ASSESSMENT OF PERFORMANCE OF NIGERIAN BANKS:

A STUDY OF SELECTED BANKS

BY

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DECLARATION

I Musa Onivehu Moru hereby declare that this study was put together by me in fulfilment of the postgraduate requirement for the award of the degree of Master of Science (Accounting and Finance).

The assessment of the selected Banks as shown in this study represent my honest findings. I accept full responsibility for my comments and views as contained in the study.

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1998

DIGITIZED

CERTIFICATION:

This thesis entitled Assessment of Performance of Nigerian Banks: A study of selected banks by MUSA ONIVEHU MORU meets the regulations governing the award of the degree of Master of Science (Accounting and Finance) of Ahmadu Bello University, and is approved for its contribution to knowledge and literary presentation.

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ABSTRACT

This research focuses on the performance assessment of Nigerian Banks. To achieve this objective five Banks are selected for a detailed performance - analysis. They are Union Bank, WEMA Bank, United Bank for Africa (UBA), Lion Bank and Savannah Bank.

The research problem is the apparent wide-spread incidence of financial distress in the banking industry in Nigeria which has led to the withdrawal of the licences of twenty-six banks (thirteen each of the commercial and Merchant Bank(s). The assessment is carried out through the application of the known financial - risk indices with a view to highlighting the efficiency of the various aspects of the operation of the selected Banks. To this end Osaze's version of the Discriminant Analysis models which is more relevant to the situation of the developing countries like Nigeria, is used to assess the selected banks in this study.

The study reviews some of the previous researches on bank performance. It is pointed out in the literature review that there appears to be only one published research on Bank performance in Nigeria as at the time of this study. This study was carried out by Adekanye (1989), Appendix A Pg. 105. Also, the criteria used by the regulating authorities in Nigeria and America to assess Bank performance are discussed.

The study examines certain variables that appear to influence Bank performance in Nigeria. These include influence by government through ownership of shares, issuance and frequent changes in financial policies via regulation and deregulation of the interest and exchange rates.

The main source of data in this study is the Bank's financial statements covering the five-year period (1990-1994). Other sources include extracts from the print media. They form the appendices in this study.

It is expected that the investors will find this study a useful material that could help to reduce their errors of judgement when choosing companies for investment. By highlighting the defects in the use of the Capital/Asset ratio for identifying problem Banks and by identifying a more efficient alternative, the bank examiners are most likely to find this study an easy basis for predicting bank failure.

Since the available records show that not much study has been conducted in the area of bank performance in Nigeria, it is expected that this study will increase the frontier of knowledge in bank performance assessment.

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CHAPTER ONE

INTRODUCTION

The financial performance of a corporation is of great importance to many different groups. The performance of the banks in particular in the economy is usually of major concern to most governments, individuals and organisations, because the banks occupy a special place and play a significant role in the economy.

Infact, the banking sub-sector may be said to be the backbone of the economy because almost all the major financial transactions that take place today within the economy must pass through the banks in order to come into effect. In addition, most of the other sectors owe their existence, sustainance and growth to a well established banking system.

The economy is therefore probably more sensitive to significant changes in the level of performance in this sub-sector than in most of the other sectors. Government, as the regulating authority, is concerned with the level of performance of the banks because the economy as a whole depends on a sound financial sector. Individuals and organisations are concerned because they are interested to know the risk involved when they deposit their money with the banks. This group desire to know from time to time the performance situation in the banking industry in order to decide whether to move their funds out of the banks to the other areas of investment.

But given the developing nature of our economy, the low literacy level of the average investor and the dearth of reliable data in the country, it is doubtful whether the investors can really make informed financial decisions. It is therefore hoped that this study shall provide the investors the needed information to make profitable financial decisions.

The need to assess the performance of the banking industry also arose due to the peculiar behaviour of the sub-sector particularly following the introduction of the Structural Adjustment Programme (SAP) in 1986 and then, the current trend, in which the sub-sector is

witnessing a decline in performance as is reflected in wide spread losses being reported. For example, by 1990, the account of the National Bank of Nigeria (NBN) with the Central Bank of Nigeria (CBN) stood overdrawn. The bank was only saved through a CBN grant of N550 million out of which N450 million remained unpaid before the CBN detailed the Nigerian Deposit Insurance company (NDIC) to take over the administration of the affairs of the bank in 1991.

Five other banks have followed the path of the National Bank of Nigeria. They are Kapital Merchant Bank, Financial Merchant Bank, Alpha Merchant Bank, Group Merchant Bank and the Republic Bank. They were faced with very serious liquidity problems. Both the Kapital Merchant Bank and Financial Merchant Bank were forced into liquidation by the CBN "for jointly owing about N200 million in inter – bank placement and for being greatly distressed".

This was the situation as at 1994. The list of the problem banks have been on the increase ever since. (Appendix A page 98-107). The researcher was therefore tempted to ask – what is happening to the banking industry in Nigeria? Why was profit in the sub-sector soaring along side depressed industrial and commercial sectors in the past? And why this sudden change – a trend in which most banks are alleged to be in a distressed position? This is a very serious problem recognising the role of the banking sub-sector in the economy.

According to William (1952), a healthy financial sector, a sound banking system and an efficient capital market are absolutely essential to a sound economy.

Although the position of the non-banking financial institutions is equally threatened, the situation in the commercial and merchant banks is more important to the country because they are the nerve centre of the nations economic heart beat.

I feel strongly that the above questions must be answered and that the answers may lie in a careful performance – assessment of some selected banks.

1.1 Overview

Chapter 1 is divided into five parts. These comprise the introductory part, the problem statement, purpose of the study, significance of the study and finally the scope of the study. This chapter is somewhat a key to all the other chapters in that it highlights the nature of the study and gives an introductory note on what to expect in the main body of the study. By this, the chapter provides a brief explanation of the problem which I am set to tackle.

The relevance of the study is highlighted by relating the banks' level of performance to the level of the individual's economic wellbeing. Consequently the chapter provides some examples drawn from the banking industry to illustrate the damage which some banks have suffered as a result of their low level of performance.

The focus of attention of research is also discussed in this chapter. The performance assessment is done with the consideration of the environmental background of the banking industry in terms of the bank regulations and the Structural Adjustment Programme. Consequently, the effect of deregulation of the interest rate and the devaluation of the Naira on the bank's profit margin and asset replacement cost respectively are also considered. From this background, we then studied each major aspect of the bank's operation using analytical financial techniques such as financial ratios upon the banks historical financial records.

The purpose of the study is also identified in this chapter. Apart from the academic desire to push further the frontier of knowledge in this area of study, it is my hope that the study shall be found very useful by the majority of bank depositors and shareholders who operate with a high degree of ignorance about bank risks.

Finally, the research problem is discussed under the "problem statement" below.

1.2 Problem Statement

It is no secrete that the banks in Nigeria are going through a very hard time currently. Apart from the National Bank of Nigeria, Kapital Merchant Bank, Alpha Merchant Bank and Finance Merchant Bank which have since gone out of business, several other banks are faced with very serious liquidity problems today.

The pathetic situation attracted the following comment from a financial analyst Ughamadu (1991) "..... their condition (banks) was such that many of them could not even honour withdrawal orders from their customers". Also Asabia (1981) made the following comment "..... information indicated that of the 87 licensed banks in 1990, only 7 large commercial banks and 8 of the older merchant banks, can be said to be making meaningful profit .....practically all 15 State owned banks are in difficulty ....."

The following are excerpts taken from some Nigerian newspapers:

(i) "THAT SHOCKING PICTURE ON THE BANKING INDUSTRY ..... depositors and shareholders directly deserve to know the banks that are technically insolvent ..... the monetary authorities should make bold to identify the banks"

- (Business Times – Oct. 28 1991)

(ii) "CELEBRATING BANK FRAUD ..... The government is not helping issues in the bank fraud question because some of its bank directors if not most of them, are hardly screened".

- (Business Times – 29th July 1991)

(iii) "ALERT ON NIGERIANS!: BEWARE, THESE BANKS ARE NOT SAFE":

"COMPRENSIVE LIST OF DISTRESSED BANKS:

1. African Continent Bank
2. National Bank of Nigeria
3. Cooperative & Commerce Bank
4. Merchant Bank of Africa
5. The Republic Bank Ltd
6. Financial Merchant Bank
7. North-south Bank Ltd
8. Premier commercial Bank Ltd
9. Inland Bank Ltd
10. Afri Bank (IBWA)
11. Access bank Nig. Ltd
12. Inter-State Merchant Bank
13. Continental Merchant Bank
14. Credit Commercial Bank Ltd
15. ICON Merchant Bank
16. Habib Nig Ltd
17. F & B International bank
18. Oceanic Bank International
19. First African Trust bank Ltd
20. Amicable Bank Nig. Ltd.
21. Owena Bank Plc.
22. New Nigerian Bank Ltd
23. Merchantile Bank Ltd

24. Pan African Bank Ltd.
25. Gulf Bank Ltd.
26. Fidelity Merchant bank
27. Great Merchant Bank
28. Gamji Bank Plc.
29. Trade bank Plc.
30. United Commercial bank Ltd.
31. Orient Bank Plc.
32. Alpha Merchant Bank Ltd
33. New Africa Merchant Bank
34. Savannah Bank Ltd.
35. Allied Bank Ltd.
36. Nigerian – Arab Bank Ltd.
37. Bank of the North Ltd.
38. Tropical Continental Bank
39. Nigerian Universal Bank
40. Progress bank Nig. Ltd.
41. Lobi Bank Nig. Ltd.
42. Highland Bank Ltd.
43. Inter City Bank Plc
44. Pinnacle Commercial bank Ltd.
45. Diamond Bank Nig. Ltd.
46. Hallmark Nig. Ltd.
47. Nigerian Merchant Bank Ltd.
48. Merchant Banking Corp.

49. First Inter State Merchant Bank
50. Grindlays Merchant Bank
51. A.B.C. Merchant Bank
52. Nigbal Merchant Bank
53. Prime Merchant Bank
54. Kapital Merchant Bank
55. Nationwide Merchant Bank
56. Lead Merchant bank
57. Marine Inter-Bank Ltd.
58. Credit Lionel Bank Ltd.
59. Midas Merchant Bank
60. New World Merchant Bank
61. Group Merchant Bank
62. Peak Inter Bankers Ltd.
63. Federal Mortgage Finance
64. Centre Point Merchant Bank
65. Federal Saving Bank.

- (Razor – 8th Nov, 1994) - Appendix A pg. 98

The seriousness of the matter lies in the fact that none of the Banks mentioned above has issued a statement to refute the allegation inspite of the adverse effect the publication may have on their reputation.

From the above therefore, it can be seen that there is a serious problem in the banking industry and the position of the depositors and other investors greatly threatened.

The problem in the banking industry prompted the Federal Government to set up the Failed Banks and Financial Companies Tribunal in 1994 to among others, try any bank chief Executive or other bank staff accused of misappropriating bank funds and investigate cases of negligence on the part of the banks management leading to the banks financial losses or failure.

Having identified the problems, the manner in which the problems shall be tackled with a view to identifying the causes and providing possible solutions, are set out under the "aim of the study" below:

1.3 Research Questions

1.3.1 Is capital-base a major determinant of Bank performance?

1.3.2 Is management-quality a major determinant of Bank performance?

1.3.3 What is the effect of government policy on Bank performance?

1.3.4 How effective is the capital/asset ratio traditionally used by the monetary authorities (NDIC and CBN) for identifying problem Banks? 'Capital' here refers to shareholders' funds (share capital + reserves) and 'assets' refers to total assets. It appears that in the view of the monetary authorities, a high capital/asset ratio is an indication of high performance.

1.3.5 What is the Banks' potentiality for further capitalisation to meet the "minimum capital-base" requirement of five hundred million naira (N500m) by December 1998?

1.4 Aim of the Study

All forms of research, no matter their aim, usually point to one direction and that is, to expand the frontiers of knowledge in the area of study. These frontiers may include:

i) The development of an improved quality of service or product at a reduced cost. The aim is to make the product or service more competitive amongst its available substitutes.

ii) A research may be conducted with the aim of developing an entirely new idea and making discoveries in areas that were hitherto unknown.

iii) A research may be conducted with the aim of solving a problem that has a serious adverse effect on the day-to-day life of a large section of the society. For example, the researches being carried out currently all over the world, to find effective drugs against the AIDS virus or the one that is engaging this researcher here – to find answers to the problem of most of the banks in Nigeria allegedly on the path of distress, evidenced by the collapse of a good number.

From the above stated background we have set forth the following objectives:

iv) To identify broadly, the variables that affect the performance of the banks in Nigeria.

v) To find out the extent to which such variables affect the returns obtained from the business operations of the selected banks.

vi) To examine and apply the methods by which we may develop expectation about these variables in the future.

vii) To obtain an explanation for the behaviour of the banking industry in Nigeria.

1.5 Significance of the Study

The central position occupied by the banks in the economy signifies the magnitude of the problem currently plaguing the banking sub-sector in Nigeria. The

relevance of this study therefore stems from the fact that it is directed towards providing a solution to the problem.

Thus, some of the immediate usefulness of this study are enumerated below:

i) Government will be in position to appreciate the real problems of the banking industry and hence, improve the quality of the relevant policies that may be designed to improve performance in the sub-sector.

ii) This study will enable the depositors to be more objective in their choice of the banks to invest in.

iii) The study will enable banks shareholders to have a more objective assessment of the various banks for the purpose of making informed investment decisions.

iv) This study will be an addition to the existing state of knowledge especially as relates to performance in the banking industry.

v) The study will enable the officials of NDIC modify their assessment criteria with a view to minimising the incidence of failure in the banking industry.

1.6 Scope of the Study

This research is limited to the study of certain aspects of the operations of the banks in Nigeria. We have only considered those factors that appear to have material effect on corporate earnings, payment of interests and dividends to corporate investors and business performance generally

In the study of each major aspect of the banks operations therefore we have based our investigation mainly on the banks historical financial records, using analytical financial techniques such as ratios. We have also recognised the environmental background in which the banks operate and which appears to have a tremendous influence on the returns and the general performance of the banks. These include:

i) **Bank Regulation:**

This refers to the control of the bank operations by the monetary authorities through the issuance of policy guidelines from time to time. The guidelines are necessary in order to curb the excesses of some banks which may tend to engage in some unethical practices for profit purposes. The guidelines serve as a standard used by the deposit insurance company to assess compliance by the banks during the company's examination of the banks records.

The aspect of the regulation which probably has had the greatest effect on the banks operations, is the sudden and frequent changes in the policy guidelines, making it difficult for the banks to develop long-term projections.

ii) **Portfolio Constraint**

The assets (loans) and liabilities (deposits) held by banks are controlled with a view to restraining the banks from holding high-risk investment and liability portfolios. For example, a high-risk asset is one likely to require buffer against unforeseen losses. In Nigeria, part of this constraint is packaged into what the Central Bank of Nigeria refers to as the Prudential Guidelines.

