
Turning Inward? Or Fighting the Crisis with Further Opening? Evidence from the Nigerian Banking System

Dozie Okpalaobieri

African Center for Economic Transformation, Accra, Ghana

1. Introduction

The unprecedented global economic crises which have afflicted the whole world over the past two years have their origins in the advanced industrial economies of the West. While African countries bear no responsibility for this crisis, they are suffering its worst effects¹. They have been hit with falling prices, especially those countries that trade in a few commodity exports, and reduced capital flows as foreign investors exit these markets to shore up their losses at home and the level of remittances fall as Africans who work abroad and send money home lose their jobs. Real GDP growth is now projected by the IMF to drop below 2 percent in 2009, down from an average of over 6 percent for the last few years.² In light of the global crisis, the fear has been that African governments would introduce more protectionist policies as a response.

According to Moss (2009), with the major western powers facing their own economic crisis, confidence in the capitalist system is likely to come under pressure and there is a risk that momentum for reform may stall; and it would be a shame if governments gave in to the temptation to return to a command economy or use the crisis as a cover to re-nationalize companies or interject the state into the market in ways that has proved so harmful in the past. This fear may be unfounded. Interestingly, a number of African governments seem to be doing just the opposite and are introducing commerce-liberalizing measures, as can be seen from data on the Global Trade Alert website³. One example of this is the proposed policy by the Governor of the Central Bank of Nigeria.

In an interview with the *Financial Times* of London on June 18, 2009, the newly appointed Governor of the Central Bank of Nigeria (the "CBN"), Mallam Sanusi Lamido Sanusi, announced that the bank would relax the rules on foreign ownership of Nigerian banks, a decidedly anti-protectionist and pro-market move. Currently, the policy has limited foreign equity holding in any of the Nigerian banks to 10 percent, and the CBN needs to approve any takeover of shareholding of more than 5 per-

1 AllAfrica.com, "Africa: Continent and the Global Crisis - Time to Throw Away Neo-Liberalism," Editorial August 21, 2009, <http://allafrica.com/stories/200908210783.html>

2 Todd Moss, "How the Economic Crisis Is Hurting Africa - And What to Do About It," - CGD Essay May 2009, www.cgdev.org/content/publications/detail/1422072

3 www.globaltradealert.org

cent. Taken in the context of the global economic crisis, where governments are becoming more protectionists by raising tariffs, this potentially liberalizing move by the CBN is a welcome response. However, the question also remains whether the move is a response to the crisis as experienced across the world, or whether it is a response to a more micro-level issue. It seems to be both cases.

As far back as 2007, there was a growing foreign interest in the Nigerian banking sector. However, the then CBN Governor, Dr. Charles Soludo, announced that foreign institutions will be barred from taking over the top ten banks in Nigeria, as these ten banks collectively account for 71 per cent of the country's banking system. He did point out that the foreign banks were free to come in and operate, get a license to operate, but not allowed to take over any of the top banks. The restriction does not debar foreign banks from setting up businesses in Nigeria on their own if they satisfy the N25 billion capital base requirements and other statutory prescriptions. Neither does it prevent acquisition in Nigerian banks below the top ten, as can be seen by Actis' 19.1 per cent equity stake in Diamond Bank. (Afrinvest 2008). He noted that the introduction of that policy regime would not restrict the inflow of foreign direct investment into the financial sector. It is important to note that foreign investors preferring to invest in existing banks could only do so in smaller banks that do not make up the top ten.

This paper will explore the reasons behind the policy change, whether foreign ownership will make a difference, and will conclude with an impact analysis of the new Governor's decision.

2. Why the change?

Mallam Sanusi, the new Governor, has indicated that the restrictive policy currently in place is not a sustainable one and that this move is part of a plan to try and strengthen Nigeria's financial system. (Reuters June 2009). Experts have cited various issues in the Nigerian banking system that would be resolved with the introduction of foreign ownership, such as weak corporate governance and disclosure, ineffective rule-based supervision and lax prudential regulation. For example, in April 2008, United Bank for Africa plc (UBA), one of the country's biggest banks, fell foul of American regulators who served it with a US\$15 million fine for ignoring anti-money laundering regulations despite several warnings. On August 14, 2009, the CBN Governor relieved 5 Nigerian banks' chief executive officers of their jobs, citing among other reasons, excessively high levels of non-performing loans in the five banks, attributable to a combination of poor corporate governance practices, lax credit administration processes and the absence or non-adherence to the banks' credit risk management practices. According to the Governor, the percentage of non-performing loans at these five banks to total loans ranged from 19 per cent to 48 percent of the value of their respective loan portfolios.⁴ The bulk of these non-performing loans were made to friends and political associates and, as a result, there was no incentive to make the creditors pay back, barring regulatory enforcement.

