Prevention of Bank Failure in Nigeria through Strategic Internal Reforms

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Abstract
This study investigated apparent and remote causes of bank failure with a view to incorporating strategic internal reforms into the reform agenda of banks to justify the efficacy of home-grown solutions to bank failure. This is because most of the prescribed solutions drawn from sources external to the banking environment and foreign countries had not yielded significant positive effects. The general objective of the study was to determine the extent to which strategic internal reforms could prevent bank failure in Nigeria. The specific objectives were to identify the internal reforms that can contribute significantly to survival of banks in the present competitive global environment and determine the nature and strength of their contributions. The methodology adopted was that of extensive review of literature and data obtained from regulatory authorities in the post consolidation era in the Nigerian banking industry. It was found out that the reforms that led to consolidation, and increase in capital base from N2 billion to N25 billion, by banks in Nigeria in 2005 were short-lived and alien to Nigeria as some of the consolidated banks still ran into problems of liquidity soon after consolidation which led to the Central Bank of Nigeria's intervention again. The study therefore concluded that with strategic internal reforms, more stability could be achieved in the Nigerian banking industry to strengthen foreign investment drive in the economy.

Keywords*: bank failure; internal reforms; global environment; consolidation; foreign investment; stability.*

Introduction

Banking reforms in Nigeria through various regulatory authorities have not had significant positive effects on optimal service delivery to customers as observed by some scholars. According to Sanusi (2012), economic reforms are periodically embarked upon in Nigeria to ensure that every part of the economy functions effectively for the achievement of macroeconomic objectives of price stability, full employment, high economic growth, and internal and external balances. It is also to properly reposition the banks in particular in the global environment to carry out their intermediation functions profitably. It is also aimed at ensuring that the Nigerian economy becomes one of the 20 largest economies by the year 2020 and to prevent failure in the banking industry.

The banking environment has witnessed several reforms by the regulatory authorities over the years. In 1958, after the first banking ordinance of 1952, the colonial government raised the

capital requirement of banks, especially the foreign commercial banks, from ₦200,000 to ₦400,000 and this was subsequently increased to ₦1.5million in 1969 (Nwanko, 1987). Ever since, the issue of banks' recapitalization has been a continuous occurrence, as it has been in other economies all over the world.

Statement of the Problem

In spite of the various reforms that had taken place in the Nigerian banking sector over the years, much had not been achieved (Soludo, 2004). According to Soludo (2004), at the special meeting of the bankers' committee on July 6, 2004, he stated that the goal of reform was to help the banks to become stronger players in a manner that will ensure solvency leading to higher returns to the shareholders over time and eventually impact greatly on the Nigerian economy. A recent review of the occurrences in the industry (CBN, 2014 & 2015), points to the fact that all these expectations are far from being achieved, as interest rate is still very high, hovering between 25 – 30%, and lenders still show apathy to extending bank loan to the real sector of the economy, even when borrowers are prepared to take the loan at the prevailing interest rate, thereby leading to low productivity and increase in youth unemployment. Furthermore, some banks have not paid dividends to their shareholders since the recapitalization exercise of 2005. Hence, the need to consider other possible strategies that can lead to achievement of relative stability in the banking sector of the economy. This has essentially spurred the researcher to consider internal rather than external strategic reforms which has not yielded the desired dividends. It therefore behoves on the researcher to look at internal strategic reforms which are a form of internal architecture with a view to enhancing the service delivery status of banks. Therefore, there is need to assess the internal architecture of banks to be able to position them for effective service delivery to both their current and prospective customers. This was the researcher‘s focus in this study.

Methodology

The methodology adopted in this study was that of extensive literature review and evaluation of reports of deposit money banks and the CBN annual reports after consolidation up to year 2015. The descriptive method of analysis was adopted on the figures contained in the various reports.