Under these guidelines, banks are to make adequate provisions for bad and doubtful debts in their books of account. This means that it is no longer enough for the banks to grant loans on collateral. In addition to the collateral the individual banks must set aside enough funds in the form of provision against default in loan repayment.

iii) Capital Adequacy

Banks should have adequate capital in order to avoid embarrassment arising from liquidity problems. Banks accept and deal with depositors money. It is therefore essential that they have sufficient capital base in order to protect depositors funds and sustain public confidence in the banking system.

According to Itzhak (1968), the capital adequacy regulation imposed on the banks by the monetary authorities, is to ensure that banks observe the minimum capital requirement aimed at reducing the incidence of bank failure and for protecting the depositors.

In Nigeria, the minimum capital – base for the commercial banks was increased in 1990 from N20 million to N50 million and from N12 million to N40 million for the merchant banks.

But the question which has been left unanswered even in the existing literature is "just how much capital is adequate"? It is very difficult if not impossible to fix an optimum capital base for the different banks.

Chapter II of this study is a review of the relevant literature with respect to the assessment of the performance of companies, with emphasis on the banking sub-sector of the economy.

1.7 Definition of Terms

1.7.1 Earning Power (Total Assets to Sales):

This is the asset turnover. It is the speed at which the assets are being turned over into sales. It measures the ability of the assets to generate earnings. If the above ratior gives say 1.5 times. It means that every N1.00 worth of asset generates N1.50 of sales.

1.7.2 Gross Earning Power = $\frac{\text{Gross Profit}}{\text{Total Assets}}$

1.7.3 Net earning Power = $\frac{\text{Net earnings}}{\text{Total Assets.}}$

1.7.4 Operating Profit = Profit before interest and tax.

1.7.5 Capital adequacy: that amount of capital which enables a bank to hold a sufficiently large amount of investment portfolio and yet respond easily to changes in the demand of its creditors.

CHAPTER TWO

LITERATURE REVIEW

2.1 Historical Development of Banking in Nigeria

By the end of the 19th Century, the Nigerian monetary system had began to develop alongside barter trading. The first bank that was established in Nigeria was the British Bank for West Africa, in 1893. This bank after undergoing a number of organisational changes, is known today as the First Bank of Nigeria. This was followed in 1916 by another foreign bank, called the colonial Bank. This bank also metamorphosed into today's Union Bank of Nigeria.

The first well organised indigenous bank was established in 1933 and called National bank of Nigeria. This was followed in 1948 by the African Continental Bank and another foreign bank, called Anglo-French Bank. This bank was also reorganised and called the United bank for Africa. In 1949, another indigenous bank, called Agbomagbe Bank now WEMA Bank, was established.

The urge to establish indigenous banks began when the foreign banks began to discriminate against the local traders and businessmen and in favour of the relatively bigger foreign businesses.

By the time the Central bank of Nigeria was established in 1959, there were 8 banks operating in Nigeria. Of these, 5 were indigenous and three were foreign. The three foreign banks now indigenised and called First Bank of Nigeria, Union Bank of Nigeria and United bank for Africa, dominated the Banking scene. The three banks still account for the larger proportion of the banking business in Nigeria presently.

According to Nwankwo, (1991) in a recent world rating of 500 banks, they were ranked 354th, 420th and 425th respectively.

It must be noted that the primary motive of the foreign banks that came to Nigeria was not to develop the Nigerian economy but to "follow the trade". Thus, the growth of banking was slow before the independence in 1960 but increased rapidly after the independence. The oil boom and the multi-million Naira Development Plans of the 70s also motivated some banks from several other countries, especially in the United States, to come to Nigeria. The influx however reduced dramatically with the economic depression which began in the 80s.

The development of banking in Nigeria was also influenced greatly by government intervention.

Firstly, the alleged discrimination against Nigerians by the foreign banks motivated the government to support indigenous banking and also control the activities of the foreign banks. Apart from the establishment of an apex banking institution the C.B.N. in 1959 to regulate banking business in Nigeria, the Indigenous Enterprises Promotion Decree of 1972, was designed to enable Nigerians control the "commanding heights" of the economy and also "to get intimately involved in commercial banking activities so as to guide them to operate to the maximum benefits of the economy" Nwankwo (1991).

In 1975, the Federal Government acquired 40% of the share capital of the three biggest banks in Nigeria – first bank, Union Bank and United Bank for Africa. At this time, banking was largely concentrated in the major cities in Nigeria. In 1976, the Federal government implemented the recommendations contained in Okigbo Report, when the Central bank of Nigeria directed the banks to commence Rural banking

Programme. As a result, the number of banks and branches grew from 14 and 297 in 1970 to 25 and 1108 respectively in 1983.

The Indigenous Enterprises Decree of 1972 was followed in 1977 by the Enterprises Promotion Decree, requiring a minimum mandatory Nigerian participation of 60% in all banks operating, in Nigeria. With this development the Federal Government acquired the remaining 60% equity capital in the three biggest banks and 60% in all the other banks. From this moment the banks in Nigeria were either predominantly owned by the Federal Government or wholly owned by the State Governments. Banking in Nigeria was thus changed from the Private to Public Sector of the economy.

It should be noted that the return on investment in the major banks in Nigeria, according to Asabia (1991), was among the best in the world during the period 1970 – 73.

In 1986, the Federal Government began the Structural Adjustment Programme. This brought about the deregulation of the foreign exchange market (the Naira was allowed to float and the autonomous foreign exchange market, formerly "black market", was recognised) and interest rates are no longer fixed by the Federal Government. This development led to the influx of new banks in which neither the Federal Government nor State Governments had majority ownership. Although foreign technical partners could have upto 40% in these banks in line with the Enterprises Promotion Decree, no individual Nigerian has more than 5% ownership in the new banks. The reason for the influx of the new banks is the privatisation and commercialisation which accompanied the SAP and the sharp increase in profit level which the deregulation of the foreign exchange had made possible.

According to Nwankwo (1991) "the huge profits recorded by the well managed banks further encouraged the desire to establish more (Banking) institutions ....". Thus, between 1986, when the SAP was introduced and 1989, 33 new commercial and 31 new merchant banks were granted licence by the Federal Government.

The boom in money creation in the economy put a lot of pressure on the general price level and triggered off inflation. In 1989, the Central bank of Nigeria, in an attempt to control inflation, abolished the autonomous foreign exchange market. The liquidity level of the banks was also reduced when the Federal Government in 1989, made the CBN the sole banker for the Federal and State Government and their parastatals. Consequently, the accounts of these institutions were transferred from the commercial Banks to the CBN. This probably had a very serious effect on the level of performance of the banks.

There are about 120 banks in Nigeria today, including those that are on the path of distress.

All the above developments, according to Nwankwo (1991), have brought about a "revolution in Nigerian banking (which) no manager, operator or casual observer can afford not to reckon with ..."

2.2 **Concept of** Performance in Business

The term performance in a business environment refers to the extent to which the objectives of the firm have been realised or are being realised. An assessment of business performance entails the evaluation of the firm's past and current activities in order to establish a trend necessary for future projections. According to Osaze (1990) there are two elements considered in performance evaluation. These are the target and

actual achievement. Targets may be set by establishing a standard against which the actual is compared or by making reference to the firms past level of achievement. When the actual result is compared with the set standard, the level of performance may be described as either satisfactory or unsatisfactory. Also, the level of performance may be described as efficient or inefficient depending on the nature of activity. For example the rate of resource utilization in a production process may be described as efficient or inefficient in cost control or in financial management. On the other hand, a marketing or production strategy may be described as effective or ineffective depending on the volume of sale or number of goods produced respectively.

The economists use the term performance to describe the state of the economy. They measure the level of performance of the economy by making reference to such variables as interest rates, inflation rate, aggregate demand, production capacity of the industries within the economy and so on. In business, performance is usually measured by making reference to some accounting factors such as financial ratios.

The basis of performance assessment is therefore mainly accounting data contained in the firm's financial statements such as the income statement, statement of financial position and statement of source and application of funds.

In financial management, performance evaluation entails the assessment of the firm in terms of its financial returns and asset structure. In this regard, attention is focused on the firms solvency (liquidity and leverage), profitability and asset quality. The quality of total debt for example may be measured by calculating the ratio of bad debt provision to total debt. The higher the amount of bad debt provision in relation to total debt, the lower the quality of debt asset. This ratio is usually calculated for a number of years in order to establish a trend and the degree of management efficiency.

In this regard, either the growth rate of debt is compared to total asset or the growth rate of bad debt is compared to total debt over the years.

The assessment is usually done in the light of the major economic changes influencing the operations of the firm generally.

According to Pandey (1979) financial performance analysis is the process of identifying the financial strengths and weaknesses of the firm by properly establishing relationship between the item of the balance sheet and the profit and loss account. This analysis may be carried out by either the management, the firms owners, creditors, stock brokers and the regulating authorities. The nature of the analysis therefore differs depending on the intention of the analyst. In this study the analysis is done to serve the interest of the banks depositors, owners, other investors, the regulating authorities and the society in general. The information generated from the analysis of a firm's financial statements normally serve as a useful basis for forming an opinion about the firm's financial performance.

The study of financial analysis usually carried out by the various interests groups is discussed below.

i) **Performance Evaluation by Management**

Here, the evaluation is done within the organisation mainly to aid management in making important decisions aimed towards increasing the efficiency and profitability of the organisation. Once the goals of the organisation have been specified targets are set in order to achieve the goals. For example, a company's goal may be to dominate a certain product-market within say, two years. Cost/profit analysis are then made and targets set for each unit or department in an attempt to

achieve the set organisational goal. In this case performance measurement is internally carried out and the benefit or otherwise internally felt.

Sometimes, performance measurement is used to appraise the degree of achievement of a manager or a division of the organisation. Here the decision to be made could be the financial benefit or otherwise of the continued existence of the division or whether to promote or demote a divisional manager or departmental head.

It is believed that by measuring performance and linking each individual's reward to it, each officer in the organisation is encouraged to maximise his effort towards the achievement of the organisational goals.

ii) **Performance Evaluation by Investors**

A company's financial performance may also be evaluated by individuals external to the organisation. Individuals who have invested their money in the organisation may want to reassure themselves that:

(a) the income accruing to their investment is relatively the highest they could hope to obtain in the prevailing circumstances.

(b) The investment is secure and the income will continue to flow in the foreseeable future.

Also, potential investors (individuals with the motive and capacity to invest) evaluate the performance of various organisations with a view to selecting the best organisation in terms of solvency (security of funds) and income generation. This is usually considered to be the first step of any wise investor before he parts with his money.

(c) The management of the firm to whom they have entrusted their money is acting in the best interest of the owners of the funds.

iii) **Performance Evaluation by Creditors**

Creditors such as banks and individual lenders also analyse the financial performance of any company or individual wishing to secure a loan. The evaluation is done to highlight the credit worthiness of the loan seeker. The desire here is to assess the risk associated with the company or borrower's business. This risk can be estimated through a careful analysis of the company's financial performance over a number of years.

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iv) **Performance Evaluation by other Interest Groups**

Belonging to this group are financial analysts, stockbrokers and government agencies such as the tax authorities. Financial analysts and stock brokers, as financial advisers to certain organisations or individuals, for the purpose of speculation or record, engage in the analysis and evaluation of the financial performance of some organisation periodically.

2.3 Approaches to Performance Evaluation

2.3.1 Review of Previous Researches on Bank Performance

Not much research work on the efficiency of bank operations has been undertaken in Nigeria compared to the position in most of the developed countries. This is responsible for the dearth of reliable data in this area of study in Nigeria. One previous research on the performance of Nigerian banks was carried out by Adekanye (1989). Adekanye is the ex-president of the Chartered Institute of Bankers of Nigeria(CIBN). This research covered a period of five years from 1985 to 1989. This period was two years before and three years after the Structural adjustment Programme (SAP). He collected his research data by administering questionnaire in twenty banks and using the financial statements of some selected banks. After

analysing the data by the use of the Multiple Discriminant Analysis (MDA) he concluded that the bank business in Nigeria has been more profitable since SAP was introduced.

Most of the previous studies adopted a number of approaches to the evaluation of bank performance. Most of the time, the researchers have classified the banks along certain lines for the purpose of investigating their relative levels of performance. Some of the classifications used are as follows.

(i) **Problem/Non Problem Banks**

This classification was made by Sinkey (1975). This classification is also used by the United States' Federal Deposit Insurance Corporation (FDIC) to monitor the performance of banks.

The same classification is used by the Nigerian Deposit Insurance Company (NDIC) to assess the performance of Banks. Both the United States' FDIC and Nigeria's NDIC gave identical definition of "problem banks". According to the two monetary institutions, a problem bank is one that, based on the judgement of the monetary authorities, has violated a law, regulation or engaged in an unsafe or unsound banking practice, to the extent that the present or future solvency of the bank is in question.

The monetary authorities classify the banks for the purpose of assessment to determine the nature of the banks' liability, ascertain compliance with existing rules and regulations, evaluate control procedures and accounting practice and to determine the banks capital adequacy.

(ii) **Vulnerable/Resistant Banks**

This classification was made by Arshadi (1987). Financially vulnerable banks are those that are unable to absorb short-term shocks such as a sudden up surge

in the number and amount of withdrawals by depositors. Financially resistant banks on the other hand are those that have sufficient investment in short-term securities which can easily be converted to cash in the event of a sudden increase in withdrawal demand.

2.4 Degree of comparison in Ratio Analysis

One important feature of ratio analysis is the ease with which the different class of items being studied could be compared.

This enables the analyst to have a clear picture of the direction of change in the phenomena being studied.

2.4.1 Criteria Adopted in Ratio Analysis

The following criteria are usually adopted to enhance comparison in ratio analysis:

i) Calculating the relevant ratios of the past financial statements of the same firm. This represents an inter-period comparison of performance based on a trend which is revealed by the ratios. This trend indicates the direction of change – whether the performance has improve, remained constant or deteriorated.

ii) Calculating Ratios for the best performing selected firms in the industry.

iii) Calculating ratios based on the projected financial statements of the same firm. Here, the comparison of the firm's previous years ratios with the future ratios reveals the firm's relative strength and weaknesses in the past and future.

iv) Calculating the average ratios of the industry to which the firm belongs. The problem with this option is that it is very difficult in practice to calculate the industry's average ratio especially where there is a wide disparity between the firms in terms of accounting policy and practice.

