Impact Assessment of Bank Consolidation on the Performance of Commercial Banks in Nigeria

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Abstract: This study focuses on an impact assessment of the consolidation exercise on the performance of commercial banks in Nigeria. While prior studies focused on the financial performance of banks (with emphasis on profitability), the main thrust of this study was on how the consolidation exercise had affected different areas of commercial banks in Nigeria other than profitability. Secondary data were sourced from the annual accounts and statistical bulletins of the CBN and SEC respectively for the relevant years. The data obtained were analysed by means of sensitivity analysis, in addition to the correlation and regression analyses. The results obtained show that the consolidation exercise had positive impact on the selected variables (Non Performing Loans, Liquidity Ratio, Bank Credit to Private Sector and Bank Capital To Asset Ratio) for this study. Based on the above findings, we recommend among others that while efforts are made by the CBN to sustain the increased capital base of banks, a very sound corporate governance framework and effective risk management systems must be put in place to check the level of non-performing loans which seem to be predominant in the industry. The quality of bank credit to private sector and their recovery procedures should also be improved upon.

Keywords: Non-Performing Loans; Liquidity Ratio; Recapitalization; Return on Equity

JEL Classification: E58; G21

1. Introduction

Banking activities in Nigeria have experienced significant changes over the years not only as a result of technological advancement but also as a result of what Aregbeyen & Olufemi (2011) described as increased competition which resulted from financial sector deregulation that took place in mid 1980s.

Despite the significant improvement in the sector, it is on record (Soludo, 2006; Olokoyo, 2012; Bebeji, 2013 and Kareem, Akinola & Oke, 2014) that the industry experienced high level of competition coupled with political instability and inconsistencies in policy implementation; thus, leading to a rapid decline on the level of profitability and financial performance of banks. This is because the deregulation

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(Olugbenga and Olankunle, 1998; Taiwo & Musa; and Olusanmi, Uwuigbe & Uwuigbe, 2015), led to the proliferation of banks with the attendant problem of the banks virtually chasing the same customers (Olugbenga & Olankunle, 1998). This made the management of banks to believe that the only option for them to survive is to take excessive risks (Aregbeyen and Olufemi, 2011). The funny developments in the sector however culminated into series of bank failures, related financial shocks and crises in the banking sector in particular, and the entire economy in general (Gunu, 2009; Gunu and Olabisi, 2011; and Ajede, 2011). In line with this assertion, Uchendu (2005) listed a number of factors that were responsible for the crisis in the Nigerian banking industry. Notable among the factors identified by Uchendu (2005) was that Nigerian banks were highly undercapitalized.

In view of the above, it was no longer a surprise for the decision on the need for reform and recapitalization in the sector to have arisen, probably to prevent frequent bank failures as well as restructuring the banks by increasing its capital base in order to primarily increase depositors' confidence in the sector which will in the long run affect the overall economic activity of the country since according to Olajide, Asaolu and Jegede (2011) and Olusanmi, Uwuigbe & Uwuigbe (2015), the financial system is central to the growth process of Nigeria.

Outside Nigeria, studies had attempted to examine the impact of reforms generally on the performance of banks in both developed and developing economies like Japan (Ito and Sasaki, 2002; Montgomery, 2004; and Montgomery and Shimizutani, 2005), Indonesia (Soemonagoro, 2006), Malaysia (Allen and Boobal-Batchelo, 2005), and Sweden (Gjirja, 2003). In Nigeria, efforts have been made to study the impact of the recapitalization on various indices such as shareholders fund, total assets, costs of equity, number of branches, employment, as well as manpower planning and control (Aregbeyen and Olufemi, 2011; Ajede, 2011; Gunu and Olabisi, 2011; and Gunu, 2009). To date, not much empirical works have been conducted to the knowledge of the author on the area of the impact of the reform with respect to bank recapitalization as if affects the financial performance of commercial banks in Nigeria with emphasis on financial ratio measures like Capital to Assets Ratio (CAR), Liquidity Ratio (LR), and indices like Return on Equity (ROE), level of Non Performing Assets (NPAs), Credit to Private Sector (CPS) amongst others. Thus, this study is designed to fill the existing empirical gaps as well as adding to existing empirical evidence in available literatures on this area, using the Nigerian banking industry as a case study. Attempts would be made to distinguish this study from previous ones in Nigeria.

