OLS) technique. This study found out that the deregulation of the banking sector has positive and significant effect on bank performance. Obadeyi (2014) investigated effect of financial reforms on- banking performance in emerging market. The study covered between 1992 and 2011, because the last reform in banking sub-sector was in 2005 during Prof. Charles Soludo as CBN governor (Pre-Lamido era). Automated Statistical Package Technique (ASPT) was used to analy**z**e the model and Ordinary Least Square method was adopted to analy**z**e existing relationship of variables and there behaviours. The study revealed that the effect of financial reform on banking performance is mixed. It was discovered that financial reform is not a causal factor for effective banking performance aid development; but there is need for strong capital account policy to regulate short term capital flow and exchange rate volatility. Oluitan, Ashamu and Ogunkenu (2015) examined the effect of mergers and acquisitions on bank recapitalization in Nigeria with emphasis on the impact of the strategy on economy development. The study makes use of data from the foremost eight banks in Nigeria that account for over 60% of the banking transaction in the country. The research work was evaluated through regression analysis of secondary data covering ten years (2002-2011) from the sample banks. The result suggests that the effect of the latest recapitalization policy was positive on the operational capability of the Nigeria banking system. Olayinka and Farouk (2014) assessed the impact of consolidation on the performance of banks in Nigeria. The study used a period of 12 years from 2000 to 2011 comprising six years pre and post consolidation era. The study utilizes secondary data obtained through annual reports and CBN banking supervision. T-test was employed to test the hypothesis formulated. The findings of the study show that consolidation has significant positive impact on the performance of banks in Nigeria.

4. METHODOLOGY

Due to the nature of the study, *Ex-Post Facto* research design was adopted for the study. E*x-post facto* research design is a systematic empirical inquiry in which the researcher does not have direct control of independent variables they have already occurred.

The population of the study consists of eight (8) deposit money banks linceced with international authorization, namely; access bank, first bank plc, fidelity bank plc, FCMB plc, GTB, UBA, Union bank plc and zenith bank plc. The data were obtained from the annual reports and audited accounts of the deposit money banks and Central bank statistical bulletin from 2004 to 2020. To achieve the objectives of this study, the data required were those of the discriminating variables that include: Minimum capital requirement, total assets, and profit before tax.

Model Specification

This study adapted Okotori and Ayunku (2020) bank reform model. The study prediction in bank reform was computed as follows:

$PBT = \beta_1 MCR_{it} + \beta_2 TOA_{it}$ ……………… ………………………..……………..et

Where:

PBT = Profit before tax of the bank in year t, as a proxy for financial performance (dependent variable)

MCR = Minimum capital requirement of the bank in year t (Independent variable)

TOA = Total assets of the bank in year t (control variable)

Method of Data Analysis

Data extracted were analyzed using descriptive statistics, while the hypothesis for the study were tested with the Multiple Regression analysis and Person Correlation statistical tools analysis to establish the effect of and the relationship between the independent and dependent variables with the aid of E-view 9.0.

Decision rule:

Using SPSS, 5% is considered a normal significance level. The accept/reject criterion was based on the p-value, alternative hypothesis will be accepted. If p-value > 0.05 otherwise reject and accept the null hypothesis.

Data Analysis and Results

Data analysis

Table 1: Descriptive Statistics

	PBT	MCR	TOA

Mean	49578328	3.82E+10	2.79E+09
Median	44996410	5.00E+10	1.84E+09
Maximum	1.28E+08	5.00E+10	9.34E+09
Minimum	10244806	2.50E+10	8.05E+08
Std. Dev.	40681794	1.29E+10	2.38E+09
Skewness	0.612689	-0.117851	1.630568
Kurtosis	1.957117	1.013889	4.715856
Jarque-Bera	1.833988	2.833470	9.618581
Probability	0.399719	0.242505	0.008154
Sum	8.43E+08	6.50E+11	4.75E+10
Sum Sq. Dev.	2.65E+16	2.65E+21	9.06E+19
Observations	17	17	17

Table 1 shows the mean (average) for each of the variables, their maximum values, minimum values, standard deviation and Jarque-Bera (JB) Statistics (normality test). The results in table 1 provided some insight into the nature of the selected Nigerian banks used in this study.