2.4.2 Assumption in Ratio Analysis

In ratio analysis, it is generally assumed that the probability of a sickness or bankruptcy is high for a firm with low current ratio, high debt ratio and low rate of return. With this assumption the ratios could be calculated for a firm for inter-period comparison or for a number of firms, for inter-firm comparison.

2.4.3 Reliability of Ratio Analysis for Inter-Firm comparison

Ratio analysis affords the analyst, management, creditors and owners of business an easy way of making a quantitative judgement of the financial condition and performance of a business. The usefulness of ratio analysis lies in its ability to provide an easy and reliable means of assessing performance.

But the question is, can the information produced from ratio analysis be relied upon absolutely as a basis of comparing performance? "Degree of comparison" refers to the extent to which the information generated from ratio analysis can be relied upon for making comparison.

2.4.4 Degree of Comparison and its General Limitations

Degree of comparison is usually limited by the deficiency which arises from the use of individual ratios separately to assess performance. Also, ratio analysis does not take account of certain extra-balance-sheet events which may affect a firm's performance. Consequently, two ratios calculated as indicators of performance may produce conflicting judgement of a firm's performance. For example, in the Bank, a high total Loans and Advances to total Deposit ratio normally indicate high performance because:

(a) Depositors funds are not idle

(b) As the Bank is able to invest a large proportion of the total deposit, it is most likely to generate enough return (interest on loans and advances) to pay the interest on deposit.

But the Bank's actual rate of return may be very low, indicating low performance. This happens when a large proportion of its debt (loans and advances) become bad probably as a result of the self-serving loans, etc., granted by the management. This ratio can therefore lead to a misleading judgement because the theoretical assessment (ratio analysis) is at variance with actual performance. The degree of comparison of inter-Bank performance using this ratio is therefore very low.

i) **Limitations in Inter-period comparison**

Inter-Period comparison of performance is made difficult when certain factors that influence performance change from one year to another. A change in the monetary policy of the government in one year may change the performance of a business in that year compared to the previous years. For example, some Banks may have recorded low performance in the year when the accounts of government ministries and parastatals were transferred from the commercial Banks to Central bank. with the current (1997) change in government monetary policy which withdraws the Central Bank from retail banking business and transfers the accounts of government ministries and parastatals back to the Commercial Banks, some Banks may record improved performance as a result.

Thus, the effects of these non-balance sheet events on performance suggest that ratio analysis cannot be relied upon solely for assessing and comparing performance.

ii) **Limitations due to the Use of Single Ratio**

The degree of comparison is reduced when a single ratio such as current ratio (current assets/current liability) is used to make inter-firm comparison of performance. The general rule is that a 2 to 1 or more of current assets to current liability is satisfactory. But in practice, firm A with less than 2 to 1 current ratio may be doing quite well while firm B with a 2 to 1 or higher current ratio may be finding some difficulty in meeting its short-term financial obligations.

This happens if the quality of firm A's current assets is higher than that of firm B. For example, a large proportion of firm B's current assets may comprise bad or slow-paying debtors. This reduces the degree to which current ratio can be used to compare the performance of firms A and B.

2.4.5 Efforts which have enhanced the Degree of comparison in Ratio Analysis

Efforts have been made by a number of researchers to device a means by which the stated limitations are reduced to a minimum level. This has resulted in the use of a combination of ratios which are analysed jointly to assess a firm's performance. These ratios together, enhance the degree of comparison of performance because they can discriminate between successful and distressed firms. This type of ratio analysis is called Multiple Disciminant Analysis (MDA).

2.4.6 Multiple Discriminant Analysis (MDA)

In the accounting literature the probability of bankruptcy is associated with financial ratios.

The MDA model combines a number of ratios with discriminating characteristics. The individual ratios which are traditionally used in financial analysis are not very effective because of a number of limitations. For example two ratios may produce conflicting judgement of a company's performance. Also, it is usually difficult to choose a correct basis for inter-firm comparison when the individual ratios are calculated.

Efforts have therefore been made by researchers to refine ratio analysis in order to make it more effective. These efforts which took the form of combining a number of ratios which can be used to classify companies as financially healthy or unhealthy, were made by Wall et al., (1928), Horrigan (1968), Beaver (1966) and Altman (1968). However, the models developed by the above mentioned researchers have been found to be unapplicable to the situation of the developing countries. This is mainly because they are studies which are based on data collected from large conglomerates in Europe and America whereas most of the businesses in developing countries are relatively small. The analytical models were therefore designed to suit the peculiar nature of companies in the developed economies. For example, the use of the most modern computers and other automated systems in the production of goods and services make the Euro-based data greatly unapplicable to the situation of the developing economies of the 'Third World' where the system of production is greatly labour-intensive. Due to the above difference, the efficiency of assets, capital and the profit proportion of each unit of sale are likely to be a lot higher in the advanced economies of Europe and America. In fact the Europe-based analytical models such

as Altman's Multiple Discriminant model, have been found to grossly misclassify the firms in the developing countries. For example, if Altman's model was used to assess the firms, including the Banks in Nigeria, the indication would most likely be that all of them are failure prone!

In order to overcome this problem of non-existent applicable model for the developing countries, Osaze (1985) developed an analytical model designed "Specifically to suite the situation of the developing countries" According to him the purpose of his study is ".... to develop a more meaningful, useful and less complicated model for a less developed country like Nigeria". His model contains eight ratios each of which has a specific range of scores as shown below.

2.4.7 Osaze's Analytical Model

(i) **Factor**	
Cash/Ta	**Point**
31 – 40%	16
31 – 30%	12
11 – 20%	8
5 – 10%	4
Less than 5%	0
(ii) Pat/NW	
31 – 40%	12
21 – 30%	10
16 – 20%	8
11 – 15%	6
5 – 10%	4
Less than 5%	0

(iii)	**Factor**	
	EBIT/TA	
	Over 30%	12
	21 – 30%	10
	16 – 20	8
	5 – 10%	4
	Less than 5%	0

(iv)	**GE/ACCT REC.**	**Point**
	More than 2.0 times	12
	1.51 – 2.0 "	10
	1.1 – 1.5 "	8
	0.91 – 1.1	6
	0.5 – 0.9 "	4
	Less than 0.5	0
(v)	PAT/LA	
	Over 30%	12
	21 – 30%	10
	16 – 20%	8
	11 – 15%	6
	5 – 10%	4
	Less than 5%	0

(vi)	**RE/PAT**	
	Above 30%	12
	21 – 30%	10
	16 – 20%	8
	11 – 15%	6
	5 – 10%	0

(vii)	***Profit trend over 5-year period (PAT)***	
	Factor	**Point**
	Firms with rising net profit every year	16
	Firms with stable and level profit each year	12
	Firms with profit each year but no uniform trend	10
	Firms with profit each year but a declining trend	8
	Firms with loss in any one of the first three years only	6
	Firms with loss in first three years only	2
	Firms with loss in all five years	0

(viii)	**Deposit Trend Over 5 – year period**	
	Factor	**Point**
	Banks with rising total deposit every year	12
	Banks with stable and level total deposit each year	10
	Banks with non-uniform total deposit trend	4
	Banks with declining total deposit trend	0

2.4.8 Osaze's Performance Verdict

i) 60 points and above – high performers, not likely to fail

ii) 40 – 59 points – need to be scrutinised or studied carefully before a conclusion is made as to whether they are failing or not.

iii) 0 – 39 points - poor performers, most likely to fail.

Key

TA - Total Asset

PAT - Profit After Tax

NW - Net Worth

EBIT - Earning Before Interest and Tax

GE - Gross Earnings

ACCT. REC. Account Receivable

LA - Loans and Advances

RE - Retained Earnings

2.4.9 (a) Osaze's Ratio Classification

The objective of Osaze's study is to ".... Reduce the risk to which creditors, shareholders and potential investors are exposed". That is, to highlight the "probability of a firm going bankrupt or defaulting on its debt obligations". According to him, the ratios selected "..... constitute what have been determined as the best descrimination between bankrupt and successful firms". These ratios ".... Through pilot studies of special Nigerian cases, are found to be the best indicators of risk in a firm in Nigeria".

The ratios are classified broadly as:

(i) Capital structure ratios:

(ii) Profitability ratios;

(iii) Liquidity ratios

The ratios chosen under these broad classification are:

(i) Capital Structure Ratio

a) Retained Earnings to Net Profit.

b) Deposit Trend.

The ratio shows the firm's growth potential. It also shows the extent to which the shareholders make sacrifice for the firm's long-term growth and survival. The deposit trend shows the growth or otherwise of the investors (depositors) confidence in the Bank.

(ii) **Profitability Ratio**

a. Earnings before interest and Tax to Total Assets.

b. Net Profit to Networth

c. Net Profit to Loans and Advances

d. Profit Trend.

(iii) **Liquidity/Solvency Ratio**

a. Cash to Total Assets

b. Gross Earnings to Account Receivable.

2.4.9 (b) **The Accuracy of Osaze's Risk Index**

Osaze tested his model on the financial result of 30 successful firms in Nigeria and found that only 2 firms (6.7%) were misclassified. T hat is, 2 firms out of 30 were classified as unsuccessful although they are actually successful. The error margin is therefore 6.7% or about seven in a hundred.

On the other hand, when 30 bankrupt companies were assessed with the model, 26 of them were indicated as unsuccessful, 3mis-classified as successful while one

firm was classified as requiring closer scrutiny (a score of between 40-59). In this case the error margin is 3/30 or 10%. The model is therefore about 90% accurate.

As at the time of this research, no other study has produced a more accurate model for the developing countries than that by Osaze. The model is therefore the one used to assess the selected Banks in this study.

2.5 Government Intervention in the Banking System

2.5.1 Ownership of Shares

Government maintains control of the banks sometimes, by taking up majority of the banks' share capital. This is especially true of most of the Asian and African Countries where until recently, the economies are highly centralised. The banks in which government hold majority shares usually, are some of the Country's largest banks. In Nigeria, government had majority share-holding in the Union Bank, First bank, Afri-Bank (IBWA). United bank for Africa (UBA), and the Allied Bank. Government also maintains control-holding in most of the big specialised banks such as the Federal Mortgage Finance and the Nigerian Industrial Development Bank (NIDB).

In Europe and America, however, the banks enjoy a measure of freedom in this regard. Of recent, most of the publicly owned companies including the banks in the developing countries, have been granted a greater degree of autonomy as most of the Countries change from controlled to market economy.

The implementation of the deregulation programme which made governments in Nigeria to relinquish their ownership in the nation's banks, is currently being reviewed because of the seemingly negative impact this may have on the economy. The ownership forfeited by government was intended to be taken over by the Nigerian

public and companies. But the ownership was largely taken over by some foreign interests (most especially British interest). This phenomena gave the foreign interests majority holding in those banks. This is contrary to the objectives of the indegenisation Decree of 19[illegible] and the Enterprises Promotion Decree of 1979.

This phenomenon affected the four biggest banks in Nigeria – First Bank, Union Bank, United bank for Africa and the International Bank for West Africa.

If the situation is not reversed, the Executive Directors of the banks who are normally appointed by the government and so represent government interests, will have to be withdrawn as the banks will prefer to appoint their own Executive Directors rather than those imposed on them by government. The banks, acting purely on commercial ground, will then recruit the best hands in terms of qualification and experience. The banks will therefore not go for individuals who have connections within the government or enjoy government patronage but have little knowledge about banking business.

In view of the above, government is bent on withdrawing the ownership taken over by the foreign interests and maintaining its control of the banks management board by retaining the power to appoint the managing and Executive Directors by virtue of its majority holding.

2.5.2 Appointment of the Members of the banks Board of Directors

The appointment of the members of the board of directors of the banks in which government has majority ownership is usually done by government. This practice probably affects the banks performance because they are not given the free hands to recruit the best hands in terms of qualification and experience. Moreover, it is normally difficult for the Institute of bankers to call an erring bank Chief Executive

to order since his appointment and or dismissal are not within the prerogative of the institute.

It has been seen in the past, situations in which some banks that are not doing well in terms of earnings continue to enjoy government patronage in terms of foreign exchange allocation and government deliberate refusal to order a reorganisation of the bank. In most cases, top government appointments are strongly related to the political strength of the beneficiary of the appointment.

This mode of appointment also apply, in most part to the banks in which government had majority shares. The result is that these government appointees of the banks tend to run their banks as though they were an extension of the public service. According to Ughamadu (1990), the laid down policies of these banks are often bye-passed in major financial decisions in order to satisfy the 'god fathers' within the government rather than pursue the best interest of the bank. Hence bank loans were granted indiscriminately to individuals who regarded these loans largely as their share of the 'national cake'. Therefore, no attempt is made, whatsoever, to repay the loans.

During the second republic for example, a political top wig in Kaduna State was alleged to have taken a loan amounting to N50m from the bank of the North. Subsequently, attempts were made within the bank, to write-off this loan as 'bad debt'. This attempt was however stopped when an alarm was raised.

The story is not different with respect to the other banks in which both the States and Federal government maintain a majority interest. It is therefore said that unless there was a change, the chief executive of the banks controlled by government will continue to run down the banks as long as their allegiance is primarily to government rather than to their individual banks.

2.5.3 Bank's Policy – Guidelines

The banks policy guidelines are documents/circulars issued from time to time by each Country's central or apex bank to inform the registered banks of government policy with regard to specific aspects of banking, to which the banks are expected to comply. Frequent changes in these guidelines mostly in the developing countries, make it difficult for the banks to develop long-term activity projections.

According to Adekanye (1992), the frequent regulation and deregulation of the interest rates and foreign exchange market led to the predominance of short-term credit in most of the banks, (see Appendix A, pg. 105). This should be expected because the risk and level of uncertainty generally involved in long-term credit are higher in an economy that is burged down with frequent changes in monetary policy. Also Adeyemo (1992), said that the banking sector in Nigeria has remained volatile due to changes in policies by the monetary authorities. He then sited the tight liquidity squeeze through the issuance of the stabilisation security, a policy embarked upon by the monetary authorities to combat inflation, as being one of the major problems of the banks. The devaluation of the Naira arising from the deregulation of the foreign exchange market has further compounded the problem of the banks through increased asset replacement and general operational costs.

The banks responded by adopting a defensive approach. They tightened credit lines to customers and raised their interest rates (interest rate was deregulated). As a result of these high lending rates most businesses could not raise funds from the banks for their operation. The resulting liquidity problems led to reduced capacity utilisation in most business. This in turn adversely affected the level of activity in the banks.

2.5.4 Legal Action Against Erring bank Operatives and Defaulting Debtors

In various Countries of the World, specific legal procedures have been established to check the actions of the managements, staff and debtors of the bank that may lead to financial losses by the bank. In Nigeria, the Failed Banks Tribunal was established in 1994 to try the chief executive and other members of staff of the bank for any professional misconduct or lack of professional care resulting to financial losses by their banks. In December 1995, the Kano zone of the tribunal recovered the sum of eleven million Naira (N11m) from the chief executive of Group Merchant Bank. The amount represented a loan-advance granted to the managing director's own private company but which had become irrecoverable.