2. Literature Review and Conceptual Framework

The term *"consolidation"* has received various definitions in the literature. A general consensus on the definition is that consolidation is a policy strategy designed to enhance commercial banks' performance through an increase in their capital base either by means of mergers, recapitalization or by means of absorption (Bebeji, 2013; Osuji & Okoli, 2013; and Bebeji, Dogarawa & Sabari, 2014). In line with the above, Soludo (2005), described consolidation as a combination that results in a legal dissolution of combining entities such that a new company emerges with the hope of enhancing performance. Consolidation increases the size and concentration of entity, and at the same time, it reduces the number of interests in such a company. Shih (2003) is of the view that bank consolidation reduces the level of insolvency risk since it results to asset diversification. While embarking on consolidation, the pattern and manner in which it is done matters alot. This is because, according to Aregbeyen & Olufemi (2011), consolidation can be of two types - market-driven or government induced. Accordingly, Aregbeyen & Olufemi (2011) pointed that while the market-driven consolidation is prominent in developed countries (where rather than using bankruptcy or other means, consolidation is used to efficiently eliminate excess capacity in identified industries); the government induced consolidation is common in developing countries. According to Ajayi (2005) as cited by Aregbeyen & Olufemi (2011), the government induced consolidation is borne out of the need to resolve issues of financial distress prominent in banking industries, especially in developing economies with the hope of preventing systematic crises by restricting operations of banks that were inefficient.

2.1. Consolidation, Recapitalization and the Nigerian Banking Industry

The consolidation of the banking industry in Nigeria started in 2004 when the CBN mandated all banks to meet the N25billion minimum paid-up capital by 31st December, 2005 (Donwa and Odia, 2010; Donwa and Odia, 2011; and Bebeji, 2013). The crux of the consolidation exercise in the Nigerian banking industry was recapitalization since banks needed adequate capital which according to Babalola (2011) would provide a cushion to withstand abnormal losses not covered by current earnings, such that banks would be able to regain equilibrium thereby re-establishing a normal earnings pattern.

In attempting to explain the ideology behind the recapitalization policy in Nigeria, Oladejo & Oladipupo (2011) noted that recapitalization as a reform in the banking industry was designed amongst others to create a more resilient, competitive and dynamic banking systems that would support and contribute positively to the growth of the economy. Oladejo & Oladipupo (2011) further opine that the exercise would

guarantee strong and forward looking banking institutions that would be technology driven and ready to face the challenges of liberalization and globalization.

No doubt, recapitalization is simply a policy thrust aimed at raising the minimum paid-up capital (capital base) for banks in the country. The general belief is that banks with strong capital base would have the ability to absorb losses that may arise from non-performing liabilities (Adegbaju & Olokoyo, 2008).

Soludo (2004), pointed that recapitalisation of the Nigerian Banking Sector became necessary as a result of the fact that there was a high concentration of the sector by small banks whose capitalizations were below $10 million, yet were having very high fixed and operating costs. In order to survive, banks were advised to either consolidate with existing banks or raise additional funds through the capital market (Sulaimon, Akeke & Fapohunda, 2011).

2.2. The State of the Nigerian Banking Industry before and after the 2005 Consolidation Exercise

2.2.1. Before the 2005 Consolidation Exercise

Before the consolidation exercise of 2005, the banking sector in Nigeria was presumed to be fragile (Soludo, 2004, and Adegbaju & Olokoyo, 2008). According to CBN (2004), of the 89 banks that were in operation as at 2004, only 10 banks could account for 51.9% of total assets, 55.4% of total deposit liabilities, and 42.8% of total credit. CBN (2004) further lamented that only few banks (10 banks) were rated as sound following the CAMAL parameters for rating. The rest were either satisfactory (51 banks), marginal (16 banks) or unsound (10 banks).

Note that prior to 2004, the number of satisfactory banks in the country stood at 63 (2001), those that were "marginal" were 8 (2001), while those that were unsound was 9 (also in 2001). These figures however rose respectively to 51, 16 and 10 by 2004. The marginal and/or unsound banks according to CBN (2004) and Soludo (2004) exhibited such weakness as undercapitalization, illiquidity, weak/poor asset quality, poor earnings etc.

