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Capital Base and Performance of Money Deposit Banks in Nigeria: Pre and Post Consolidation Era

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Abstract: *This study explored the impact of capital base on the performance of Money Deposit Banks in Nigeria pre and post consolidation. The study adopted across sectional survey design, with total population of 22 Money Deposit Banks in Nigeria. A sample of 5 banks based on their level of profitability and capital base were randomly selected from the total population. The study used secondary sources to extract data from Annual Reports and Financial statements from the selected banks. Simple regression analysis technique was used to analysis the data. The findings show the loan management system in Nigeria over a long period of time has been bad in Nigeria since these (loan) is one of the main source of revenue of the banks. The results also showed that the bank's lending activities has not been accurately documented and appropriately checked. Though banks do give loan some dishonest bank officials especially those at the top management level who divert bank loans to personal loans and use the proceeds for them self.*

Keywords: *Loan, profitability, loan, capital base,*

1. Introduction

The financial market serves as the operational framework of the financial system in which all financial transactions involving distribution of financial assets take place. Financial market is classified into money market and the capital market. The financial instruments serve as the means through which hands are exchanged in the financial system different financial instruments are used in different financial markets. For instance, the instruments used in money market are treasury bills, treasury certificates, commercial papers, bankers unit find, ways and means advances etc. while the financial instruments operational in capital market are debts instruments (e.g. Preference and ordinary shares).

The regulators of the financial system include the Central Bank of Nigeria, Nigeria Deposit and Insurance Corporation, and the Securities and Exchange Commission.

Banking has ceased to be an entirely arm-chair profession, because it is only those banks that can effectively monitor the environment and adequately satisfy the customers with their operational module that can survive. The primary forces that had significantly changed the environment of banking are political and economic power as well as the dynamic impact that technology has had on the banking industry. It becomes pertinent that banks that desire to succeed must remain dynamic, make deft moves, respond to new customer demands faster and work with staff who have big hearts to make powerful decision as situations demand, such banks must be able to take risks within the limits of corporate definitions, size and new market opportunities immediately and innovate continuously (Ogunbanjo, 2002).

Volume of loans and advances that a bank is capable of creating is directly related to the level of the bank's capital (Greuning & Bratavonic, 2003). Capital adequacy determines banks' performance in terms of profitability.

This research work, in attempt to assess and appraise the need for a strong capital base as an indicator of performance, has the following basic objectives in focus:

- To determine the various measures of performance of banks in Nigeria

- To examine specific factors that are useful in enhancing the performance and capital base of commercial banks
- To examine the cost of an inadequate capital on the performance of banks and the extent the banks are using their capital base as competitive instruments

In specific terms the following questions are relevant:

a. Does capital base have an impact on banks profitability?

b. What impact does the consolidation exercise (increased capital base) have on banks performance?

c. How does capital base affect other indicators of performance besides profitability?

The following hypotheses are be formulated from the objective;

HYPOTHESIS 1

H_0: There is no significant relationship between capital base and banks' profit before tax

H_1: There is a significant relationship between capital base and banks' profit before tax

HYPOTHESIS 2

H_0: There is no significant relationship between capital base and banks' return on asset

H_1: There is a significant relationship between capital base and banks' return on asset

2. Review of Literature

Globally, activities of banks reflect their unique role as the engine of growth in any economy. The importance of the financial sector of an economy which comprises banks and non – banks financial intermediaries, the regulatory framework and the ever increasing financial products, in stimulating economic growth is widely recognized especially in developmental economics. **(Uboh, 2005)** set the pace for the landslide of other works on the interdependent relationship between banks and economic growth. Capital base provides a benchmark for measuring returns, without it, investors and companies would be unaware of how they are doing relative to their investments (CBN (2006). The capital base of banks was defined as 'paid up capital (Ordinary shares and non-redeemable preference shares) and reserves unimpaired by losses, i.e total shareholder's funds (Altunbus, et al 2007)