The tribunal in March 1996, sentenced the Managing Director to one year in prison without an option of fine. The managing director of Alpha Merchant bank was also sentenced, in absentia, to five years in prison for illegally transferring the sum of N355 million to his private company. In April 1996 the Lagos zone of the tribunal heard how Chief Ajayi the managing director of the Republic Bank granted loan-advances totalling N127 million to seven different companies in which he has substantial interest. He was ordered to deposit the sum of N65 million with the tribunal within one week while the Nigerian Deposit Insurance Company shall sell his private properties to recover the balance. The director also allegedly violated the banking regulation by doubling as the managing director of the Republic bank and Director, Finance Merchant Bank. Some financial commentators maintain that the "sanitizing" exercise is necessary in order to halt the deteriorating image of the banking institution in the eyes of the Nigerian public.

The question that one may ask is how effective are the procedures employed by the officials of the Nigerian Deposit Insurance company, who are the bank

examiners, to ensure that the information reflected in the individual banks quarterly returns to Central bank are authentic and that appropriate guidelines are being kept to?

Also, since the tribunal is an adhoc body, will the Nigerian Deposit Insurance Company be able to continue from where the tribunal stops after the current military administration handed over power to a civilian government? And, shall we always need a tribunal to ensure the safety of the depositors' money in the banks? The questions are inexhaustible.

Whatever happens, the Nigerian Deposit Insurance Company may need to reassert itself as an insurer of the depositors funds. One interesting pattern can readily be observed in the current 'sanitizing' exercise. It is that so far, with the exception of the National Bank of Nigeria, most of the banks involved in this problem are the new banks (banks established after the introduction of the SAP).

The banks' major debtors are also made to feel the weight of the law in the current exercise. For example, a man and his son who were alleged to have received the sum of N75m and N25m as loan respectively but failed to pay back were summoned before the Abuja zone of the tribunal.

Since government is now considering extending this cleaning exercise to government parastatals and private companies, it is hoped that future administrations do not abandon this policy of ensuring accountability not only in the banking industry but also in the other sectors of the economy.

2.5.5 Rescue Grant

Part of the functions of the Deposit Insurance company in most countries is to bail out the Banks in distress if, by the assessment of the company, the banks concerned can be restructured and put back on the path of profitability. The company does this by providing a recovery loan or rescue grant to the distressed bank.

Some analysts especially in the developing countries have questioned the usefulness of this grant. Their argument is that the management of most banks tend to abuse the shield provided through the insurance scheme by holding unnecessarily high-risk portfolios in both assets and liabilities. These banks usually promise unrealistic interest rates on deposits and grant loan advances of large sums of money without sufficient collaterals.

According to analysts, it is a normal phenomenon in business that some companies are efficiently managed and flourish while others are poorly managed and die. Therefore, the banks that are poorly managed and could not cope should be allowed to die naturally. This is a normal stabilization process in the financial system. Any attempt by government to keep these category of banks in operation will be counter-productive, not in the best interest of depositors or the society as a whole.

It will be recalled that in September, 1995 the Federal Government, through the Central Bank of Nigeria and the Nigerian Insurance Deposit company, compiled a list of seventeen banks which were officially declared totally distressed. Government is currently contemplating putting out these banks for sale to intending buyers in order to recover the amount owed to depositors, shareholders and other creditors. The banks involved are listed below:

1. National Bank of Nigeria (NBN)
2. African Continental Bank (ACB)
3. Progress Bank
4. F.A.T.B.
5. City Merchant Bank
6. Lobi Bank
7. Republic Bank

8. Premier Bank
9. Nationwide Merchant Bank
10. Alpha Merchant Bank
11. Credit Lionel Bank
12. Gamji Bank
13. Nigerian Universal Bank (NUB)
14. North-South Bank
15. Nigerian Oceanic Bank
16. Group Merchant Bank
17. Kapital Merchant Bank

Whatever the Scheme of action adopted finally by government in respect of the above banks it is hoped that the following points shall be considered.

For a bank to qualify for a rescue grant it is this researchers view that there must be a genuine evidence that the bank concerned had strived sufficiently in the past to manage and utilise its resources in a manner that will otherwise not plunge the bank in a situation of distress. In this circumstance, the management of the bank must be seen to have exhibited a high level of probity and professional care in the handling of the banks resources. Major decisions that may lead to the creation of a contract between the bank and other parties (within or without) must be based purely on economic considerations and in the best interest of the bank. In this regard consideration should be given to the survival of the bank both in the short and long term in the decisions that are likely to lead to the creation of liabilities or income for the bank.

With this background, it becomes relatively easy to categorise distressed banks for consideration for a rescue package. In the case of the seventeen banks which have

been officially declared as distressed, the actions of the Chief Executives and other members of the banks management are likely to fall short of the required standard as stated above. Most banks chief executives have been accused of playing "father Christmas" with the banks resources by granting loans "off record" or without collaterals. Going by the revelations made at the tribunals one of the causes of distress in most of the banks is closely related to financial misappropriation by the banks chief executives. Whether the cause of a bank's distress emanates from defaulting debtors for large sums of bank money in loan advances or the creation of high risk liability portfolios (promising unrealistic interest rate on a category of deposits) it appears that the managing director of the bank has a tremendous power to chart a path of success or failure for the bank and so must be held responsible as such. It must be remembered how the Bank for Credit and Commerce International (BCCI), one of the world's largest financial conglomerates, was pulled down by the unilateral and irrational decisions of all-powerful self-serving managing director.

An ex-president of the Chartered Institute of Bankers of Nigeria (1996) has a different view as far as the problem in the banking sub-sector in Nigeria is concerned. He holds the government and its monetary agencies responsible largely for the unfortunate situation in the banking industry. Government is not very sincere in the bid to stabilise the industry. For example, the seed of distress was sowed by government when in 1989 large sums of money in excess of a billion Naira "belonging to both the Federal and State Governments including their parastatals", were withdrawn from the banks as their accounts were transferred to the Central Bank of Nigeria. Most of the banks, apart from the few large ones, have not really recovered from that shock. In addition, States and Local Governments constitute debtors of substantial amount to the banks. They should be forced by the Federal Government to

pay up. The other possible reason the ex-president of the banking institute gave for the distress is that not all the banks currently operating are members of the institute. Some of the new banks that are not members of the institute lack the required experience in banking.

2.6 Major Economic Forces Influencing Corporate Performance

2.6.1 Inflation

Devaluation and price instability especially in the developing countries have led to a significant fall in the value of money. Theoretically the banks are supposed to gain from this development because they retain the difference between the original value of funds deposited and the reduced value which they pay back to the depositors.

Companies in the manufacturing business suffer greatly during inflation because the cost of raw materials and machinery rise sharply and exert serious financial pressure on the company. The company's products on the other hand, take sometime to be completed and put in a saleable condition.

During inflation therefore, banks perform better than those companies outside the financial sector of the economy.

2.6.2 Global Recession

This has led to a fall in world trade. The price of oil, Nigeria's major foreign exchange earner, fell from $29 in 1981 to about $15 per barrel in 1992. Currently the price fluctuates between $17 and $18 per barrel. International banking is a major aspect of the business of most banks. They finance business transactions abroad on behalf of their clients. The tempo of this aspect of the banks business has been reduced significantly due to the global recession. The problems faced by the banks in this area was further compounded when in 1989 government abolished off-shore guarantees as collaterals for loans in Naira.

2.6.3 Political Stability

Political instability, mostly in the developing countries scare away foreign investors and so discourages the flow of capital into these countries. This phenomena has a very serious effect on the performance of all the companies including the banks in these countries.

In Nigeria, the frequent change of government has a direct influence on the operation and hence the performance of the banks. Whenever there is a change of government especially through a coup d'etat, a vacuum is usually created because the exit of the old leadership and the entry of the new one is not simultaneous. The old leadership ceases to exist and the new one is not named. So for at least one week during which the would-be leaders consolidate their hold on political power, there is usually a cursory gap in terms of who to take major decisions on economic issues.

A change of government in Nigeria and indeed, most other developing countries is usually characterised by a change in the economic policy, abandonment of on-going projects and a reviewal of the existing contract agreements. Financial and other business activities usually come to a halt. For the first two weeks after the change of government, there is usually a lull in economic activities as the business community wait in anticipation of new policies to be announced by the new government.

Indeed, it is risky for any individual or association to take major financial decisions during this period. The losses that may be incurred as a result of changes in monetary policy especially those bordering on interest and foreign exchange rates may be too great to bear. The effect of these developments on the banks is crippling. Interest on deposits have to be paid eventhough the money had been lying idle in the bank's "strongroom" during the period.

One of the most difficult of such periods which the banks had to go through was the period of the Nigerian Civil War from 1967 to 1973. Banking business especially in the war-affected areas, came to a halt as the bank offices were kept under lock-and-key. At the peak of this period some irate soldiers were alleged to have raided and stolen money from the locked-up banks.

After the annulment of the 12th June 1993 election, there was violence across the Country especially in the South-west. People were moving to their home-States with the fear that there might be war. Business activities came to a standstill especially in Lagos area where the banks are mostly concentrated and where most of the banks in Nigeria situate their head offices. There was mass withdrawal of money from the banks by the depositors. Some people were fleeing the Country and needed money to pay for the flight. Other people wanted to have enough cash reserve to feed their families while the trouble lasted. This was followed by the closure of virtually all the banks in the South-west of the country for fear that they might be attacked by some vandals.

Therefore, political instability probably has had a profound negative effect on the performance of the banking industry. Looking at the above picture, there is no gain saying that banking and indeed, all other businesses require a peaceful environment and an enduring political stability in order to build a solid foundation for increased performance.

2.6.4 Competition

The banks usually engage in a cut-throat competition by promising unrealistic interest rates. The banks that are mostly involved in this practice are those that one may refer to as the "new generation", banks. They are the banks that came into being with the introduction of SAP. They are probably in a hurry to catch up with the older

and financially much more stronger banks – the group that one may refer to as the "old generation" banks. In most cases the banks do not think of where to invest the depositors money that will generate a return higher than the rate which they have promised to pay on deposits.

But it is a common knowledge that in a market where there are so many participants all competing for the available financial resources and investment opportunities, it is almost impossible for one participant or small group of participants to earn a profit that is abnormal or greatly above the industry's average. Therefore these banks are likely to find it very difficult to earn a profit on loan advances or other investments that is higher than the interest promised on deposits. If the banks are operating on a capital whose cost is higher than their rate of return, they are likely to find themselves on the path of distress.

However, the high level of competition among the banks resulting from the influx of new banks with the introduction of SAP has increased the quality of bank service. New packages of bank service such as Week-end Banking, Automatic withdrawal Card (which enables a customer to withdraw money from any branch of the bank) and Automatic Funds Transfer (which saves a customer the risk of carrying large amount of cash on a journey) are now available. These products, designed for the convenience of bank customers, were hitherto non-existent.

2.6.5 Adequacy of Capital

It is usually said that banks should have a large capital base as a platform for accepting deposit from the public. For many years it was believed in the United State of America and Europe that banks should be heavily capitalised in order to survive. The belief was that adequate capital is fundamental to banks performance.

In Nigeria, adequate capital base was used as a yardstick for granting licence to the banks. Consequently the banks minimum capital base was increased in 1991 from N20m to N50m for the commercial banks and from N12m to N40m for the merchant banks.

Theoretically there is a direct relationship between capital and failure. Inadequate capital theoretically leads to bank failure. But in practice a lot depends on the banks examiners (officers of the Deposit Insurance Company) to identify problem banks before failure. Moreover there is the question of just how much capital is adequate.

The bank examiners usually rely on the banks capital/asset ratio for identifying problem banks with a view to preventing bank failure.

Several empirical studies such as Cotter (1967), Benston (1973) and Santomero et al., (1977), all showed that capital/asset ratio is an inefficient tool for identifying problem banks. Cotter, in his study, found that the mean (average) values of the capital/asset ratios for those banks that failed and those that did not are not statistically different. Benston studied the capital/asset ratios computed for several banks by the American Deposit Insurance Corporation (D.I.C.) and concluded that capital plays a small role in the prevention of bank failure. This was because most of the banks with low D.I.C.'s capital/asset ratio (an indication of impending failure) did not fail. Santomero, in his own study, concluded that "the bank industry is exposed, on the average, to a very small risk of suspended operation resulting from capital variations".

All the above show that capital is not a major factor for determining the performance of a bank. It is hoped that the present research shall reveal the importance of capital to banks' performance in a developing country like Nigeria.

2.7 Assessment of Management Impact on Performance

That the performance of a business is normally influenced to a great extent by its management is not in doubt. The success or failure of a business can be attributed directly or indirectly to the nature of individuals that constitute its management. Thus, if a business is lucky to have a management made up of individuals who have the right qualification, experience and discipline, that business is likely to tread the path of profitability. Such a business is normally rated as a high performer on the assessment scale. This type of management would normally formulate policies that are in tune with the prevailing economic circumstances, implementable and are in the best interest of the business.

On the other hand if a company is saddled with a reckless and self-serving management whose actions are never in tune with its profit-maximising objective, then it is likely to tread the path of distress or failure.

Thus, the actions of the management of a Bank which may make or mar its performance can be broken broadly into two stages.

2.7.1 Policy Formulation Stage

Here, policies formulated are passed down to the lower managers in the form of guidelines specifying standards and indicating the direction of resource utilisation. The importance of these guidelines is that they:

(i) State categorically the objectives of the firm.

(ii) Reduce areas of conflict during implementation

(iii) Enhance co-ordination of activities at the implementation stage.

(iv) Make for easy monitoring during implementation to reduce the incidence of deviation

(v) Make the products or services of the firm relatively competitive and attractive to the end users as wastes and costs are minimised.

If management is able to generate policies with the above stated qualities, then the short and long-term objectives of the business are likely to be achieved and the impact of the management on the company's performance is positive. Conditions which normally hamper management'' positive impact on performance are:

(i) Situations where there is no harmonious working relationship among the board members.

(ii) Where board-room politics has led to a high level of staff turnover robbing the business of its intelligent, hardworking and honest board members.

(iii) Where there is a clash of interest as personal goals conflict with the goals of the organisation.

(iv) In the case of the Bank, where policy-guidelines handed down to the banks by the monetary authorities (CBN and NDIC) are bye-passed or ignored. Some of these guidelines are the Prudential Guideline and the Credit Ceiling which respectively means that in addition to collateral, a Bank should set up a Sinking Fund for each major loan-advance granted to cushion the effect of default and that loan advance above a certain amount should be referred to CBN for approval.