Following the decision of the CBN on the need for banks to embark on the consolidation/recapitalization exercise, banks were therefore mandated to drastically increase their minimum capital base to N25 billion. This amount prior to 2005 was only N2 billion (Nasiru, Joshua & Nasiru, 2012 and Sani & Alani, 2013). This decision however led to a remarkable reduction in number of banks in the country. Immediately after the deadline for banks to consolidate by a way of recapitalization (December 31st, 2005), the number of banks operating in the country was seen to have reduced in number to 25 banks (Bakare, 2011; Oleka & Mgbodile, 2014 and

Oluitan & Ashamu, 2015). This reduction was from 89 banks that were in operation as at 2004.

2.2.2. After the 2005 Bank Consolidation Exercise

Immediately after the consolidation exercise of 2005, the number of banks in the country stood at 25. Shortly after that, there was a further merger of Inland Bank with First Altantic Bank Plc (FinBank Plc), in addition to another merger of Stanbic Bank Limited and IBTC Chartered Bank Plc (Stanbic-IBTC bank Plc). This made the number of banks in the country to reduce in number to 23 banks. Again, when Citibank Nigeria Limited came on board, the number of banks in the country had a slight increase to 24 banks.

With subsequent mergers and/or acquisitions that took place between 2008 and 2013, in addition to the revocation of the operating licenses of three banks that failed to show the ability of recapitalising by a mandated deadline of 30th September, 2011 given by the Central Bank of Nigeria (CBN), the number of banks in Nigeria by the end of 2013 became 21.

It is noteworthy however that following the collapse of the sub-prime lending market in August, 2007 in the United States of America (Bunesco, 2010), economies across the globe were adversely affected, Nigeria not an exception. In view of this, the post-consolidation/recapitalization performance of banks in Nigeria was believed to be overcast in 2008 following the global financial and economic crisis. This was as a result of the fact that foreign investors were in a hurry to liquidate their investments in order to repay their outstanding loans back in their country. This action which was in a bid to avoid excessive lending rate was believed to have had a negative impact on the Nigerian stock market. This negative impact or near collapse of the stock market did not only affect the financial performance of some of the banks, it also increased their risk exposure. According to Sanusi (2010a) the post-recapitalization challenges in Nigeria could be attributed to inability of regulators and the industry to sustain and monitor the sector's explosive growth which resulted to a huge level of in-built risk in the system. Furthermore, Sanusi (2010b) pointed that from the reports of a special examination team of the CBN/NDIC nine (9) out of the 24 (twenty) banks in Nigeria as at 2010 were in grave situation; a situation that prompted immediate intervention by CBN. The reports further revealed that Capital Adequacy Ratio in ten banks were below the minimum accepted ratio of 10%. In light of the above situation, Adegbie, Asaolu & Enyi (2013) are of the view that the Nigerian banking industry should no longer be seen as the bedrock of the economy. It is therefore necessary to conduct a study of this nature to evaluate the extent to which the consolidation exercise of 2005 had impacted on the Nigerian banking industry.

2.3 Review of Empirical Studies

It is noteworthy however that the findings in empirical literatures differ on the effect of reforms and/or recapitalization on the performance and/or efficiency of banks in the world over. According to Stern (2002), while liberalization of financial services brought about mutual opportunities to the world, it also may have raised mutual vulnerabilities. Thus, scholars like Taggart (1978), Fama (1980) and Weber (1984) noted that from their review of the free banking era, the banking system actually worked quite well during periods of little or no regulation. In support of this view, Berger, Demsetz and Strahan (1999) assert that bank consolidation does not significantly improve the performance and efficiency of banks.

On a different note, a substantial body of literature have over the years indicated that financial sector reforms significantly have improved the performance of banks in different ways. Prominent among these can be found in the works of Berger and Mester (1997), Okoro (2006), Somoye (2008), Owusu-Antwi (2009), Farooq et. al. (2010), Donwa and Odia (2011).