4 Sanusi Lamido Sanusi, "Developments in the Banking System in Nigeria," Address by the Governor of the Central Bank August 14, 2009, <http://www.cenbank.org/Out/speeches/2009/Govadd-14-8-09.pdf>

According to Sebastian Spio-Garbah, an analyst with the Eurasia Group, despite the assurances given by the new Governor to scrap the 10 per cent limit on foreign ownership, Nigerian banks will still face a myriad of regulatory, economic and political hurdles. Previously, the Eurasia Group has found that international banks already operating in Nigeria, such as the UK's Standard Chartered Bank, Citigroup, and South Africa's Standard Bank, have been unable to win a significant market share of the local loan and deposit market, despite their competitive rates and marquee global brand names.⁵

3. Will foreign ownership make a difference?

If foreign ownership is the solution, what problems are the CBN trying to solve? A contrarian might argue that the problems in Nigerian banks were exacerbated and highlighted by the global crisis. As the global crisis set in, foreign banks and investors that extended credit to Nigerian banks began to cut back their credit lines or completely eliminated them. As the banks experienced reduction in these credit lines, they also experienced higher risk provisioning for non-performing loans that have also contributed to the tightening of liquidity in the system. Tightening liquidity means a reduction in the trade credit the Nigerian banks can grant to their customers engaged in international transactions. Given the above, and despite the liquidity deficiency suffered by the foreign banks at the moment, it is logical for the CBN to promote a policy option that serves to encourage the foreign banks to enter the Nigerian banking market with the following aims:

3.1. Recapitalization with fresh capital to shore up Nigeria's capital base

It has been argued that the Nigerian Banking sector needs new capital to remain vibrant, and that the foreign banks would be in a good position to provide that input. According to Oluba (2008), with the massive withdrawal of funds by foreign institutional and private investors who provided credit lines to Nigeria banks, a vacuum was created that placed a strain on the system. Many of these investors withdrew funds mostly to service debts in overseas markets.

It is important to note however, that while local banks have sought to mobilize deposits from the consumer sector, the vast disproportionate amount of deposits and lending still comes from, and goes to, the government sector and to other large corporations or well heeled elite.⁶ As a result, any foreign bank seeking to enter the Nigerian market will essentially be competing for those same deposits and loans despite their acquisition, unless it has a superior retail strategy that would still be profitable to deploy despite the country's challenging infrastructure bottlenecks.

The new Governor wants institutions that contribute to growth and transformation in the Nigerian economy. According to Chizea 2009, in the past, foreign banks

5 "Foreign banks face regulatory, political hurdles despite Sanusi's open arms," *Business Day* June 24, 2009, http://www.businessdayonline.com/index.php?option=com_content&view=article&id=3375:foreign-banks-face-regulatory-political-hurdles-despite-sanusis-open-arms&catid=1:latest-news&Itemid=18

6 *Business Day*, (June 2009)

discriminated against Nigerian economic agents in the extension of credit and had adopted a rather short-term perspective in doing business and would not bother to extend credit to the real sector - agriculture, manufacturing and mining. Most of the lending done by these foreign banks was to corporate customers in the country. This notion is borne out by the four existing foreign banks in Nigeria in the limited types of business they do - structured trade finance, correspondence banking, offshore currency lending, project (asset-based) financing, custodial and cash management services, wealth management and capital and money market services - and where their branches are located. They also seem reluctant to expand their branches across the country and are concentrated in a few metropolitan areas. Currently, only Standard Chartered and Citigroup have sizeable operations in Nigeria. Lastly, in the current economic climate, fresh capital may be hard to come by.

Having said that, if this proposal goes forward, now would be a good time to enter the Nigerian banking market. While capital may be scarce now, in the long run, the quest for fresh capital will be realized and the government can provide the right business environment to enable the foreign banks to expand beyond the typical metropolitan areas. Providing the right business environment means ensuring that the proper infrastructure is in place (e.g. transport and electricity to power the businesses), that the police and the judiciary are competent to ensure that contracts are properly enforced; and that there is a fair tax system that does not stifle business operations for many that include these banks and their customers. This would go a long way to fulfill the Governor's quest for growth and transformation, considering that Nigeria's financial sector remains under intermediated (Afrinvest 2008).