2.7.2 **Policy Implementation State**

Management is likely to make a positive contribution to performance at the implementation stage under the following conditions:

(i) Where the internal control system put in place are effective.

(ii) Where there is a strict adherence to the management policy-guidelines by the members of staff.

(iii) Where high-quality financial decisions are made on behalf of the owners of business. Since the members of management are supposed to be specialists in the various aspects of a company's business, it is expected that its financial decisions will yield a higher performance than if the owner alone took it upon himself to manage the business.

(iv) Proper co-ordination of the various lines of activities in order to achieve goal congruence (that is, various managers don't 'pull' in different directions thereby stagnating the business).

However, it is normal to find management falling short of the above expectation resulting in a reduced or negative contribution to performance. Management bye-passes the installed internal control system and abuse the trust reposed on it by mismanaging the company's resources.

The resources of the business are diverted to meet personal desires. Their actions are therefore totally at variance with the stated objectives of the company. Undoubtedly its impact on performance in this case will be negative.

In the case of the Banks, this negative attitude may take the following forms:

(a) Members of the management grant self-serving loans. These are loans granted to individuals fronting for the managing director or to a company in which the managing director has a substantial interest, without adequate collateral.

(b) Loans may be granted off-record. These loans represent an arrangement whereby the officer granting the loan and the borrowee agree that a certain amount of money belonging to the Bank be

released to the borrowee off-record. The loan is used to finance a short-term project (say one year or less). At the end of this period the money plus an agreed percentage is returned. The officer of the Bank returns the original amount to the treasury as if it never left the Bank and keeps the profit. In some cases such loans are never repaid.

(c) Members of the management play "father Christmas" with the resources of the Bank by indiscriminately waving interest on loans, especially those granted to friends or relations.

These actions of the management reduce the profitability and the general performance of a business.

2.8 Summary of the Chapter

The chapter reviews the relevant literature in this area of study. An update of this frontier of knowledge was made by supplementing the existing literature with the opinion and analytical views of seasoned bankers, financial and economic experts. The chapter began with a review of the environmental background and growth of banking in Nigeria.

The development of the banking and the entire monetary system in Nigeria got to the level it is today through deliberate policies of the Federal Government to rescue, support and indegenise the system, especially after the independence in 1960. It must be recalled that the foreign multi-national companies and their European traders were alleged to have been all out to frustrate indigenous participation in the banking business and limited the development of the monetary system to the level that would enhance their exploitation of the economic resources of Nigeria.

The chapter also explains the concept of performance and relates it to banking business. This is followed with the discussion of the various methods of assessing performance. The methods adopted by both the monetary authorities and financial experts are also examined. Consequently, the methods of classification that would enhance the assessment of bank performance are discussed. The classification and assessment of bank performance that is most suited to the Nigerian situation is expressly identified and adopted for the methodology of this research in chapter three.

One of the major materials employed in this study is the banks' financial statements. Financial statements are the score-board for assessing the performance of any profit – maximising business.

The chapter identifies ratio analysis as the major tool for assessing the financial performance of a company. The most important of these ratios and the one mainly employed in this study is the Osaze's Multiple Discriminant ratios.

Economic forces have both positive and negative effects on bank performance. The increased competition resulting from the large number of banks raise the quality of bank service. But because of the high level of competition some banks may engage in unconventional practices to woo potential depositors. In this regard they promise to pay unrealistic interest rates on deposits. This practice can greatly reduced the level of financial performance of the banks.

The management of the bank, headed by the managing director plays a major role in forging a path of profitability or otherwise for the bank. If a bank is endowed with efficient and honest management team it is likely to survive the effect of the ever changing economic fortunes which characterise business activities generally. If on the other hand a bank is unlucky and has a management team that is self-serving and

financially reckless, the bank will operate below cost and may begin to thread the path of distress.

Government influences the performance of the banks through such measures as ownership of shares and monetary policies. The Central Bank is the principal agent of the government as far as the monetary policy -- formulation and implementation are concerned. As the bank of last resort, it ensures stability in the banking system.

The Nigerian Deposit Insurance Company as the bank examiner, is expected to reduce the rate of ban k failure. These two monetary authorities probably have not been very effective in their role of identifying the problem banks early enough with a view to preventing the incidence of distress and reduce the rate of failure. Many banks in Nigeria are in a situation of distress presently. It is probably because the situation appears to be beyond the control of these two monetary agencies that government decided to apply a more forceful measure to stop the drift by setting up the failed Banks and Finance Companies Tribunal. This measure which one may refer to as a last resort, is aimed at redeeming what appears to be the lost image of the banks.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Population and Sample-size

The population of the conventional banks (commercial and merchant banks) on which this study is focused is 120 (1994). Of these, twenty-five banks are selected to form a group out of which a final selection of five is made to constitute the sample-size.

This sample-size is considered appropriate for this study. A larger sample-size is most likely to result in the generation of a very large volume of data. This will make the analysis cumbersome and unidirectional.

The theoretical support for the above sample-size chosen lends itself from the fact that usually, the performance of a company is influenced by forces common to all the companies within a given industry. According to King (1967), if an industry is attractive, there is a strong indication that the companies within it are attractive and conversely, if a given industry appears unattractive, there is some likelihood that many if not all of the companies within it are also unattractive. Since industry-wide forces influence the earrning performance of all the companies within the industry, a performance assessment of a few companies within the industry is likely to produce trends which are in near sympathy with the industry's behaviour as a whole.

3.1.2 Sampling Method Used in this Study

The stratification method of sampling is adopted for this study. This is because the elements that make up the population (individual banks) are not homogenous in terms of size and age. Therefore, the whole population of the banks is divided into three groups on the basis of age as follows:

I. **First Generation Banks:** These are the banks established before the Nigerian Independence in 1960. They include First Bank, Union Bank, National bank of Nigeria. United Bank for Africa (UBA) WEMA Bank and African Continental Bank (ACB).

II. **Second Generation Banks:** These are the Banks established after the Nigerian Independence in 1960. They include Allied bank, Afri Bank (IBWA), Nigerian Arab Bank, National Merchant Bank, New Nigerian Bank, Nigerian Universal Bank, Bank of the north and Cooperative and Commerce Bank and Savannah Bank.

III. **Post – SAP Banks:** These are the banks established following the introduction of the Structural Adjustment Progrmme in Nigeria in 1986. The Banks include Rims Merchant Bank, New African Merchant Bank, Eko International Bank, Commerce Bank, Universal Trust bank, Alpha Merchant Bank, Group Merchant Bank, The Republic Bank, Fidelity Merchant Bank, Gamji Bank, Trade Bank and Lion Bank. 47

From these groups, 25 banks are selected (five from group one and ten each from groups two and three). Out of the 25 banks, secondary data, in the form of financial statements are collected from 5 banks, also selected randomly.

The reason for the above division is that time has an over-whelming influence on management efficiency, size of profit and experience. In Nigeria, the older Banks appear stronger and dominate the financial market. Also, economic variables and government regulations which have great influence on bank performance, are essentially period oriented. Efforts were made to select

at least, a bank from each of the above group depending on the availability of data for the period under review.

As stated earlier in Chapter II, a study on the performance of Nigerian Banks was carried out previously by Adekanye (1989). The research covered a period of 5 years from 1985 to 1989. That is, two years before and three years after SAP. Subject to the availability of the necessary data, this current research is expected to cover a period of five years – from 1990 to 1994.

3.2 Methods of Data Collection

Data collection involves the process of gathering information and other necessary data upon which the facts of the research are built. Research data are usually collected from two major sources. These are the primary and secondary sources. The primary data are collected with the use of questionnaire, case study, interview and by observation. Secondary data on the other hand are usually obtained from recorded information contained in literatures, films, journals and unpublished materials.

3.3 Method of Data Collection Employed in this study

The case study method of data collection is used in this study. A case study is an isolated indepth study of one or a few elements chosen from a larger population of identical elements. A case study presupposes that the elements within the population being studied are fundamentally identical and that it is impracticable to study each element to a great detail within a reasonable time.

The case study in this research involves extracting information from the historical financial statements of selected banks. The need for a case study arises from the fact that is practically very difficult and unnecessary to carry out a detailed study

of each of the one hundred and twenty (120) commercial and merchant Banks in Nigeria (1994) in order to highlight the direction of performance in the industry.

3.4 Data Analysis Techniques

The analysis technique employed, usually depends on the nature of the research data. Two of the commonly used techniques are:

3.4.1 Regression Analysis

This is a statistical analysis designed to measure the extent to which one factor changes with specific amount of changes in another factor. In operational research, regression analysis technique is commonly used to analyse data.

For example, it can be used to find the optimum product – mix of a company.

There are several methods of regression analysis. Some of the commonly used are:

i) Graphing

ii) Least Square

iii) Trend analysis

3.4.2 Financial Ratio Analysis

Ratio analysis is the production of ratios from financial statements in order to highlight key relationships and results for the purpose of evaluating the financial performance of a company.

According to Pandey (1979) financial analysis is the process of identifying the financing strength and weaknesses of the firm by properly establishing relationships between the items of the balance sheet and the profit and loss account.

Financial ratio has been described as a 'very powerful tool' for analysing business performance. Compared to the analysis of absolute values, financial ratios are far more accurate as shown below.

3.4.3 **Trend Analysis Based on Absolute Values**

This is an inaccurate method of analysing performance.

For example, consider the financial summary of Mahmoud Ozovehe Umar Co. Ltd shown below:

Five Year Financial Summary of Mahmoud Ozovehe Umar Co. Ltd.

	1990	1991	1992	1993	1994
	₦000	₦000	₦000	₦000	₦000
Ord. Share Capital	17,000	17,000	17,000	17,000	17,000
Capital Res.	7,500	7,500	7,5000	7,500	7,500
Revenue Res.	5,100	5,100	5,100	5,100	5,100
Share Prem.	1,400	1,400	1,400	1,400	1,400
Debenture Red. Res.	2,050	3,850	7,452	8,975	11,531
Shareholders Funds	33,050	34,852	38,452	39,975	42,531
Bank borrowing	-	-	-	-	-
Capital employed	44,050	45,852	48,452	51,225	53,681
Use of Funds:					
Fixed Assets	38,455	29,780	31,442	34,015	35,681
Net Current Assets	11,595	16,072	17,010	17,210	18,000
	44,050	45,852	48,452	51,225	53,681

Turnover & Profit:

Turnover	55,240	65,847	87,520	53,911	62,331
Profit before Tax	5,112	10,005	12,400	7,717	11,281
Profit after Tax	3,222	4,002	7,400	3,712	6,000
Dividends	1,800	2,200	3,800	2,189	3,444
Debenture Red Res.	1,422	1,802	3,600	1,523	2,556

Extract from Mahmoud Umar Co. Ltd.

(Analysis of Absolute Values)

	1990 ₦ 000	1994 ₦ 000	Difference ₦ 000
Total Asset	44,050	53,681	9,631
Total Sales	55,240	62,351	7,111

The asset-base of the company increased from N44 million in 1990 to N53 million in 1994. This helped to increase the sales from N55 million in 1990 to N62 million in 1994. That is, the asset base was increased by N9 million between 1990 and 1994 and this helped to increase the sales by N7 million over the same period. This is ordinarily interpreted as an enhanced performance between 1990 and 1994. But this is totally misleading and grossly inaccurate. The problem is that this analytical method fails to consider the efficiency of each naira worth of asset. Below is the analysis of the same extract based on financial ratios.

3.4.4 Trend Analysis Based on Financial Ratios

The dictionary meaning of ratio is "the relationship between two or more things". According to Pandey (1979), a financial ratio is the relationship between two accounting figures expressed mathematically. Ratios enable the users of financial

statement to summarise large quantities of financial data and to make an informed judgement about the firm's performance. Ratio analysis helps the users of financial statement to establish easily the trend of a firm's performance over time.

In the accounting literature a lot of importance is attached to financial ratios for assessing the performance of firms. The probability of a firms success or failure is associated with its financial ratios. For example, it is assumed that the probability of a sickness or bankruptcy is high for a firm with a low current ratios, high debt ratio and low rate of return.

The ratio to compute using the extract on 3.4.3 is the Asset Turnover, also called Earning Power of the assets. Gross profit/Total Assets indicates the earning power of each unit of asset.

	1990 ₦ 000	1994 ₦ 000
Total Assets	44,050	55,240
Total Sales	53,681	62,351

Asset Turnover (Earning Power)

$$\frac{53{,}681}{44{,}050} \qquad \frac{62{,}351}{55{,}240}$$

KASHIM IBRAHIM LIBRARY

$$= \quad 1.25 \text{ times} = 1.1 \text{ times}$$

The turnover is higher in 1990 than in 1994. That is, the speed at which the value of the assets are recovered from the sales is higher in 1990 than in 1994.

It also means that every N1 worth of asset in 1990 produces N1.25 amount of sales whereas each naira worth of asset in 1994 produces N1.1 amount of sales.

The analysis of the marginal earning power of the company is as follows:

Marginal Earning Power

	1990 ₦ 000	1991 ₦ 000	Difference ₦ 000
Total	44,050	45,852	1,802
Total Sales	55,240	65,847	10,607

Marginal earning power (1990/91) = $\frac{10,607}{1,802}$ = 5.7

The company invested N44 million in assets in 1990. This generated a sale of N55 million. An additional investment of N1.8 million in assets generated a sale of N10.6 million. That is, each naira invested in assets in 1990 generated a sale of N.125 and each additional naira invested in assets generated a sale of N5.7. thus, the decision of the company's management to expand the asset – base by N.18 million in 1990 was worthwhile as it has enhanced the company's performance.

Financial ratio analysis is usually carried out on the basis of the following:

i) Profitability ratio

ii) Liquidity ratio

iii) Leverage ratio

iv) Activity (efficiency) ratio

v) Multiple Discriminant Analysis (MDA)

Some explanation has already been given in chapter II (pages 33 – 35) With regard to each of the ratios stated above except leverage and activity ratios.

Leverage ratio measures a firm's long-term financial strength. This ratio, also called Capital Structure Ratio, measures the funds provided by lenders (debt) against

those provided by owners (equity). Thus it measures the extent to which a firm has relied on debt for financing its assets. The higher the debt/equity ratio the riskier the firm's business. This is mainly due to the interest on debt which the firm is obliged to pay whether or not profits are made.

However, debt represents a relatively cheap financing instrument because its charge on the firm's profit is fixed. Maximum benefits can therefore be derived from debt financing when there is an appropriate mix of debt and equity. There is however no general agreement as to what constitute an 'appropriate' debt – equity – mix.