It is however pertinent to note at this juncture that in assessing the performance of banks, different approaches have been suggested in the literature. Bank performance can be assessed on the basis of profit and cost using the Data Envelop Analysis (DEA) or Stochastic Frontier Analysis (SFA) (Grigorian and Manole, 2002; and Bonin, Wachtel and Hasan, 2004). Also, bank performance can be analysed on the basis of profitability by looking at key variables such as Return on Assets (ROA), Return on Equity (ROE) as well as Net Interest Margin (NIM). It is in line with the above paradigm that Athanasoglou, Brissimis and Delis (2005) in a survey of emerging markets investigated the effect of bank-specific industry related and macroeconomic variables on the profitability of banks in Greece. Their study found that variables such as capital, labour productivity growth and operating expenses to a large extent had a significant impact on the profitability of banks in Greece. Athanasoglou, Brissimis and Delis (2005) also noted in their findings that size, ownership status and industry concentration does not significantly affect the profitability of banks.

As evidenced in the literature, proponents of recapitalization believes that increase in size could potentially increase bank returns through revenue gains as well as at the same time, reducing industry risk through the elimination of weak banks in the system.

Wahab (2001) analysed the performance of commercial banks under reforms and observed that though reforms had favourable impact on the overall performance of commercial banks generally, major issues like low productivity in the sector despite the existence of reforms still needed some considerations for further improvements. Similarly, Somoye (2008) conducted a study on the performance of commercial banks in post consolidation era and pointed that consolidation in the banking sector

can go a long way to create better opportunities for banks especially in the area of diversification.

In addition to the aforementioned, Umar (2009) conducted a study on the impact of banking industry recapitalization on employment in Nigerian banks using simple percentages and the multiple regression analysis. The study revealed that there was reduction in the level of employment in the industry between 1999–2001, but experienced an appreciable increase in the level of employment between 2006-2008 owing to an increase in the number of domestic branches.

In another vein, Aregbeyen and Olufemi (2011) examined the impact of recapitalization and consolidation on the cost of equity of banks in Nigeria in order for them to measure the effectiveness and efficiency of the recapitalization and consolidation programme in the country. They used the student t-test to test the difference between the mean cost of equity capital for all sampled banks prior to consolidation and after the consolidation exercise. Their study revealed that the recapitalization programme brought about a considerable reduction in the cost of equity capital in the sampled banks.

Bank performance according to Okafor (2012), also depends on the level of efficiency exhibited in the application of human, financial and material resources available to a bank. It is however a known fact that the management of banks do face several risks in the process of managing the resources available to their respective banks. Hence Okafor (2012) added that banks operate on the premise of minimising risks since any bank that assumes all risks cannot adequately serve the credit needs of her customers and in the long run may not be able to respond appropriately to the demands of economic development owing to liquidity and capital adequacy problems.

One key factor that impinges on bank efficiency and profitability is the extreme dynamism of the banking regulatory environment (Okafor, 2012) which of course is a function of changes in government policies. In Nigeria for instance, the financial sector (banking sector inclusive) has been visited with different reforms designed to cater for the various operation within the sector. Okafor (2012) further asserted that major areas so far affected in the Nigerian banking sector include the minimum capital requirement of banks, methods of access to foreign exchange, determination of foreign exchange rates, composition of bank credit mix and the imposition of a common year reporting date (31st December) on all banks. It is a general believe that these reforms in the banking sector have far reaching implications particularly on the profit margin as well as the performance of banks generally in the country.

3. Research Methodology

In this study, we adopted the quasi experimental research design and secondary data were obtained and analysed with the Ordinary Least Square (OLS) technique. The study population consist of the 21 banks that were in operation in Nigeria as at 31st December, 2012. Given the nature of available data and the number of banks in operation, the entire 21 banks in operation constitute the sample for this study. The data used by the researcher covered before and after the recapitalization exercise in Nigeria (2000 - 2012).