Policy Review

Nigerian banks which had funded acquisitions of shares on the Nigerian stock exchange, found themselves with shares which were worthless and borrowers who were unable to service their loans. Liquidity problems arose for banks due to panic in the financial system and banks had to borrow from the CBN's expanded discount window, through which banks access short term borrowing from the CBN, as a lender of last resort. The CBN having observed the increased activity of a number of banks in the expanded discount window initiated an examination of all banks to ascertain their state of health. This examination revealed a disquieting state of affairs which if not addressed immediately, would have resulted in the systemic collapse of the Nigerian banking sector. The CBN took a number of steps aimed at ensuring the stability of the Nigerian financial system and also restoring public confidence in the banking sector. These steps included, (i) changing the management of the banks; (ii) injecting funds into ailing banks; (iii) providing a guarantee to cover exposure to correspondence and other international banks; (iv) establishing an asset management company to take the non-performing loan (NPLs) out of the Nigerian banking system; (v) recapitalizing affected banks; (vi) adopting a bridge bank model to avoid the liquidation of the ailing banks; (vii) reversing the universal banking model and imposing tighter regulations.

Human Capital Development

Human capital is the stock of productive skills, talents, health and expertise of the labour force, just as physical capital is the stock of plant, equipment, machines, and tools. Within each type of capital the performance, vintage and efficiency can vary. The stocks of human and physical capital are produced through a set of investment decisions, where the investment is costly in terms of direct costs and, for human capital investment, in terms of the opportunity cost of the individual's time. The factor of human capital plays the central role in contributing to customer satisfaction, because it conducts, controls, and manages every activity of a business to provide customers with the best products and services and it can affect customers' consumption behaviour. In other words, skills, knowledge and experiences of staff of a company have positive or negative influences on the performance of products and services, which then impacts on customers' consumption (McColl-Kennedy & Kiel, 2000). This interaction with employees may be visible or invisible to customers. This means that the higher the quality of human resources, the better the likelihood of customer satisfaction.

According to Udendeh (2009), Nigeria banks have witnessed six rounds of major reforms since 1892 with the opening of African Banking Corporation of South Africa branch in Nigeria. Some of the reforms stem from circumstances of political and economic imperative, while the methods of some reforms conflict with micro-economic objectives, yet, objectives were not fully met since inception because of the volatile political environment.

S/N	Type of Reform	Period
1	Free-banking era,	1892-1951
2	Regulated era	1952-1991
3	Liberalized regulation era with specialist roles	1991-2000
4	Liberalized regulation era with universal roles	2000-2005
5	Bank recapitalization/consolidation	2005
6	Asset Management Company (AMCON)	2010
7	Decentralization of capital base	2010

Source: Summaries of various papers from CBN on banking reform.

These changes were too frequent as programmes were not allowed gestation periods and full assessment before being replaced or other reforms introduced. This might be due to the fact that internal reforms was not introduced in all these reforms, the impact of human effort should not be undermined.

Freeman and Reed (1983) definition of stakeholders in the wide sense are "any indefinable group or individual who can affect the achievement of an organization's objective or who is affected by the achievement of an organization's objectives.

The organization depends on (key) stakeholders for its continued survival since they are the suppliers of critical resources for the firm. This position is in tune with resource dependency perspective (Pfeffer & Salancik, 1978). Each firm operates simultaneously on a number of markets – capital markets, labor markets, markets of goods and services, markets of governmental patronage and public admiration – and routinely seeks "supplies" from these markets. We should note that only two types of "suppliers" (customers as suppliers of working capital and suppliers of energy and raw materials) perform irreversible transactions with the firm. However, even supplies of machinery and equipment may be arranged through leasing, supply of technological solutions may be arranged through licenses or franchising

agreements, and in many cases customers enjoy the warranty that stipulates the right to return back the purchased goods of inferior quality. Suppliers of capital, human resources, and public approval (admiration) are simply "lessors" of particular resources, and therefore they may claim their possessions at any time.

Reduction of bank failure in Nigeria through the introduction of strategic internal reform:

Enthronement of professionalism and ethical behaviour

Performance of banking industry will go a long way with professionalism and ethical behaviors. Ethics can be defined as "the guidelines or rules of conduct by which we aim to live, work and socialize (Adewumi, 1998). Ethics also refers to established rules or principles of appropriate behaviour. It has also been defined as the principle of morality and entails doing what is good and right, even when that will bring us pain. Ethics also encompasses virtues such as fairness, honesty, compassion, loyalty and integrity (Adewumi, 1998).