It was discovered that on the average over the eleven years periods (2004-2020), the sampled banks in Nigeria were characterized by positive performance (profit before tax, PBT) = 49578328. Also, the large difference between the maximum and minimum value of the = minimum capital requirement (MCR) and total assets (TOA), show that the sampled banks in this study are not dominated by companies with large profitability.

In addition, the average, the Jarque-Bera (JB) which test for normality or the existence of outlier or extreme values among the variables shows that all our variables are normally distributed and significant at 5% level and the result could be generalized. This also implies that a least square regression can be used to estimate the pooled regression models.

Test of Hypothesis

H_0: Minimum capital requirement has no significant effect on profit before tax of the Nigerian banking sector.

Table 2: OLS Regression: Banking Reform and Profit before Tax

Dependent Variable: PBT

Method: Least Squares

Date: 05/17/22 Time: 00:04

Sample: 2004 2020

Included observations: 17

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	58387778	7523620.	7.760596	0.0000
MCR	-0.001228	0.000162	-7.593120	0.0000
TOA	0.013655	0.000874	15.61833	0.0000
R-squared	0.966398	Mean dependent var		49578328

Adjusted R-squared	0.961598	S.D. dependent var	40681794
S.E. of regression	7972212.	Akaike info criterion	34.77961
Sum squared resid	8.90E+14	Schwarz criterion	34.92665
Log likelihood	-292.6267	Hannan-Quinn criter.	34.79422
F-statistic	201.3207	Durbin-Watson stat	2.048602
Prob(F-statistic)	0.000000		

Source: E-views 9.0

In Table 2, R-squared and adjusted Squared values were (0.97) and (0.96) respectively. The indicates that all the independent variable jointly explain about 97% of the systematic variations in profit before tax (PBT) of our samples banks over the seventeen years periods (2004-2020). The F-statistics (201.32) and its P-value (0.000) show that the PBT regression model is well specified.

Test of Autocorrelation: using Durbin-Waston (DW) statistics which we obtained from our regression result in table 2, it is observed that DW statistics is 2.049 and an Akika Info Criterion and Schwarz Criterion which are 34.780 and 34.927 respectively also further confirms that our model is well specified.

Based on the coefficient of -0.001228 and p-value of 0.000, was found to have a negative effect on our sampled banks profitability, but this effect was also statistically significant as its p-value is less than 0.05 value, while the p-value of total assets (TOA) is 0.000 with coefficient value of 0.013655, showing that total assets has positive and significant effect on bank performance. This result, therefore suggests that we should accept our alternate hypothesis (HI_1) which states that minimum capital requirement has a significant effect on financial performance of the Nigerian banking sector.

5. CONCLUSION AND RECOMMENDATION

The study explored bank capitalization reforms and financial performance of deposit banks in Nigeria. This has become necessary in the face of evolving developments in the industry in Nigeria especially with the exchange of baton by the Central Bank of Nigeria (CBN) governors and introduction of new ideas and reforms. As a result of this, the Nigerian banking system has undergone remarkable changes in recent years, terms of the number of institutions, ownership structure, as well as depth and breadth of operations. However the reform progaramme has brought about certain implications on Nigeria banking sector which include brand and structural implication.

From the finding of this study, it is established that there is an impact of bank reforms on the performance of banks as well as on Nigeria economy. It is therefore important that these new evolved banking groups understand the implications of their consolidation in order to be a successful unit, both in the short and long run which will in turn benefit the banking industry and the Nigeria economy at large. It is clear that the reforms has affects the performance of the banking sector over the periods, thus for a stronger and more resilient banking and financial system, banks need to improve their current state of development to be truly classified amongst the top banks in the world.

Recommendations

Based on the findings, the study recommended as follows:

a) For a bank to enjoy depositor's confidence, it must have a strong capital base as evidence of its strength and as a tool for operating profitability so that as the confidence of the depositors in the banking system increase they will make more deposit which will enhance the profitability of entire sector.

b) Deposit money bank should invest in liquid short term guilt edge financial asset such as treasury bills to ensure adequate liquidity.

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