3.1. Statistical Procedure and Model Specification

In order to analyse the data obtained in this study by means of the OLS technique, a multiple regression model was estimated. This was done by linking our dependent variable (Bank Performance – BPERF) as a function of the independent variables (non-performing loan, capital to asset ratio, bank credit to private sector, liquidity ratio, and bank recapitalization). The model to be estimated in this study is thus stated below:

$$BPERF = b_0 + b_1NPL + b_2BCAR + b_3BCPS + b_4LR + + b_5BRECAP + U_t$$

Where:

BPERF = Bank Performance (proxied by Return on Equity)

NPL = Level of Non – Performing Loans

BCAR = Bank Capital to Asset Ratio

BCPS = Bank Credit To Private Sector

LR = Liquidity Ratio

BRECAP = Bank Recapitalization (proxied by the minimum capital base (MCB) of banks for the relevant years/period.

b_0, $b_1 – b_5$ = Regression Coefficient

U_t = Error Term

4. Data Presentation and Analysis of Results

4.1 Preliminary Analysis

In this section, we present a preliminary analysis of the sensitivity of the explanatory variables (asset quality, liquidity ratio, bank credit to private sector and bank capital to asset ratio) to movements in the dependent variable: bank performance (proxied by return on equity). The statistical indicators used for this analysis are the standard

deviation, minimum and maximum values obtained from the Ordinary Least Square results. We provided a comparative analysis of the period before and after recapitalization using the standard deviation, minimum and maximum values in order to establish whether recapitalization of banks result to any material change in the industry.

Table 1. Sensitivity of Independent Variables to Movements in BPERF

Sampled Period: 13/ 2000-2012	**Std. Value**		**Minimum Value**		**Maximum Value**	
	Before	**After**	**Before**	**After**	**Before**	**After**
Sensitivity Coefficient	41.35760	60.60258	27.2300	67.8719	114.2900	144.2299

Source: SPSS Output

Table 1 showed the sensitivity of the independent variables: Non-Performing Loans (NPL), Liquidity Ratio (LR), Bank Credit to Private Sector (BCPS) and Bank Capital to Asset Ratio (BCAR) to movements in Bank Performance (BPERF) proxied by Return on Equity (ROE). A closer look at the result suggests that on the aggregate, the independent variables were more sensitive to movements in bank performance (return on equity) after the recapitalization period. The period before recapitalization recorded a standard deviation, minimum and maximum values of 41.35760, 27.2300 and 114.2900 respectively and the period after recapitalization recorded a standard deviation, minimum and maximum values of 60.60258, 67.8719 and 144.2299 respectively. With these outcomes, it implies that NPL, LR, BCPS and BCAR indicators were better off in the period after the recapitalization exercise.

4.2. Correlation Analysis

We adopted the technique of the Pearson Correlation Coefficient (PCC) to measure the degree of linear association between the dependent and independent variables in this study. According to Nachmias & Nachmias (2009), there could be strong positive relationship, a weak positive relationship and no relationship and Pearson's *r* ranges from -1.0 to 1.0, where a negative coefficient indicates inverse relations between the variables. The Variance Inflator Factor (VIF) and Tolerance Level (TL) were also used to establish the multi-collinearity between the dependent and independent variables. Note that the closer the VIF and TL to 1, the greater the collinearity between the variables.

Table 2. Correlation Results for the Independent Variables & Bank Performance

Variables	Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Correlations			Collinearity Statistics	
	B	Std. Error	Beta			Zero-order	Partial	Part	TL	VIF
(Constant)	833.337	175.612		4.745	.018					
NPL	-5.629	1.644	-.852	7.424	.042	-.804	-.892	-.837	1.559	1.790
LR	-9.901	2.350	-1.508	6.212	.024	.830	.925	.983	1.270	3.708
BCPS	-4.702E-006	.000	-.250	5.114	.347	.898	.841	.807	1.684	1.461
BCAR	-15.199	3.293	-1.523	6.616	.019	-.864	-.936	-.858	1.317	3.150

Source: Regression Output

a. Dependent Variable: BPERF

b. Predictors: (Constant), NPL, LR , BCPS, BCAR

From Table 2, one can observe that there is a perfect collinearity between the independent variables (NPL, LR, BCPS, BCAR) and bank performance (proxied by returns on equity). This was established by the VIF and TL with the value of TL ranging from 1.270 (for LR) to 1.684 (for BCPS). The VIF value ranged between 1.461 (for BCPS) to 3.708 (for LR). With the Pearson Correlation using Zero, Partial and Part Correlation, the degree of association was negative and strong for NPL and BCAR while that of LR and BCPS was positive and strong.