Several versions of leverage ratios exist. The most commonly used are:

i) Debt – Equity Ratio: This is computed by dividing total debt (short + long term) by the shareholders' funds or net worth.

$$\text{e.g. Debt-equity ratio} = \frac{\text{Total Debt}}{\text{Net worth}} = \frac{TD}{NW}$$

$$= \frac{\text{Long + short term debts}}{\text{shareholders funds}}$$

If $TD = N115,000.00$

And $NW = 9,840.00$

Then $\frac{TD}{NW} = \frac{115,000.00}{9,584.00} = 1.2$

Here, every one naira twenty kobo worth of debt is secured by one naira worth of equity. The expression of the amount of contribution by lenders to every one naira contribution by owners is called debt-equity ratio.

ii) Total Debt Ratio: This ratio can be expressed in terms of net assets (NA) or capital employed (CE). This is because net assets can be proved to equal capital employed as follows:

FA – Dept. + CA = NW (shareholders funds) + TD + CL

NFA + CA = NW + TD + CL

NFA + CA – CL = NW + TD

NFA + NCA = NW + TD

NA = CE

i.e. Total Debt Ratio

$$= \frac{\text{Total Debt}}{\text{Net Assets}} = \frac{\text{Total Debt}}{\text{Capital Employed}}$$

Suppose TD = N5,559.00

And NA = CE = 9,584.00

Then TD Ratio = $\frac{5,559.00}{9,584.00} = 0.58$

This means that 58~% of the net assets (capital employed) of the company is financed by funds provided by outside interests (lenders, depositors, etc) and 42% by owners.

Activity Ratio: The activity ratio is variously referred to as efficiency or turnover ratio. As an activity ratio, it measures the relationship between sales and assets of a business. As a turnover ratio is measures the speed at which the assets are being turned over into sales.

e.g Suppose Asset turnover = $\frac{\text{Sales}}{\text{Net Assets}}$ = 1.75 times.

This means that the net assets of the business is being converted into sales 1.75 times in a year. It also means that one naira worth of assets produces N1.75 amount of sales. This shows the efficiency of the assets.

The ratio can also be used to measure the efficiency of credit control measures by computing the debtors turnover or of inventory control by computing the inventory turnover.

$$\text{Debtors turnover} = \frac{\text{credit sales}}{\text{Average Debtors}}$$

The higher this ratio the more effective is the credit control measures. This measures the efficiency of a business in the sale of its goods, e.g. if the inventory turnover is 7.5 times, it means that the average inventory of finished goods is being converted into sales 7.5 times in a year. It also means that the average inventory of finished goods is held for (12 divided by 7.5) months or 360 divided by 7.5 days i.e. 48 days in a year.

3.5 Analysis Technique Used in this study

The analysis technique that is most appropriate for this study recognising the nature of the main data employed (financial statements) and the purpose of the research (to protect investors and to aid government and management planning) is the financial ratio analysis technique. The ratios are built based on the information contained in the historical financial statements of the selected banks.

In the accounting literature generally, ratio analysis technique is employed in assessing the financial performance of companies.

3.5.1 Research Method Employed in this Study

The historical research method is adopted for this study. As the name connotes historical research is based mainly on historical data obtained from secondary sources. Some of these sources are journals, books, films and as in this study, the past financial statements of selected banks.

Historical sources of data help the research by reducing the time and money that would otherwise be required to source data primarily from the field. This research method is the most appropriate for this study for the following reasons:

a) The data used in this study are mainly the historical financial statement of the selected banks.

b) Since the study is intended to cover a specific period (1990-94) the effluxion of time has li8ttle effect on the accuracy of the historical data collected. For example, the fact that a Bank performed poorly or efficiently during the period 1990 – 94 cannot be erased by effluxion of time. For the period 1990 – 94 therefore the financial statements which provided the historical data continues to be relevant irrespective of subsequent developments.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

Most of the data analysed here were obtained from the Banks financial statements for the five –year period (1990 – 1994). Appendices B-F pg. 108-117. The five year summary in respect of these financial statements is shown in the appendices of this study.

4.1 Bank's Operating Efficiency

Operating efficiency is measured here by computing operating expense ratio for the Banks.

$$\text{Operating expense ration} = \frac{\text{Operating expense}}{\text{Gross earnings}}$$

$$= \frac{\text{All expenses (excluding interest and tax)}}{\text{Gross earnings}}$$

$$\text{For the Banks, this is } \frac{\text{overhead + Depreciation}}{\text{Gross earnings}}$$

(i) The Bank's Operating Expenses

	1994	1993	1992	1991	1990
	₦000	₦000	₦000	₦000	₦000
Union Bank	2,845,347	174,5981	1,256,465	978451	628234
U.B.A	1631536	1185652	879,770	639782	492308
Wemma Bank	318,180	160,497	149173	969,999	92,532
Savannah Bank	657,448	339,347	243,456	164,441	90,015
Lion Bank	83,276	52,837	32,260	19,956	15,076

Source: The Bank's balance sheet & Profit and Loss A/C. (appendices B-F pg. 108-117).

ii) **OPERATING Expense Ratio** $\frac{\text{Overhead + Depreciation}}{\text{Gross Earnings}}$

	1994	1993	1992	1991	1990
Union Bank	0.491	0.443	0.465	0.536	0.442
U.B.A.	0.448	0.405	0.422	0.438	0.427
Wema Bank	0.310	0.305	0.558	0.444	0.693
Savannah Bank	0.474	0.314	0.398	0.290	0.261
Lion Bank	0.416	0.406	0.352	0.334	0.281

(See 4.3 for Gross Earnings)

With an average operating ratio of 0.475 and 0.430 respectively Union Bank and UBA's operating expenses of 0.491 and 0.448 in 1994 represent a rise above the five year average. This however does not appear to present a serious problem because the deviation from the average during the period was relatively insignificant. Wema Bank appears to be doing quite well with a drastic reduction in the operating expenses ratio from 0.693 in 1990 to 0.310 in 1994.

Its operating expenses ratio of 0.310 in 1994 is well below the five-year average of 0.460. The performance of Savannah Bank and Lion Bank is however relatively poor with Savannah Bank appearing to be facing a much more serious problem than any of the other Banks. More and more of the earnings of these two banks are being devoted to meeting their operating expenses. With an increase in operating expenses ratio from 0.261 in 1990 to 0.474 in 1994, Savannah Bank appears to be approaching the point whereby about 50% of its total earnings is consumed by its operating expense. This is probably why it recorded a net loss in 1994 and could not declare any dividend (see page 85).

4.2 Assessment of Ability to Pay Interest on Deposit

Interest payment ability is indicative of a Bank's strength to meet its short-term financial obligations as they become due. This ability is tested here by computing the interest coverage. Interest coverage shows the number of times the interest liability can be recovered from the operating profit.

$$\text{Interest Coverage} = \frac{\text{Operating Profit}}{\text{Interest}} = \frac{\text{EBIT}}{\text{Interest}}$$

i) The Banks' Interest Expenses

	1994	1993	1992	1991	1990
	₦000	₦000	₦000	₦000	₦000
Union Bank	1,494,175	1,224,806	955437	686666	512585
U.B.A	813,456	789,533	526,923	491,501	467,478
Wema Bank	243,761	172,410	110,558	99,901	87,451
Savannah Bank	479,772	376,671	239,270	244,773	191,793
Lion Bank	79,033	47,193	51,092	48,135	40,465

ii) Interest Coverage (EBIT/ Interest)

	1994	**1993**	**1992**	**1991**	**1990**
Union Bank	1.406	1.502	1.115	1.021	1.248
U.B.A.	1.262	1.466	1.037	1.037	1.251
Wema Bank	2.539	1.825	1.395	1.376	1.323
Savannah Bank	1.306	1.095	1.043	1.021	1.100
Lion Bank	1.336	1.453	1.312	1.078	1.310

(See 4.3 (ii) for EBIT)

From the above, the banks do not appear to experience any threat to their debt servicing capacity. A ratio of ₦1.00 of interest to slightly over N1.00 of available funds means that the Banks have employed adequate debt facility in their financial structure – to the best advantage of the shareholders.

WEMA Bank however appear to be more conservative in the use of debt than any of the other Banks. Its ratio of about N2.5 of earnings to each naira of interest obligation in 1994 is relatively high. It could therefore improve on its performance by employing more debt to finance its operation.

On the other hand, if the interest coverage falls below the ratio of 1:1 the Banks may begin to experience difficulty in meeting their debt-servicing obligation.

4.3 The Earning Power of the banks

This power is measured here by computing the Banks Asset Turnover

$$\text{Gross Earning Power} = \frac{\text{Gross Earnings}}{\text{Total Assets.}}$$

$$\text{Net Earning Power} = \frac{\text{Earnings Before Interest and Tax}}{\text{Total Assets.}}$$

i) The Bank's Gross Earnings

	1994	1993	1992	1991	1990
	₦000	₦000	₦000	₦000	₦000
Union Bank	5,794,505	3,937,714	2,699,987	1,824,117	1,420,778
U.B.A.	3,643,441	2,930,899	2,084,646	1,461,544	1,148,100
Wema Bank	1,003,699	526,917	267,413	218,272	183,526
Savannah Bank	1,385,963	1,079,879	611,548	567,916	345,166
Lion Bank	1,999,990	130,2141	91,608	59,731	53,588

ii) **Net Earnings of the banks**

"Net earnings" here mean "earnings before interest and Tax" – EBIT

	1994 ₦000	1993 ₦000	1992 ₦000	1991 ₦000	1990 ₦000
Union Bank	2,100,484	1,839,565	1,065,244	700,502	639,834
U.B.A.	1,026,683	1,157,610	546,590	485,958	584,023
Wema Bank	618,871	312,820	154,192	137,471	115,671
Savannah Bank	151,208	412,287	239,510	250,013	210,978
Lion Bank	105,610	68,592	51,524	37,099	38,166

iii) **The banks Total Assets**

	1994 ₦000	1993 ₦000	1992 ₦000	1991 ₦000	1990 ₦000
Union Bank	43,514,733	32,008,096	23,869,626	13,166,437	924,569
U.B.A.	24,281,979	22,975,170	18,649,831	12,688,445	11,353,857
Wema bank	6,083,814	3,145,996	1,704,613	1,402,167	1,006,251
Savannah bank	6,508,342	4,888,050	4,065,805	3,059,571	2,048,980
Lion Bank	1,141,139	954,914	548,177	383,105	328,684

(i-iii) above show the gross earnings, net earnings and total assets of the Banks. The analysis of the Bank's earning power is contained in 4.3.1, 4.3.2 and 4.3.3 below:

4.3.1 The Bank's Gross Earning Power [Gross Earnings /Total Asset]

Lion Bank	1994	1993	1992	1991	1990
Union Bank	0.133	0.123	0.113	0.129	0.153
Weman Bank	0.150	0.128	0.112	0.115	0.101
Savannah Bank	0.172	0.162	0.150	0.186	0.169
Lion Bank	0.175	0.136	0.167	0.152	0.163

From the above the earning power or the efficiency of the assets of the Banks appear to be on the increase generally during the period. However, the net earning power must also be analysed before a clear trend can be established.

4.3.2 Net Earning Power (EBIT /Total Assets)

	1994	**1993**	**1992**	**1991**	**1990**
Union Bank	0.048	0.058	0.045	0.053	0.069
U.B.A.	0.042	0.050	0.029	0.038	0.051
Wema Bank	0.102	0.099	0.009	0.098	0.115
Savannah Bank	0.027	0.084	0.061	0.049	0.103
Lion Bank	0.093	0.072	0.094	0.094	0.166

The difference between the gross earning power and the net earning power shows the administrative efficiency of each Bank in terms of their ability to keep operating expenditure as low as possible. From the data above, Savannah Bank recorded a relatively high earning power in 1994 (4.3.1) based on gross earnings (0.172). Its earning power based on net earnings in the same year (4.3.2) was the

lowest (0.027). Thus, its gross earnings (N1,385,963000) which appear relatively high compared to its total assets (N6,508,342,000), is actually loaded with operating expenses. This is why its gross earning power is relatively high and its net earning power is relatively low. None of the other Banks exhibit this sharp difference between the gross and net earning power. From 4.3.2 the average net earning power of the banks for the five-year period are:

Union Bank	0.055
U. B. A.	0.042
Wema Bank	0.065
Savannah Bank	0.065
Lion Bank	0.094

With a net earning power of 0.102, Wema Bank appears to perform better than any of the other Banks. Also, with an average earning power of 0.065 for the five-year period, its performance in 1994 (0.102) is a clear improvement. This is however short of its peak performance of 0.115 in 1990. Again, Savannah Bank's 0.027 in 1994 is far below its average of 0.065 for the period. This again represents a relatively poor performance. None of the rest of the banks performed significantly below their average for the period.

Generally a higher level of earning power than those shown for the five-year period is absolutely necessary considering the peculiar nature of the Banks' Business. The Banks are service-oriented organisations with relatively small fixed assets. It is necessary therefore that the asset (loan advances and other investments) is turned over at a relatively high speed before the asset expires (loan advances are converted into deposit repayment).

4.3.3 The Bank's Marginal Earning Power

(i) Gross Marginal Earning Power

	1993		1994
	Gross Earnings / Total Assets	Gross Earnings '94-G. Earnings '93 / Total Assets '94-Total Assets '93	Gross Earnings / Total Assets
Union Bank	0.123	0.161	0.133
U. B. A.	0.128	0.545	0.150
Wema Bank	0.168	0.008	0.165
Savannah Bank	0.172	0.223	0.162
Lion Bank	0.136	0.375	0.175

The total assets of Union Bank increased from N32,008,096,000 in 1993 to N43,514,733,000 in 1994 (see 4.3 (iii). This caused an increase in the gross earnings from N3,937,714,000 in 1993 to N5,794,505,000 in 1994 (see 4.3 (I). Hence, an additional investment of N1,1506,637,000 in assets increased the gross profit by N1,856,791,000. That is, every naira invested in asset in 1993 yielded a gross profit of 12.3 kobo and every additional naira invested in asset earned a gross profit of 16.10 kobo. The same reasoning is applicable to the other Banks whose data are shown above.

As I said previously the analysis of gross earning performance is not conclusive until the net earning performance is also analysed. This is done in order to highlight the performance of the management with regard to the size of the operating expenses contained in the gross profit. The smaller the expense content of gross profit the higher the earning power of the Banks' assets.