Bank equity capital, for its part, is either raised internally through retention of a portion of profits or is raised externally by the sale of stock or conversion of existing convertible securities or options. Again, the riskiness of a bank, or of the system as a whole, is substantially reduced by a significant increase in the levels of equity capital. The process of capital base has been argued to enhance bank efficiency through cost reduction revenue in the long run. It also reduces industry's risk by eliminating weaker banks and acquiring smaller ones by bigger and stronger banks as well as creates opportunities for greater diversification and financial intermediation (Amel and Salleo, 2002). Bobakova, (2003)**,** states that capital influences bank profitability, argues that in the arithmetical sense, the yield on own capital grows ceteris paribus as the capital proportion declines, since a given volume of capital supports a higher volume of assets A bank with adequate capitalization will surely gain more public confidence than a poorly capitalized. **Janson(2005)** emphasizes that a deposit-taking institution needs to hold capital to attract depositors. Once the capital base is watery, profitability will definitely be affected. Russo, and Harrison (2005) maintained that increasing the capital base of banks in Nigeria would strengthen them and, in the process, deepen activities within the industry. According to Onwumere (2005), the genesis of banking reforms in Nigeria is traceable in part to the period starting from 1952. Prior to this time, there was the absence of any banking reform or legislation. According to Ajayi (2005) reforms are predicated upon the need for re-orientation and repositioning of an existing status quo in order to maintain an effective and efficient state. It has been argued that the expansion in the equity base and mergers of banks will create market efficiency, low interest rates, increase in investments, low inflation among others for sustainable development (Somoye, 2006) Prior to the recent reforms, the state of the Nigerian banking sector was very weak. According to Soludo (2004), the Nigerian banking system today is fragile and marginal. He states that low capitalization of the banks has made them less able to finance the economy, and more prone to unethical and unprofessional practices. These include poor loan quality of up to 21 per cent of shareholders' funds compared with 1–2 percent in Europe and America; overtrading, abandoning the true

function of banking to focus on quick profit ventures such as trading in forex and tilting their funding support in favour of import-export trade instead of manufacturing; reliance on unstable public sector funds for their deposit base; forcing their female marketing staff in unwholesome conduct to meet unjustifiable targets in deposit mobilization; and high cost of funds. The banking system reform as an integral part of the Federal Government economic reforms took the operators unawares. The reform christened “bank consolidation” has as its core feature, the raising of banks capital base of N2 billion to a minimum shareholders fund of N25 billion. This was followed by a regulation that banks must meet these new capital base requirements by December, 2005 (Atemnkeng & Nzongang, (2006)**).** In Nigeria, the reforms in the banking sector preceded against the backdrop of banking crisis due to highly undercapitalization deposit taking banks; weakness in the regulatory and supervisory framework; weak management practices; and the tolerance of deficiencies in the corporate governance behaviour of banks (Uchendu, 2005). The primary objective of the reforms is to guarantee an efficient and sound financial system. The regulations are designed to enable the banking system develop the required resilience to support the economic development of the nation by efficiently performing its functions as the fulcrum of financial intermediation **(Kolo, 2007; and Oyewole, 2008)**. .

Table 1. *Minimum Capital Requirement and Number of Banks in Nigeria (1952-2006)*

Years	Minimum Capital Requirment	Minimum Capital in *US$	Cumulative No of Banks
1952-1978	£200,000-Foreign £25,000-Nigerian £400,000-Foreign £25,000-Nigerian N 1,500,000-Foreign N 600,000-Nigerian	235,295 29,412 470,588 29,412 1,764706 705882	45
1979-1987	N 1,500,000-Foreign N 600,000-Nigerian N 2,000,000-Merchant Bank	1,500,000 600,000 2,000,000	54
1988-Feb.	N 5Million –Comm. N 3Million-Merchant Bank	250,000 150,000	66
1988-Oct.	N 10million-Comm. N 6million-Merchant Bank	500,000 300,000	66
1989-1990	N 20million-Comm. N 12million-Merchant Bank	235,294 141,176	107
1991-1996	N 50million-Comm. N 40million-Merchant Bank	586,235 470,588	112
1997-2002	N 500million-Comm. N 500million-Merch. Bank	5.88million 5.88million	110
2003-2004	N 2billion-Universal Banking	0.0166billion	89
2004 July	N 25billion-Unive.1 Comm. Bank	0.2billion	25