4.3. Regression Results and Discussion

This section presents the regression results of the study.

Table 3. Summary of Regression Results

Model	R	R Square (R^2)	Adjusted R Square ($\bar{R}^2$)	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.947[a]	.896	.758	31.48697	.896	6.483	4	3	.078	2.382

a. Predictors: (Constant), BCAR, NPL, BCPS, LR

b. Dependent Variable: BPERF

The variable of recapitalization was proxied by the minimum capital base of banks for the relevant years, while liquidity ratio was measured by the percentage of liquidity ratio of banks as contained in the CBN statistical bulletin for the relevant years. As shown in the table above, both R^2 and $\bar{R}^2$ (R^2 adjusted) measured the fitness of the model. In other words, they measured the proportion of the variation in the dependent variable explained by the model. But since $\bar{R}^2$ is the modification for the limitation of R^2, the value of the $\bar{R}^2$ is considered to be a better measure for the fitness of the model. From the table, the value of R^2 adjusted ($\bar{R}^2$) is 0.758, indicating that the independent variables in the model are explaining 76% variation on the dependent variable. Thus, we can understand that the model of the study is providing a good fit to the data. In addition, the t-calculated of 6.212 for LR (see table 2) is greater than the t-critical of 2.365. This is an indication that a significant relationship exist between the consolidation of banks and the liquidity ratio of banks in Nigeria. This clearly indicates that, the liquidity ratio of banks has been significantly affected by the increase in the minimum capital base of banks over the years in the country.

Furthermore, we also measured bank credit to private sector by the aggregate value of commercial bank credit to small scale enterprises. Referring to Table 2 again, we observe that the t-calculated of 5.114 for BCPS is greater than the t-critical value of 2.365. This implies that the consolidation of banks had significant impact on the amount of credit given by banks to the private sector in Nigeria.

On the level of NPL, we observe that the t-calculated (7.424) (see Table 2) is greater than the critical value (2.365), a suggestion that the consolidation of banks has significant positive impact on the level of non-performing loans of banks in Nigeria. Finally, we also observe that with respect to bank capital to asset ratio, the t-calculated (6.616) is greater than the critical value (2.365), a suggestion that the consolidation of banks had a significant impact on the capital to asset ratio of banks in Nigeria.

5. Conclusion

From the results of the sensitivity of the independent variables to movement in the dependent variables as well as the test of hypotheses, one would notice that on the aggregate, the independent variables (asset quality, liquidity ratio, bank credit to private sector and bank capital to asset ratio) were more sensitive to movements in bank performance (return on equity) after the recapitalization period. The period after recapitalization recorded the highest standard deviation, minimum and maximum values and with these outcomes, it implies that NPL, LR, BCPS and BCAR indicators were better off in the period after the recapitalization exercise. The results from our test of hypotheses also revealed that a significant relationship exist between the recapitalization of banks and the liquidity ratio of banks in Nigeria. This could be as a result of the fact that following the recapitalization of banks, Nigerian

commercial banks became more liquid compared to what was the case before the recapitalization exercise. This may be the reason why we found also that the recapitalization of banks had significant impact on the amount of credit given by banks to the private sector in Nigeria. In addition to the above, this study found that the recapitalization of banks significantly affected the level of non-performing loans as well as the capital to asset ratio of banks in Nigeria.

6. Recommendation

In view of the fact that the Nigerian banking industry still seem to be fragile, the need to further increase the capital base of banks in the country cannot be overemphasized. Specifically, the results from this study points to the fact that the success and growth of the industry largely depends on the capital base of banks operating in the system. Based on the aforementioned, the following recommendations have been put forth:

i. The CBN should ensure that the increase in the capital base of banks should be sustained.

ii. Since the recapitalization policy brought about banks with adequate capital base as well as increase in credit to private sector, the management of banks on their part must ensure that they are not carried away by the act of granting of credit simply because banks are more liquid in recent times. To this end, banks and the CBN must work together to see that a very sound corporate governance framework as well as effective risk management systems are in place to check the level of non-performing loans which at the moment still seems to be predominant in the Nigerian banking industry.

iii. Efforts must be made also to improve the quality of advances as well as the recovery procedures of the growing amount of bank credit to the private sector of the economy.

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