(ii) **Net Marginal Earning Power**

	1993		1994
	Net Earnings / Total Assets	Net Earnings '94-G. Earnings '93 / Total Assets '94-Total Assets '93	Net Earnings / Total Assets
Union Bank	0.058	0.022	0.048
U. B. A.	0.500	-0.100	0.042
Wema Bank	0.099	0.104	0.102
Savannah Bank	0.084	-0.363	0.027
Lion Bank	0.072	0.199	0.043

In Union Bank the expansion of the total assets from N32,008,096,000 in 1993 to N43,514,772,000 in 1994 resulted in the expansion of the net profit from N1,839,565,000 to N2,100,484,000 (see 4.3 (ii). That is, every naira invested in the assets of Union Bank in 1993 earned a net profit of N0.058 or 5.8 kobo and every additional naira invested in asset earned a net profit of N0.022 or 2.2kobo. Therefore, the decision of the management to expand the Bank's assets resulted in the increase in net profit by 2.2 kobo per naira invested in the expansion. So the earning power of the Bank's assets was enhanced between 1993 and 1994. This therefore represents an improved performance between 1993 and 1994. The same reasoning or analysis is applicable to the other Banks in the above data.

In UBA and Savannah Bank however, every additional Naira invested in asset between 1993 and 1994 earned a net loss of N0.10 or 10 kobo and N0.363 or 36.3kobo respectively. That is, the decision by the management of these two Banks to commit additional funds to the expansion of the Bank's assets resulted in the contraction of their net earnings by 10 kobo and 36.3 kobo per naira invested in the expansion respectively. So the earning power of the assets of the two Banks got

diminished between 1993 and 1994. This therefore represents a relatively poor performance between 1993 and 1994 – as far as the asset productivity is concerned. Wema bank and Lion Bank have performed well relatively in this regard during the period.

4.4. Profitability of the Owners Investment

Owners equity represent total assets less total liabilities or the sum of common shares, reserves and surpluses less accumulated losses.

4.4.1 Return On Equity (ROE) $\frac{\text{Profit After Tax}}{\text{Net worth}}$

	1994	1993	1992	1991	1990
Union Bank	0.234	0.321	0.085	0.012	0.157
U.B.A.	0.085	0.359	0.025	0.023	0.157
Weman Bank	0.464	0.363	0.284	0.246	0.307
Savannah Bank	-0.067	0.006	0.001	0.001	0.009
Lion Bank	0.175	0.167	0.341	0.154	0.338

The Bank ROE Position in 1994 and the Five –year Average:

	Union Bank	UBA	Wema	Savannah	Lion
ROE (1994)	0.234	0.085	0.464	-0.067	0.175
Five-Year Average	0.159	0.128	0.329	-0.017	0.235

In 1994, Union Bank and Wema Bank earned 23.4 kobo and 46.4 kobo per naira of owners equity respectively. This represents an improvement over their five-year average of 15.9 kobo and 32.9 kobo per naira of owners equity respectively. UBA and Lion Bank earned 8.5 kobo and 17.5 kobo per naira of owners equity

respectively. This performance is lower than their five-year average of 12.8 kobo and 23.5 kobo, respectively. Savannah Bank on the other hand incurred a net loss of 6.7 kobo per naira of owners equity in 1994. Compared to its five-year average loss of 1.7 kobo per naira of owners equity, the bank's performance has further deteriorated.

4.4.2 Earnings Per Share (EPS) of the Banks

$$EPS = \frac{\text{Profit – After – Tax}}{\text{Number of fully paid common shares}}$$

EPS is provided in each bank's financial statement (see appendices).

The EPS is provided in terms of varying values of each Banks shares. Some adjustment is therefore made for uniformity of share value. This is intended to enhance inter-Bank comparison.

(i) **Financial Statement EPS and Share Value (SV)**

	1994		1993		1992		1991		1990	
	EPS K	SV K	EPS K	SV K	EPS K	SV K	EPS K	SV K	EPS K	SV K
Union Bank	66.2	25	71	25	13	25	12.5	25	15	25
U.B.A.	67	25	34	25	6	25	5	25	37	25
Wema Bank	135	50	68	50	20	50	11	50	8	50
Savannah bank	319	50	26	50	5	50	3	50	16.5	50
Lion Bank	15	50	12	50	10	50	4	50	6	50

(ii) **Adjusted EPS Per N1 Share of Each Bank**

	1994 K	1993 K	1992 K	1991 K	199 K
Union Bank	265	285	52	50	60
U. B. A.	268	136	24	20	14
Wema bank	270	146	40	22	16
Savannah Bank	-638	52	10	6	33
Lion Bank	30	24	20	8	12

(iii) **Five-Year Average – EPS**

Union Bank K	UBA K	Wema K	Savannah K	Lion K
142.4	119.2	96.8	-107.4	18.8

As can be seen above, Union Bank has the highest average EPS for the five years 1990-1994. Savannah Bank exhibited the poorest performance in terms of earnings per naira of owners equity. The Bank actually recorded an average net loss per share during the period. The effect of this is the shrinkage in the Banks capital as the Bank may be forced to draw on its capital to meet fixed obligations like the payment of interest on deposit.

4.5 **Adequacy of Capital**

A heavy capital base is a major determinant of Bank strength in Nigeria. This appears to be the stand of the Nigerian Government going by the data presented below for commercial and Merchant banks.

4.5.1 **Minimum Capital Base – Commercial banks**

Year	1989	1992	1997
Amount	N20m	N50m	N500m
Percentage Increase	100%	250%	2500%!

Taking 1989 as the base year the percentage increase in the capital base requirement in 1992 and 1997 are 250% and 2500% respectively. Thus in 4 years (1989-1992) and 9 years (1989-1997 the minimum capital requirement of commercial Banks increased by 250% from N20m to N50m and 2500% from N20m to N500m respectively.

4.5.2 **Minimum Capital Base – Merchant Banks**

Year	1989	1992	1997
Amount	N12m	N40	N500m
Percentage Incr.	100%	300%	4000%!

From 1989 to 1992 (4 years) the minimum capital requirement of Merchant banks was increased from N12m to N40m. This is more than 300% increase. Again, from 1989 to 1997 (9 years) the minimum capital requirement changed from N12m to N500m. This again is more than 4000% increase!

*The actual capital base of the selected Banks during the period 1990 – 1994 is given below:

(i) Actual Capital Base (called up share capital) of the Selected banks

	1990	1991	1992	1993	1994
	₦000	₦000	₦000	₦000	₦000
Union Bank	63,504	79,380	79,380	79,380	158,760
U. B. A.	75,000	100,000	100,000	100,000	100,000
Wema Bank	20,000	40,000	50,000	60,000	115,000
Savannah Bank	34,921	34,921	52,383	52,383	52,383
Lion Bank	16,170	20,213	25,266	60,266	60,266

(ii) The Banks Average Capital Base (1990-94)

Union Bank	UBA	Wema Bank	Savannah	Lion
N000	N000	N000	N000	N000
92,080.8	95,000	57,000	24,445	12,329.8

In 1990, the Capital base of the Banks are Union Bank, N63.5m; UBA N75m; Wema Bank, N20m; Savannah Bank, N34.9m and Lion Bank, N16m. In 1994 their capital bases stood at Union Bank, N158.8m, UBA N100m; Wema Bank, N115; Savannah Bank, N52m and Lion Bank, N60m.

Although all the banks appear to be far away from the N500m minimum requirement by December 1998, Savannah Bank and Lion Bank may find greater difficulty in achieving the minimum capital target. This is judging from the relatively small size of their capital base in 1994 – only four years away from 1998.

The sharp increase in the minimum capital Base may sniff life out of the distressed Banks and the Banks that are at the brink of distress. The immediate and long-term effect of this is:

a) There may be mergers and acquisitions. Consequently there would be fever and stronger Banks.

b) The harmonisation of the capital base for the commercial and merchant Banks effectively eliminate the distinction between the two category of banks in terms of areas of business specialisation.

4.5.3 Potentiality for Further Capitalisation

One option which is readily available to the Banks and which is relatively less costly is the capitalisation of the book balance of some or all of their existing reserves through a bonus issue. This is the internal option.

(i) Internal Option (Internal Source of Funds)

This potential is based on the size of the book value of some outstanding reserves of the Banks in 1994. Certain reserves such as Exchange Difference Reserve and Debt Redemption Reserve are not normally available for capitalisation. Reserves that may be capitalised are presented below:

	Union Bank N000	**UBA N000**	**Wema N000**	**Savannah N000**	**Lion N000**
Share Premium	-	-	53476	2,583	-
Reserve for Bonus Issue	39,6800	-	-	-	2,0089
General Reserve	860,356	1,477392	-	-	7608
Revaluation Reserve	-	-	-	76,142	-
Capital Reserve	-	-	100,000	-	-
Retained Earnings	-	-	61,992	-	-
Retained Losses	-	-	-	303096	-
	900,036	**1,477,392**	**215468**	**224,271**	**28,697**

The reserves of Union Bank and UBA that could be capitalised stand at N0.9 billion and N1.5 billion respectively. Bonus issues could be made to raise the amount required to beaf up their existing capital base to N500m. The current capital base of Wema Bank is N115m (1994). It needs to raise at least N385m to raise its capital base to N500m. With its existing reserve which could be capitalised standing at N215m, the Bank may not find it as easy as the Union Bank and UBA as far as the internal source of capital fund is concerned.

Savannah Bank with an accumulated loss of N224m, appears to be in the most difficult position in this regard.

(ii) **External Option (External Source of Funds)**

These are the investment funds that may be supplied by both potentiaol and existing investors through purchases of new shares. The ease with which the Banks are able to get this option through depends largely on their past performances. An unsatisfied shareholder (existing investor) is not likely to increase his stake through ownership of additional shares. Rather than accept a relatively cheap additional investment in his Bank (rights issue of shares) the investor may choose to invest his money in a much more costly shares of a more promising company. Also, potential investors may not be attracted by the low performing Banks no matter how attractive their investment packages are.

4.6 Banks Performance Assessment Based on Multi-Variante Discriminant Ratios (Osaze's Model)

(i) Variables for Discriminant Ratio Construction

	Union Bank N000	UBA N000	Wema N000	Savannah N000	Lion N000
Net Worth	1,794,324	1,577,392	552,197	(116,385)	105,340
Profit After Tax	420,199	133,503	256,279	(334,386)	18,466
Cash	21,276,894	7,075,696	3,590,991	2,264,383	508,031
Equity	158,760	100,000	115,000	52,353	60,266
Acct. REC	7,105,544	4,317,846	1022051	1,484,864	182,870
Retained Earnings	324,943	82,503	185,279	(334386)	18466
Gross earnings	5,794,505	3,643,441	1,003,699	1,385,963	199,990
Total Asset	43,514,733	24,281,979	6,083,814	5,608342	1,141,139
Loan and Advances	7,105,544	4,317,846	1,022,054	1,550,528	182,670

The above data was extracted from the 1994 financial statement of the Banks. (Appendices B-F Pg. 108-117).

(ii) The Bank's Deposit Trend

	1994 ₦000	1993 ₦000	1992 ₦000	1991 ₦000	1990 ₦000
Union Bank	28,037,838	20,114,764	15,712,902	9,739,954	6,379,730
U.B.A	18,353,987	18,627,500	17,356,193	11894450	9,694,080
Wema Bank	5,531,617	2,864,530	1,577,361	1,300,417	946,435
Savannah Bank	4,686,807	5,062114	4,338,659	3,571,781	2,616,703
Lion Bank	582,835	5,268,181	355,341	291,710	215,857

(iii) **The bank's Profit (PAT) Trend**

	1994 ₦000	1993 ₦000	1992 ₦000	1991 ₦000	1990 ₦000
Union Bank	420,199	452,357	83,530	7,938	97,699
UBA	133,503	265,437	12,865	11,014	74,573
Wema bank	256,279	102,096	36,084	25,007	18,376
Savannah Bank	(334,386)	27,216	5,238	3,492	17,265
Lion Bank	18,466	14,484	11,652	4,575	7,009

(iv) **The Banks Multi-variant Discriminant Ratios**

	Union Bank %	UBA %	Wema %	Savannah %	Lion %
PAT/LA	5.9	3.1	24.8	0	10.1
RE/PAT	77.3	61.8	72.3	0	1.0
EBIT/TA	4.8	4.2	102	2.7	9.3
PAT/NW	23.4	8.5	46.4	0	17.5
GE/ACCT. REC.	0.82	0.84	0.98	0.93	1.01 (Times)

Key to the Ratios Used

TA Total Asset

PAT Profit After Tax

NW Net Worth

EBIT Earning Before Interest and Tax

GE Gross Earnings

ACCT.REC. Account Receivable

LA Loans and Advances.

RE = Retained Earnings.

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The basis used by Osaze in scoring performance in companies (Osaze's model) is discussed under the literature review of this study (Page 33-38). It is repeated here in order to relate it to the performance score – board of the selected Banks as shown in (v) below:

(v) **Factor Osaze's Criteria for Scoring Performance**

(a)	**Cash/TA**	**Points**
	31 – 40%	16
	21 – 30%	12
	11 – 20%	8
	5 – 10%	4
	Less than 5%	0
(b)	**PAT/NW**	
	31 – 40%	12
	21 – 30%	10
	16 – 20%	8
	11 – 15%	6
	5 – 10%	4
	Less than 5%	0
(c)	**EBIT/TA**	
	Over 30%	12
	21 – 30%	10
	16 – 20%	8
	5 – 10%	4
	Less than 5%	0

(d) **GE/ACCT. REC.**

More than 2.0 times	12
1.51 – 2.0 "	10
1.10 – 1.15 "	8
0.91 – 1.1 "	6
0.5 – 0.9 "	4
Less than 0.5 "	0

(e) **PAT/LA**

Over 30%	12
21 – 30%	10
16 – 20%	8
11 – 15%	6
5 – 10%	4
Less than 5%	0

(f) **RE/PAT**

Above 30%	12
21 – 30%	10
16 – 20%	8
11 – 15%	6
5 – 10%	0

(g) **Profit Trend over 5 year period (PAT)**

Firms with rising net profit every year	16
Firms with stable and level profit each year	12
Firms with profit each year but no uniform trend	10

Firms with profit each year but a declining trend	**8**
Firms with loss in any one of the first three years only	**6**
Firms with loss in first three years only	**2**
Firms with loss in all five years	**0**

(h) **Deposit Trend Over 5 – year period**

Banks with rising total deposit every year	**12**
Banks with stable and level total deposit each year	**10**
Banks with non-uniform total deposit trend	**4**
Banks with declining total deposit trend	**0**

Osaze's Performance Verdict

1. **60 points and above:** This implies high performance and not likely to fail.
2. **40 – 59 points:** The company needs to be scrutinised or studied carefully before a conclusion is made as to whether they are failing or not.
3. **0 – 39 points:** This implies poor performers, most likely to fail.