£=British Pound Sterling $=US Dollar rates as at period of increase

N: Nigeria Currency

Sources: *Central Bank of Nigeria-Various Financial Publication (1970-2006) and Financial Markets.*

Table 2. *Nigeria: State of the Banking Industry*

Category	2001	2002	2003	2004	2005	2006
Sound	10	13	11	10	25	10
Satisfactory	63	54	53	51	-	5
Marginal	8	13	14	16	-	5
Unsound	9	10	9	10	-	5

Sources: *CBN Publication (2006)*

In terms of Assets, figure I shows that the total asset of all the 89 banks operating in Nigeria in 2004 prior to the consolidation was N3, 753.28billon (US$28.250billion) and rose to N6400.78billion (US$49.88billon) indicating a growth rate of 70.54.16 per cent within one year after consolidation. The asset size of an average bank which was N42.172billion (US$0.3174 billion) grew geometrically to N267.482billion (US$2.0856billion) within a year after the consolidation exercise, a growth rate of 534.27 percent. This was an impressive performance.

Table 2. *Pre-Post Consolidation Performance of the Nigerian Banks*

Macroeconomic Indicators	N'm 2004 (a)	N'm 2005 (b)	N'm 2006 (c)	% Change Increase(+)Decrease (-)Or Difference(D±) (a - c)
Average Lending (Nm)	14,371.238	42,380.180	80,788.854	+462.15%
Average Assets(N'm)	42,171.66	132,017.34	267,482.50	+534.27%
Average Deposit(N'm)	10,482.36	85,007.13	188,478.55	+1690.05%
AverageNet Worth(N'm)	7,708.73	19,708.88	38,831.31	+403.73%
Return on Equity(%)	35.28	12.72	11.12	-24.16(D)
Return on Asets(%)	8.37	3.01	2.07	-6.30(D)
Assets Utilisation(%)	33.62	11.52	11.04	-22.56(D)
Total Bank loan & Advance	1,294,449.5	1,859,555.50	2,338,718.80	+80.67
(N'm)	0	14,572,240.00	18,067,830.00	+58.34%
GDP(Current Basic Prices)	11,411,070	7.06	7.17	+0.67(D)
(N'm)	6.5	11.6	10.6	+0.60(D)
Real GDP (growth %)	10.00	129.00	128.3	+3.43(D)
Inflation Rate	132.86	17.8	18.30	+0.61(D)
Exchange Rate N/$	18.91	19.50	28.70	+8.28(D)
Min. Lending Rate	20.42	13.0	10.0	+2.80D)
Max. Lending Rate	12.80	442,008.9	525,482.0	+68.87%
MRR/MPR	311,646.8	1,212,218.545	2,142,745.733	+223.82%
Credit to the Private Sector	662,712.600	41.80	41.84	+7.43(D)
(N'm)	34.41			
Bank Market Capitalisation(N'		2,900,062.072	5,120,943.220	+165.89%
m)	1,925,937.5			
Bank Market	3	8.32	11.86	+6.06(D)
Capitalization/NSE		11.8	28.34	+1.22(D)
Capitalisation(%)	5.80	30.8	27.82	+0.18(D)
Total Market Cap. NSE market	5.70			
Cap. (total)	26.6	3.03	2.91	+0.18(D)
Bank Mkt Cap. /GDP		76.7	96.8	+24(D)
NSE mkt cap./GDP	2.73	23.77	22.47	+1.6(D)
Credit to Private Sector growth	72.8	1,859,555.50	2,338,718.8	80.67%
rate (%)	24.08			
Credit to private sector/GDP	1,294,449.5	4,515,116.67	6,400,783.9	70.54%
Averageloan/Deposit Ratio (%)		2,036,089.9	1,826,275.60	+9.92%
Credit to private Sector/Total	3,753,277.8	591,738.7	953,001.20	+173.55%
loan (%)	1,661,482.1	30.98	35.43	+2.54(D)
Loans Adv.	348,387.6	3.03	2.91	+0.18(D)
Total Assets (N' m)	32.89			
Total Deposit Liabilities((N'm)	2.73			
Capital+ Reserves((N'm)				
Comm. Bank Asset/GDP(%)				
Non-financial Private Sector				
Bank Credit/GDP(%)				