Professionalism refers to competence, technical skills or specialist knowledge that arises from an extensive period of training and often entails subscription to a code of ethics which stresses qualities such as integrity, objectivity, competence, confidentiality and independence. (Odozi, 2010). He defined professional ethics as the standard of competence and practice or code of conduct required in a given calling, line of business, trade group or specialized occupation. He however stressed that with respect to financial services sector, the concept of professional ethics encompasses an array of written and unwritten norms and best practices, such as trust, honesty, integrity, fairness, competence, loyalty, transparency, accountability, self-discipline, confidentiality, compliance and social responsibility. Business success can be attributed to good strategy and prudent management. However, no business will survive for very long on a record of cheating, swindling and exploitation. Neither can a financial institution live on its wits by perpetually exploiting legal loopholes (Odozi, 2010).

Many banks failures have been caused mainly by the operators' lack of ethical practice. Sanusi (2010) remarks that thousands of poor people who have kept their life savings in the bank or those who invested their savings to buy banks shares lose them due to unethical practice of the operators.

Another ethical misdemeanour in Nigeria banks is governance malpractice within banks. Sanusi (2010) says although consolidation/reform created bigger banks, it failed to overcome the fundamental weaknesses in corporate governance in many of these banks. It is well known in the industry that since consolidation, some banks have been engaging in unethical and potentially fraudulent business practices. In addition, many banks' boards were known to have obtained unsecured loans at the expense of depositors.

Adequate record keeping

There has been a confirmed case of mass falsification of records to deceive the regulators and the public as reported by the CBN. Sanusi (2010) reports further that a lot of the capital supposedly raised by these so called "mega banks" was fake capital financed from depositors' fund. For example, 30 percent of the share capital of some banks was found to have been purchased with customers' deposits. A bank also reportedly used depositors' funds to purchase about 80 percent of its Initial Public Offer (IPO). It paid ₦25 per share when the shares were trading at ₦11 on the Nigerian Stock Exchange and these shares later collapsed to under ₦3.00 (Sanusi, 2010).

Inadequate disclosure was another unethical practice exhibited by the operators. Unfortunately, the CBN equally displayed incompetence by not acting fast in protecting

depositors and the nation. The CBN did not act to enforce the accuracy of their reports (Sanusi, 2010).

Minimizing cases of frauds and forgeries

The CBN 2007, 2008 and 2010 annual accounts and reports showed that there had been an increase in the number and amount involved in attempted fraud and forgery cases. There were a total of 1,974 reported cases of attempted frauds and forgeries, involving ₦24.5b, US$1.4m. Euro 451,075.0 and 2,635.0 pound sterling compared with 1,553 reported cases involving ₦8.8b, US$591,487.8, 35, Euro390.8 and 12,410.0 pound sterling in 2008. Out of which 746 cases were successfully executed by the perpetrators and resulted in losses to the banks amounting to ₦6.4b, US$175,594.3 and 2,585.0 pound sterling compared with 825 cases involving ₦2.7b ,US$238,621.5, Euro390 and 12,410.0 pound sterling in 2007; while in 2006, 612 cases involving ₦4.6b, US$1,753,024.06 and 14,399.74 in 2006. It was unfortunate that number of fraud and forgery in 2010 almost triple what is was in 2008. In 2010, there were a total of 5,960 cases of attempted fraud or forgery, involving ₦19.7b and US$19.2m, compared with 3,852 reported cases involving ₦33.3b, US$1.0095m, 11,000.0 Euro and 2,800.0 pound sterling in 2009. Out of this amount, the actual losses to the banks were ₦11.4b and US$10.98m. Most of the successful fraud was perpetuated via the electronic system, reflecting weaknesses in the internal control systems of banks in Nigeria. The ugly trend as noted above still continued in 2014 and 2015. According to NDIC report, the profile of frauds and forgeries in 2014 and 2015 were as follows: The reported incidents of frauds and forgeries in the banking industry rose to 10,612 fraud cases in 2014 compared to 3,786 cases reported in 2013, representing an increase of 180.29%. In the same vein, the amount involved increased from ₦21.80 billion in 2013 to ₦25.61 billion in 2014, an increase of 17.48%. Also the expected/actual loss increased from ₦5.76 billion in 2013 to ₦6.19 billion in 2014, an increase of 7.46%. Similarly, the rising incidence of frauds and forgeries in the banking system continued in 2015. During 2015, a total of 12,279 fraud cases were reported representing a 15.71% increase over the 10,612 fraud cases reported in 2014. The amount involved, however, decreased by ₦7.59 billion or 29.63% from ₦25.61 billion in 2014 to ₦18.02 billion in 2015. Similarly, the expected/actual loss decreased by ₦3.02 billion or 48.79% from ₦6.19 billion in 2014 to ₦3.17 billion in 2015.