3.2. Corporate governance improvements

In Nigerian banking today, the discipline of governance is missing. Corporate governance can be defined as an internal system encompassing policies, processes and people, which serve the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, objectivity and integrity

Good corporate governance can enhance country and corporate image, help attract quality employees and investors, and stand the country and organization out amongst peers as a good place to work and do business. The Code of Corporate governance in Banks released after the consolidation exercise in 2005 in the sector on ownership of banks says "the recent practice of free non-restricted equity holding (in banks in the country) has led to serious abuses by individuals and their family members as well as governments in the management of banks. In fact, Bala-Usman (2005) in a lecture on bank ownership in Nigeria criticized the concentration of the private ownership and control of Nigerian banks in a few hands. He wondered whether such concentration was an attempt to "fabricate" corporate "global players," with no roots in the real processes of domestic savings by the people of Nigeria and in productive domestic investment into the economic foundations of their lives. It is also recognized that individuals who form part of management in which they also have equity ownership have a compelling business interest to run them well."⁷

⁷ Central Bank of Nigeria, "Code of Corporate Governance for Banks in Nigeria Post Consolidation," March 1, 2006 (Effective April 3, 2006)

This was not the case in many instances. According to Business in Africa (2008), none of the banks had complied with the requirement of independent directors, even as seven banks had executive directors as members of the Board Audit Committee, contrary to the provisions of the corporate governance code. Secondly, a good portion of the funds used to recapitalize the industry were loans banks gave to their customers to buy the bank's own shares. This was certainly not a good practice by any standards. In addition, there was a lot of inter-bank borrowing, enabling them to remain liquid and make super-normal profits during the financial year-ends. The lid came of this borrowing scheme when the CBN ordered a common year-end for all banks, to forestall the window dressing the banks were engaged in.

Another principle of corporate governance is disclosure. In the 2009 Nigerian Banking Report (Afrinvest 2009), the research firm noted that "individual banks have very often managed to acquire significant risk exposure levels that may not be captured by traditional loan book assessments." They also point out the "structural deficiencies that allow for effective risk creation and retention in ways that are not clearly discernable based on current reporting requirements." This is a pervasive problem, and one that needs to be resolved for any progress to be made in the industry, and one on which the foreign banks can effect change. In an address by the CBN Governor in 2009, he noted that a few Nigerian banks, mainly due to huge concentrations in their exposure to certain sectors (Capital Markets and Oil and Gas being the prominent ones), but due to a general weakness in risk management and corporate governance, have continued to display signs of failure.

In this vein, the CBN has called for greater disclosure on the parts of banks and better yet, for foreign ownership in Nigerian banking. Currently, Nigerian banks are pitched against some of their stakeholders because of asymmetry of information causing business transactions to be pricey. The banks that understand this, according to Afrinvest, are the major winners that are able to provide clarity and transparency and will be the first in the pecking order for corporate and large ticket business. Disclosure does pay dividends and transparency increases liquidity. The foreign banks will put pressure internally to improve systems and processes, and on the other hand, will put pressure on the banking industry to get their acts together in moving the banking industry as a whole to best practices in the corporate governance area, by virtue of their high-quality standards and transparency and the resulting business they are able to attract. Their entry would lead to the development of the underlying bank supervisory and legal framework

3.3 Risk management expertise

Recently, Donli (2008) decried the lack of technical expertise on risk management despite reforms in the Nigerian banking industry. According to Uwah (2009), rules of risk management in Nigerian banks seemed non-existent as people with annual incomes of less than N2 million were given loans to the tune of N100 million without a second thought concerning how they would pay back if anything went wrong. The Eurasia Group also noted in May 2009, that banks in Nigeria may have \$10 billion in toxic assets. The bad debt being partly the result of at least 1 trillion naira of margin loans used to buy shares as equities soared almost 13-fold since 2000.⁸

8 Paul Okolo, "Standard Bank to Increase Nigerian Branch Network," September 7, 2009, http://www.bloomberg.com/apps/news?pid=20601116&sid=aNkIMfmCd_yY#

Afrinvest Research (2009) noted that the challenges with margin loan exposure reflect merely a symptom of a larger underlying problem; "structural weaknesses that allow short-term funds flow from banks to other financial institutions for trading purposes, without appropriate disclosure and supporting mark-to-market accounting requirements. In fact, before the onset of the global crisis, a few Nigerian banks were willing to reveal accounting and financial information beyond the required minimum, creating a confidence issue which has been exacerbated by the crisis (Fagbule 2009). Now, investors and shareholders alike are asking for more information than they used to get. Proper risk management can be brought to bear by foreign banks in eliminating this practice, and create a competitive environment that would eliminate the incentive on the part of banks not to disclose pertinent information.

The CBN Governor plans to do his part to ensure the maintenance of public confidence through appropriate disclosure and would reinvigorate the policy of zero tolerance on all professional and unethical conduct. According to the Governor, banks would also be required to further strengthen their risk management process, while pursuing more vigorously the present supervisory methodology of risk-based and consolidated supervision with special emphasis on macro-prudential regulation and sound stress testing practices.