Sources: *Various audited Accounts of Consolidated banks as at 2006 Financial Year; Central Bank of Nigeria Statistical Bulletin 2005*

However, an assessment of the level of capitalisation of an average bank prior to the exercise indicates an equity base (Net worth) of N 7.71 billion (US$0.06168billion) rising to N38.83billion (US$0.31064billion) in 2006, indicating a growth rate of 404 per cent. The leverage ratio measured in terms of equity to total asset also declined from 18.28 per cent 2004 to 14.52 per cent

in 2006 for an average bank. This ratio compares favourably with the CBN minimum level of 10 per cent. The post consolidation ratio is also better in terms of its distribution among the banks compared with the pre-consolidation ratio where more than 70 per cent of the equity and assets were concentrated in (the largest five banks) less than 5 per cent of the existing banks. However, the intermediation activities of an average bank improved significantly by about 1,690 per cent from an average deposit base of N10.48billion (US$0.08384) in 2004 to N188.48billion (US$1.50784) in 2006

The profit efficiency/asset utilization has not been impressive. Although the banks have been able to double their gross earnings from their pre consolidation performance level, their profit and asset utilization efficiencies have declined since the conclusion of the consolidation. For instance, the industry return on equity declined from 35.28 per cent in 2004 to 11.12 per cent in 2006, while return on asset declined from 8.37 per cent to 2.09 per cent over the same period. The asset utilization ratio also declined; while an average bank was able to earn 34 kobo for every N1.0 asset in 2004, this declined to 11kobo in 2006. Thus, while the consolidation has improved the structure of the Nigerian banking industry in terms of asset size, deposit base and capital adequacy, the profit efficiency has not been impressive. The banks will need to become more efficient in terms of their ability to generate enough return to justify the increase in the equity base as well as the resources put at their disposals by their stakeholders. The lending capacity of the banks improved significantly as a result of the consolidation. As at 2004, an average bank could only lend about N14, 371.billion. Whereas, the consolidation strengthen the bank where a typical bank in Nigeria in 2006 could lend an average of N80.788billion. This represents a growth of 462.13 percent growth. (see figure 1)

Lemo (2005) and Imala (2005) noted that before capitalization, unhealthy competition existed in the market caused by the relative ease of entry into the market as a result of the low capital base and this necessitated some banks to go into rent-seeking and non-banking businesses, which are not related to core banking functions.

In addition, scale economies are not unlimited as larger entities are usually more complex and costly to manage (De Nicoló et al., 2003)**.** Mohammed (2005) states that the introduction of 25 billion naira minimum capital base was designed to ensure a diversified, strong and reliable banking sector which will ensure the safety of depositor's money, play active developmental roles in the Nigerian economy, and be a competent and competitive player in the African regional and global financial system. The reforms are designed to enable the banking system develop the required flexibility to support the economic development of the nation by efficiently performing its functions as the pivot of financial intermediation (Lemo, 2005)**.**

Now that the exercise has been concluded, attention has clearly shifted to its term effects on the Nigerian banking system (Omoh, 2006). Banks' performance is measured by its capacity to maximize returns on investor's funds. In the Nigerian economy bank performance is determined by a number of factors, namely lending rates, deposit rate, management effect, ownership and control, market structure etc (Somoye & Ilo, 2009)**.** In order to have an effective and efficient financial system both the banks and the regulatory institutions exert a lot of concerted efforts. This accounted for the reason why the CBN initiated the consolidation exercise in 2005. This section will discuss some of the factors that influence banks performances in Nigeria banking industry and elsewhere. This is the rate of interest at which a Bank lends to it customers. In Nigeria, banks' major roles are financial intermediation and promoting the payment system to ensure efficient and effective allocation of depositor's money. **Somayo & Ilo, (2009)** also discussed the impact of lending on bank performance. They pointed out that the Nigerian government, through the CBN, set the lending rate for financial intermediaries at their various prevailing levels in the banking industry. To buttress their argument, they argued that the CBN set the rate to favor specific sectors in order to encourage or discourage lending to various sectors of the economy.