Compliance with corporate and regulatory requirements

Banks and bankers must comply with corporate and regulatory requirements, if Nigeria must witness stability and growth in the financial industry (Sanusi, 2010).

Banks should be in the hand of those who not only understand that banking is a journey full of dangerous corners, and tagged risks, which if improperly approached, may lead to fatality; but also they must have strategic mind-set and ability to recognize those corners, and be equipped to navigate over them successfully (Asikia, 2010). Ologun (1994) in Asikhia (2010) asserted that banks were manned by academically qualified people but most of them lack the practical strategy of the modern banking system. According to the 2011 Annual Report and Accounts of Chartered Institute of Bankers, Fellows members were 581 in 2010 and 674 in 2011 a growth rate of 16 per cent. While the Associate members were 4,560 in 2010 and 4,586 in 2011 with a growth rate of just 0.57 per cent. This is a clear indication that Chartered Institute of Bankers of Nigeria needs to take urgent and strategic steps toward increasing the rate of professional to keep the banks alive. Banks should encourage their staff to be professionally qualified, and higher institutions should encourage their students especially in the Banking and Finance Department to register and start the professional examination alongside with their degree examination. The government should support the industry with enduring policy and security of job and life (NDIC annual report, 2011)

There are two critical factors that will make a financial organization to be successful: These are character and capacity. Osayameh (1986) opines that character refers to trustworthiness, credibility, integrity, and willingness to meet obligation. Capacity is the ability to utilize the money well and it is developed overtime. The things that give rise to capacity building are: education, training, skill, expertise, experience and technical managerial ability (Osayameh, 1986).

Infrastructural Improvement

Customer satisfaction is a benchmark to which an organisation must set its objectives and also to reduce and prevent bank failure. In addition, accompany can only be successful by reforming its internal architecture. A company will be successful when its products or services meet expectations and requirements of customers. If a company aims for customer retention, customer satisfaction is the best way to retain customers' future purchases. Taylor and Baker (1994); Jamal and Naser (2003) stated that service quality has been described as a form of attitude that results from the comparison of expectations with performance. Individual needs, wishes and expectations with regard to the value of the product or service can be measured by some of the following elements, such as friendly and helpful salespersons, informed advice, reasonable price, high quality, and a long guarantee period (Raab & Ajami, 2008).

It is imperative that customers evaluate and perceive quality of service on the grounds of physical objects surrounding the service environment also, such as staff, facilities, infrastructure and the image of the organisation. Wakefield and Blodgett (1999), and Dabholkar, et al. (1996) asserted that physical surroundings of the organisation providing services affect perceptions, responses and behavioural intentions of customers on service quality. As Jamal and Naser (2003, p.33) said, "Customers, however, make inferences about the service quality on the basis of tangibles (the buildings, the physical layout etc.) that surround the service environment".

In 2005, the CBN mandated all Nigerian banks to increase their capital base from ₦2 billion to ₦25 billion in order to improve their competitiveness on the international market and to increase profitability. Significant capital was raised and as a result, the banks were under pressure to realize greater profits and in turn, generate higher returns to shareholders. Nigerian banks became involved in securities trading, margin lending as well as huge oil and gas financings due to the increase in oil and gas prices at the time, thus fuelling a market bubble. The global recession of 2008 had a significant ripple effect on the Nigerian banking system. The result was that investors and traders in Nigeria had to liquidate their positions in profitable markets to fund their losses elsewhere. This led to huge exit of foreign investors from the Nigerian capital market and the attendant fall in share prices.

Conclusion

From the policy reviews and content analysis considered above, it becomes apparent that with strategic internal reforms, and greater commitment by the various stakeholders, more stability could be achieved in the Nigerian banking industry to strengthen foreign investment drive in the economy.

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