How would foreign banks help in this instance? The entry of foreign banks in low-income countries has been shown to improve risk management practices, and "imported" supervision from parent country regulators, has thereby helped strengthen banking systems. (Claessens and Lee 2002). Part of the strengthening comes from the efficiency and robustness that the banks will develop on entry into the banking market. Empirical evidence shows that increased penetration has been correlated with lower financial intermediation costs and greater efficiency in financial services provision.

For example, according to Chukwumah (2001), the operations of some foreign banks in Nigeria suggest excessive adaptation to the labour or work practices in Nigeria, resulting in civil service type productivity. These foreign banks have poor or little parental support and the Nigerian subsidiary are sometimes not well integrated into the parent bank strategy. In contrast, Citibank, the most successful foreign bank in Nigeria, introduced radical changes that permanently affected banking in Nigeria, and developed significant banking competency. Citibank succeeded in redefining service standards in the industry. He explained that Citibank was successful because they came into the Nigerian market with a clear focus on high-end corporate, high-net worth individuals, a focus on energy, trade, foreign exchange, multinationals, cash management services and corporate finance. They also had very highly skilled professionals with a strong knowledge of the local market and extremely good support from their parent bank in the areas of competency and skill development, technical management and market development which leverages its global relationship.

While these developments are welcome, not all elements of the Nigerian society benefited from Citibank's presence, especially given the highly specialized areas Citibank chose to focus. The retail banking sector is largely ignored. This raises the question that the developmental impact of introducing foreign banks may well be sizeable and positive, but the benefits are not evenly shared across the society. This needs to be remedied by encouraging the foreign intermediaries to participate in all segments of the financial sector, from the retail and microfinance segment to the larg-

er corporate segment catering to big businesses.

Having said that, it is generally recognized that the participation of foreign banks helps to deepen the financial sector and improve efficiency in the banking sector. As more actors with an international presence increasingly participate in this sector, they also help the process of banking globalization. Foreign ownership has been shown to help develop a more efficient and robust financial system. Across the globe, increased foreign participation has generally been found to improve the efficiency and competitiveness of, and help strengthen, countries' financial systems, including through facilitating the privatization of state banks and broadening access to financial services. (Claessens and Lee 2002). If foreign banks buy heavily into Nigerian banks, the manufacturing sector stands to benefit, as it would encourage foreign trade and ease transactions, with enhanced access to international capital and better resource allocation on the parts of the banks.

Uwah (2009) agrees, when he correctly notes that the manufacturing sector is already giving kudos to the CBN Governor's signals to foreign investors, that the time has come for them to buy heavily into Nigerian banks. The view from manufacturers is that Nigeria needs the investment of the foreign banks to develop the economy and that, with adequate regulation and strict monitoring for compliance, the foreign banks could be compelled to act in the interest of Nigeria. Also important is the need to grow strong roots in the domestic processes of savings and investment in agriculture, industry and the real sectors of the economy.

4. Conclusion

Like Nigeria, other African governments are faced with challenges brought on by the global crisis and policy decisions to mitigate these challenges. Too often there is a knee-jerk protectionist approach to crises such as this, but in this current crisis, by and large African governments seem to have taken a different approach. African governments have taken a country by country approach as well as a regional approach, which serves to seek out solutions to the common problems they face. For example, African ministers of finance and planning and the governors of the central banks met in Tunisia last year to discuss the crisis and its implication for Africa. This was a meeting jointly organized by the three main African institutions, the African Development Bank, the African Union Commission and the Economic Commission for Africa. The crux of their decision was the need to deepen the economic and structural reforms that have served Africa well over the last two decades. Some African countries initiated country-specific reforms such as the Nigerian policy discussed above. This approach included interest rate reductions, recapitalization of financial institutions, increased liquidity to banks and firms, fiscal stimulus packages, trade policy changes and regulatory reforms.

The question of whether to liberalize or go down the protectionist path depends on the specific issues facing the country or the particular sector within the economy. It is in that vein that African policy makers, such in the Nigerian context, examine the issues at hand and design policy options in response to those problems. Whether a further opening up would be a benefit to many is a question that has to be balanced with the cost of opening up.

In the Nigerian context, while foreign ownership of Nigerian banks is welcomed for the benefits they bring, it is important that such entry be combined with a commitment to open markets, adequate infrastructure, including good information, a proper framework for secured lending and sufficient transparency. That not many foreign entities seem to have taken advantage of the rule enabling foreign entities to invest more than the 10% limit, points to the difficulty in the Nigerian business environment as mentioned earlier and the need for wider reforms aimed at improving the overall environment for business. Such reforms would only take effect in the long term. If one adds to that the fact that the foreign banks expected to increase financial prudence and disclosures to the Nigerian market, are the very banks that have been weakened by the global crisis, that many foreign banks are relatively illiquid at the moment, and that some of these banks are selling off their assets in emerging markets including Nigeria, then the conclusion to draw is that foreign ownership in the banking sector will take a while to have an impact.

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