3. DATA PRESENTATION, ANALYSIS AND INTERPRETATION

The various data generated through secondary sources in the course of this research are presented and analyzed in this section for the major purpose of testing the validity or otherwise of the

hypotheses. This section is categorized into three parts namely: summary of data collected, analysis and interpretation of data obtained and testing of the hypotheses.

Table1. *UBA: capital base and performance*

YEAR	PBT (N'mill)	ROA(N)	DPS(N)	OSC(N'mill)	SP(N'mill)	RSVS(N'mill)
2001	1,585	0.0085	0.25	850.000	0	7,577.000
2002	2,238	0.0113	0.3	850.000	0	8,932.000
2003	4,816	0.0240	0.45	1,275.000	0	12,492.000
2004	5,608	0.0269	0.6	1,275.000	0	16,784.000
2005	6,239	0.0251	0.6	1,530.000	0	16,172.000
2006	12,514	0.0147	1	3,530.000	23,209.000	20,882.000
2007	26,988	0.0245	0	5,748.000	119,066.000	40,007.000
2008	54,637	0.0359	1	8,622.000	114,036.000	65,497.000
2009	22,989	0.0164	0.1	10,778.000	113,645.000	63,296.000

Table2. *GTB: capital base and performance*

YEAR	PBT(N'mill)	ROA(N)	DPS(N)	OSC(N'mill)	SP(N'mill)	RSVS
2001	2,050.323	0.0501	0.4	750.000	0	3,276.177
2002	3,107.315	0.0524	0.83	1,000.000	2,172.666	4,777.316
2003	4,144.919	0.0498	0.6	1,250.000	2,172.666	6,238.755
2004	4,883.256	0.0408	0.7	1,500.000	2,172.666	7,945.312
2005	6,527.537	0.0389	0.76	2,873.248	18,831.536	9,190.185
2006	10,024.936	0.0329	0.7	3,000.000	21,391.928	16,253.614
2007	15,350.231	0.0321	1.03	4,000.000	21,391.928	22,041.260
2008	27,198.704	0.0381	0.75	6,839.708	119,076.565	35,136.791
2009	26,959.809	0.0247	1	9,326.875	119,076.566	60,072.347

Table3. *Zenith bank: capital base and performance*

YEAR	PBT(N'mill)	ROA(N)	DPS(N)	OSC(N'mill)	SP(N'mill)	RSVS(N'mill)
2001	2,802.580	0.0466	0.5	1,026.658	0.300	5,698.989
2002	3,999.398	0.0432	0.9	1,026.658	0.300	8,279.010
2003	5,440.471	0.0483	0.7	1,548.555	0	11,103.022
2004	6,404.885	0.0331	0.7	1,548.555	0	14,125.813
2005	9,164.787	0.0278	0.7	3,000.000	18,224.000	16,566.000
2006	15,154.000	0.0248	1.1	4,587.000	67,760.000	28,054.000
2007	23,289.000	0.0263	1	4,633.000	69,237.000	38,963.000
2008	48,939.000	0.0291	1.7	8,372.000	255,047.000	75,064.000
2009	31,753.000	0.0202	0.45	12,559.000	255,047.000	60,777.000

Table4. *First Bank: Capital Base and Performance*

YEAR	PBT(N'mill)	ROA(N)	DPS(N)	SF(N'mill)
2001	6,201	0.0291	1.3	17,093
2002	5,087	0.0191	1.3	17,747
2003	13,393	0.0418	1.5	25,040
2004	14,106	0.0451	1.55	38,621
2005	15,145	0.0401	1.6	44,672
2006	16,128	0.0299	1	60,890
2007	22,097	0.0290	1	77,351
2008	38,020	0.0326	1.2	339,847
2009	46,110	0.0277	0	351,054

Table5. *Access bank: capital base and performance*

YEAR	PBT(N'mill)	ROA	DPS(N)	OSC(N'mill)	SP(N'mill)	RSVS(N'mill)
2001	116.081	0.0145	0	600	0	319.493
2002	-17.947	-0.0016	0	1350	479.536	114.248
2003	810.639	0.0359	0.05	1350	329.536	685.820
2004	951.750	0.0304	0.1	1500	0	1,202.830

2005	751.033	0.0112	0	4055.607	8535.754	1,480.563
2006	1,119.449	0.0064	0	6978.161	20277.386	1,638.339
2007	8,043.165	0.0245	0	3,489.081	20277.386	4,618.424
2008	19,042.106	0.0185	0.4	8,071.252	146,047.149	17,883.625
2009	28,105.815	0.0416	0.65	8,107.130	146,446.833	30,276.794

4. Testing of Hypotheses

The simple linear regression technique was applied to each of the hypothesis and the decision to be taken depends on the P values obtained. For each of the hypothesis, the decision rule is to reject the null hypothesis (H_0) and accept the alternate hypothesis (H_1) where the P value is less than 0.05 (P value<0.05) or to accept the null hypothesis (H_0) and reject the alternate hypothesis (H_1) where the P value is greater than 0.05 (P value>0.05)

HYPOTHESIS 1

H_0: There is no significant relationship between capital base and banks' profit before tax

H_1: There is a significant relationship between capital base and banks' profit before tax

BANK	P VALUE	ACCEPT/REJECT H_0	ACCEPT/REJECT H_1
UBA	0.01	REJECT	ACCEPT
GTB	0.000	REJECT	ACCEPT
ZENITH BANK	0.000	REJECT	ACCEPT
FIRST BANK	0.000	REJECT	ACCEPT
ACCESS BANK	0.027	REJECT	ACCEPT

Remarks: From the results obtained, it can be inferred that there's a significant relationship between capital base and profit before tax of all the sampled banks

HYPOTHESIS 2

H_0: There is no significant relationship between capital base and banks' return on asset

H_1: There is a significant relationship between capital base and banks' return on asset

BANK	P VALUE	ACCEPT/REJECT H_0	ACCEPT/REJECT H_1
UBA	0.023	REJECT	ACCEPT
GTB	0.298	ACCEPT	REJECT
ZENITH BANK	0.270	ACCEPT	REJECT
FIRST BANK	0.098	ACCEPT	REJECT
ACCESS BANK	0.118	ACCEPT	REJECT

Remarks: From the results obtained, it can be inferred that there's no significant relationship between capital base and return of asset of all the sampled banks with the exception of UBA

5. Conclusion and Recommendations

The research on the effect of loan management on the performance of Nigerian banks revealed a lot of negative results. These findings have overt and covert implication – on the growth of the loan management in the banking system and on the role of banks in the economy. The findings show the loan management system in Nigeria over a long period of time has been bad in Nigeria since these (loan) is one of the main source of revenue of the banks. The test also showed that the bank's lending activities has not been accurately documented and appropriately checked. Though banks do give loan some dishonest bank officials especially those at the top management level who divert bank loans to personal loans and use the proceeds for them self. The official might have been able to achieve this high mismanagement of loan because they are the only one in charge of the fund at hand in the banks and they do not have the unexpected arrivals of audit teams checking the funds available at hand to correspond with that on the banks cashbook or the banks financial records This research work also disclosed that of all the banks tested the guaranteed trust bank proof to have the best loan management of all the banks since it still shows to a reasonable level that there is presence of the effect of loan management on performance but this should not be seen as a conclusion that it is good enough as there is still a very wide gap of improvement that should be should be filled by GTB. The findings also revealed that the use of cannons of good lending might not have been used in always used in assessing a customer seeking

for loan to determine if he is credit worthy or not. It also shows that the ineffective management of loan portfolio's credit risk requires that the Board understand and control the bank's risk profile and its credit culture. Banks should review their credit portfolio continuously with a view to recognizing any deterioration in credit policy and also that the use of sound credit management will ultimately reduce high incidence of loan ineffectiveness on performance The goal of every organization is to remain in business through profit making. It is also worth mentioning that granting of loan contributes to the profit of banks through the charging of interest. Loans given to borrowers, shareholders' and depositors' money and hence should be critically evaluated before they are being granted and they should be continuously checked to for proper management.

Effective management of loan portfolio credit risk requires that the Board understand and control the bank's risk profit

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