(vi) The Banks Performance Scores (Points)

	Union Bank	**UBA**	**Wema Bank**	**Savannah**	**Lion**
Deposit Trend	12	10	12	4	10
RE/PAT	12	12	12	0	0
EBIT/TA	4	0	4	0	4
PAT/NW	10	4	12	0	6
CASH/TA	16	12	16	16	16
GE/ACCT REC	4	4	4	4	6
PAT/LA	4	0	10	0	4
PROFIT TREND	16	16	16	6	16
TOTAL SCORES (Points)	78	58	86	30	62

(vii) **The Bank's Performance Verdict**

Union Bank

Its total score is 78 points. Its performance is satisfactory. It is therefore financially successful and not likely to fail.

U.B.A.

Its total score is 58 points. It is on the boarderline. It therefore needs to be scrutinised closely before a conclusion is drawn.

Wema Bank

Its total score is 86 points. Its performance is satisfactory. It is therefore financially successful and not likely to fail.

Savannah Bank

Its total score is 30 points. It's performance is poor. It is financially unsuccessful. It therefore has a high probability of failure.

Lion Bank

Its total score is 62 points. It is more or less on the boarder line. It therefore needs to be observed carefully before a conclusion is made as to its performance situation.

4.7 Summary of Findings

4.7.1 A heavy capital base does not appear to be a major determinant of Bank performance. This is evidenced by the pattern of performance of the selected Banks. For example,

UBA ranks very high on the basis of capital base but very low on the basis of performance level.

4.7.2. Management quality appears to be a major determinant of corporate performance.

This is because the management is capable of charting a path of success or failure for the company including the Banks, irrespective of the company's capital base.

4.7.3 Government policies which come in the form of guidelines have tremendous effect on Bank performance. These guidelines seek to control the operation of the Banks via portfolio constraint, credit and interest ceiling and issuance of "stabilisation security". Frequent changes of these policies has had a serious negative effect on Bank performance.

4.7.4 Capital/Asset ratio used by the CBN and NDIC is an ineffective tool for identifying problem Banks. It is expected that when the Banks are ranked in the order of capital/asset ratio and in the order of performance, the two rankings will exhibit similar pattern of ranking. But while UBA ranks very high on the basis of capital-base, its ranking on the basis of performance is very low.

4.7.5 There are two sources of funds available to the Banks for further capitalisation. These are:

a) Internal sources (reserves that could be capitalised via rights issue of shares): Only Union Bank and UBA appear to be comfortable with this source of funds.

b) External sources (funds that may be supplied by potential investors: Only Union Bank and WEMA Bank which appear to be performing well may have an easy access to this form of funds.

To attract investors, UBA, Savannah Bank and Lion Bank may have an uphill task, going by their performance situation. Their investment packages may have to be very attractive in order to achieve this objective.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

This study assesses the performance of Nigerian Banks. It begins with the introduction of the study. The introduction gives a short summary of what to expect in the main body of the study.

The literature is very comprehensive. It begins with a brief review of the history of banking in Nigeria. The concept of performance is reviewed broadly from the point of view of researchers, Bankers and the regulatory bodies. The influence of government, bank management and the general economic variables on Bank performance are adequately highlighted.

The central focus of attention in the Banks performance assessment is both on the use of financial ratios as a tool of performance analysis and the Banks financial statements. Consequently the various approaches to the use of financial ratios are reviewed. Attention is then drawn to the inapplicability of the Euro-America based analytical models such as the Altman's model to the situation of the "Third World" countries. The modified multi-variant analysis model by Osaze applicable to the developing countries is adopted for this study.

The influence of government on bank performance ranging from direct ownership of shares, appointment of key members of management, variation of interest and foreign exchange rates are reviewed.

The inappropriateness of the capital/asset ratio used by the bank examiners (e.g. NDIC) for identifying problem banks is highlighted in chapters two and four.

The impact of the structural adjustment programme introduced by Government in 1986, on bank performance is also highlighted.

The effect of the major economic variables on bank performance such as inflation, recession, competition, capital adequacy and indirectly, political stability, are reviewed. The influence of the management on bank performance cannot be over emphasised. The bank with the most modern equipment may record a very low level of performance if it is saddled with an incompetent and self-serving management. Consequently, the influence of the management on bank performance is discussed broadly in chapter two.

The method adopted in this research is specified in the third chapter of the study after a careful review of the various existing methodologies. A selection of five banks out of the one hundred and twenty (120) commercial and merchant banks in Nigeria (1994) was made. The banks were divided into three groups on the basis of age from where the five banks for the research were selected. Efforts were made to select at least one bank from each of the three groups depending on the availability of the required data (financial statements) for the five-year period under review.

The chapter highlights the various methods of data collection and analysis available and ends by specifying the method that is most appropriate for this research.

Chapter four gives a detailed presentation and analysis of data extracted from the banks' historical financial records. A number of individual ratios such as operating expense ratio, interest coverage, asset turnover, return on equity are computed to assess the operating efficiency, ability to pay interest on deposit, asset earning power, and profitability of owners' investment respectively. Other non-ratio basis of assessing bank strength such as adequacy of capital is also analysed.

Consequently, the potentiality of the individual banks to meet the minimum capital-base requirement and the likely re-organisation within the banking industry are analysed.

But as pointed out in chapter two, individual ratios cannot be completely relied upon for assessing performance because of the existence of the possibility of conflicting indication of performance when used. Therefore, Osaze's multi-variant analysis model which is free from this defect is used to assess the performance of the banks.

The main sources for the data presented and analysed are the Banks' financial statements. The analysis is easy to understand and the performance level of the five selected banks clearly shown. The study covers the five-year period from 1990 to 1994. But due to circumstances beyond my control certain bank-oriented events that took place between 1995 and 1997 are brought into the body of the research especially at the levels of introductions and literature review.

The study reveals that a heavy capital base is not a prerequisite for high performance in the banks. Using this model, a clear pattern of performance exhibited by the selected banks is thus shown as follows:

Five banks were selected for the study. These are Union Bank, UBA, Wema Bank, Savannah Bank and Lion Bank.

Union Bank and Wema Bank appear to have performed satisfactorily during the period and therefore not likely to fail.

UBA and Lion Bank appear to be on the boarder line in terms of their performance.

Savannah Bank appears to have the poorest performance, having scored the lowest point on the basis of Osaze's Risk Index. Savannah Bank therefore appears to be failure prone during the period.

This study represents a fair assessment of the performance-position of the selected banks.

5.2 Conclusion

The conclusion of this research reflects the opinion of this researcher with regard to the performance-situation of the Nigerian Banks. This is based on the research findings and are as follows:

5.1.1 Assessment of Heavy Capital Base in Relation to Bank Performance in Nigeria

The average capital base of the selected Banks as analysed in section 4.5 are:

Union Bank – N92m: UBA – N95m; Wema bank – N75m; Savannah Bank – N24m, and Lion Bank – N12m. When ranked in the order of average size of capital, the pattern would be:

Bank	**Ranking**
UBA	1st
Union Bank	2nd
Wema Bank	3rd
Savannah Bank	4th
Lion Bank	5th

But the ranking, based on the performance-scores analysed in section 4.6 (vi) is:

Bank	**Ranking**
Weman Bank	1st
Union bank	2nd
Lion Bank	3rd
UBA	4th
Savannah Bank	5th

The implication of the two rankings above is that if the size of the capital base is the major determinant of Bank Performance, the two rankings will exhibit similar pattern and the rank of each Bank will remain unchanged. But while UBA is ranked very high base on the size of its capital base, it is ranked very low in terms of performance scores. The conclusion therefore is that a heavy capital base is not a major determinant of Bank performance.

In this regard, a lot appears to depend on the quality of the management, entire staff and the equipments with which the banks business is carried out. With the ratio of the banks that appear to performed well to those that did not perform so well standing at 40% to 60%, the conclusion is that majority of the banks in Nigeria during the period (1990 – 1994), were failure-prone.

5.2.2 Pattern of Performance

The pattern of performance does not strictly reflect size or age of the Banks. UBA, a relatively larger and older bank performed lower than Wema bank.

5.3 Research Limitations

A number of problems tended to hinder the easy conduct of this research. These are:

5.3.1 **Dearth of Data**

The dearth of research in this area of study in Nigeria greatly limits the source of information for research purposes. Most of the Banking institutions are very reluctant to volunteer information outside their financial statements probably because of the high level of competition amongst them or because of the existence of the failed banks and financial companies Tribunal. None of the Merchant Banks visited could even provide their financial statements for the five-year period covered on this research. However, the financial statements of the selected Banks were obtained from Stock Exchange Commission.

Most of the texts that discuss banking and Bank performance extensively have foreign authors. A greater proportion of the data provided in such texts are therefore of greater relevance to the developed economics of Europe rather than to a developing country like Nigeria.

In the developed economies, many companies develop extensive data on various aspects of the activities of business enterprises including the Banks. Their services greatly enhance research efforts. In Nigeria, because of our low level of technology and economic development, these services are not available and so the average researcher is virtually on his own.

5.3.2 **Bank Fraud**

We are aware of the effect of large scale fraud on the performance of the Banks. We have not used the incidence of Bank fraud to measure Bank performance because of lack of verifiable information and also because the banks were not incorporated to engage in fraudulent business.

Bank fraud, most of the time, are extra-balance sheet activities which are relatively difficult to verify. The Banks books of account from where one could extract some information regarding bank fraud are not ordinarily available to researchers. Infact the officials of the NDIC are only able to gain access to the information because of their statutory role as bank examiners. Therefore most information about fraud have secondary sources and are not easily verifiable. This is probably one problem area in this field of study to which researches may wish to address their minds in the future.

5.4 Recommendations

5.4.1. The banking regulatory authorities (CBN and NDIC) should recognise that a heavy capital base is not a major determinant of Bank performance. More attention should be paid to other variables that affect performance such as the quality of loans and advances and the attitude of the Bank operatives towards the efficient management of the depositors' funds in their custody.

5.4.2. Government should not influence the Banks in the appointment of their key officers. This will enhance the performance of the Banks because:

i) The Banks will be able to recruit the best hands available in terms of qualification and experience as key members of the management.

ii) The Board of Directors will be more equipped to check erring members and instil financial discipline in the operation of the Banks.

iii) The quality of the Banks' loan assets will be enhanced as certain individuals will no longer use government influence to obtain and regard bank loan as part of "national cake".

5.4.3. Frequent changes in the monetary policies and the CBN guidelines to the Banks, especially with regard to interest and exchange rates should be avoided. The changes have the tendency of provoking speculation in the financial circles which may result in low performance in the banking industry as most Banks may then concentrate on short term lending because of the uncertainty that surround the returns on long term lending.

5.4.4. The Bank examiners should shift from their tradition of heavy reliance on the use of capital/asset ratio as a criterion for identifying problem Banks. A combination of discriminant ratios applicable to the situation of the developing countries such as Gross Profit/Total assets, Gross earnings/Account receivable would be more useful and effective.

5.4.5. The Banks with inadequate internal source of funds which could be capitalised to meet the minimum capital base requirement should put together a strong machinery for attracting potential investors.

(a) They should place a very attractive interest rate on some category of investments such as Short Term Deposits. The risk usually involved in promising a very high interest rate on deposits can be greatly reduced if the Banks' investment portfolios are well diversified.

(b) They should not only be consistent in dividend payment to their equity investors, the amount of dividend payment per share should be reasonably high compared to the high-performing banks.

5.5 Suggestion for Further Studies

As a result of the difficulty involved in detecting Bank Fraud especially at the early stage, researchers may wish to evolve an easier method of fraud detection in the Banks. This will enhance the efficiency of the Bank examiners in recognising the "early warning signs" in problem banks. This is important in view of the fact that Tribunals are adhoc measures and are arrangements which come into effect after the damage might have been done.

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Appendix A: Extracts from some daily Newspapers

Nov. 8 1994

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RAZOR

ALERT ON NIGERIANS

BEWARE, THESE BANKS ARE NOT SAFE

HOW OVER N200 BILLION WAS UNCOVERED IN NIGERIAN BANKS AND FINANCIAL INSTITUTIONS

FULL DETAILS OF THE FINANCIAL DISTRESS IN THOSE BANKS REVEALED

ALL NIGERIA PLC (AMP-TWO LTD: NIGER)

1. Dr. (Mrs) Sinai Ibhaze - Chairman (Ogun State)
2. Alhaji S. Mohammed - M.D./C.E.O (Kano State)
3. Alhaji Yusuf Al-Mujtahid - Executive Director (Sokoto State)
4. Mr. Obafemi Adelaye - Executive Director (Oyo State)
5. Mr. E. A. Ekpo - Director (Akwa Ibom State)
6. Mr. Femi Aniluko - Director (Lagos State)
7. Mr. Ik Mamadi - Director (Ondo State)

NIGERIA-ARAB BANK

1. Engr. A. Yusuf- Chairman
2. Alhaji A. Gumi- M.D./C.E.O
3. Alhaji Usman Bilatu - Executive Director
4. Alhaji A.D. Galadanchi - Executive Director
5. Mr. Jeff's Coker- Director
6. Alhaji Bello Katagun - Director
7. Mr. Joe Bardi - Director

HISTORICAL BACKGROUND

GANI FAWEHINMI LAUNCHES NATIONAL CONSCIENCE

"Abacha has given us the best opportunity for a united opposition against his regime. Human rights groups and pro-democracy bodies have no choice now but to come together and fight this dictatorship in a unified way. On 1 Oct. 1, we launching a nationally united party and join the people in action to democracy"

October 10, 19[illegible]

NOVEMBER 8 1994 COVER TEAM [illegible]
Dapo Sotunmu [illegible]

Comprehensivolist of Distressed Banks

1. African Continental Bank Plc (ACB)
2. National Bank of Nigeria (NBN)
3. Cooperative & Commerce Bank (CCB)
4. Merchant Banking of Africa
5. Republic Bank Limited
6. Financial Merchant Bank
7. North-South Bank
8. Premier Commercial Bank Plc
9. Inland Bank Plc
10. Afri-Bank Plc
11. [illegible] Bank of Nigeria Plc
12. [illegible] Merchant Bank Plc
13. Continental Merchant Bank
14. Credite Commercial Bank Limited
15. ICON Merchant Bank
16. Habib Nigeria Bank Ltd
17. F & B International Bank ltd
18. Oceanic Bank International Ltd
19. First African Trust Bank (FATB)
20. Amicable Bank of Nigeria
21. Owena Bank Plc
22. [illegible]
23. [illegible]
24. [illegible] Bank Limited
25. [illegible] Ltd
26. [illegible]
27. [illegible] Merchant Bank
28. [illegible]
29. [illegible] Bank Plc
30. United [illegible] Bank Ltd
31. [illegible] Bank Plc
32. Alpha Merchant Bank Plc (Jimi Lawal [illegible] escaped with the bank's funds
33. New African Merchant Bank Ltd
34. [illegible] Bank Ltd
35. [illegible]
36. [illegible] Bank Plc
37. Bank of the North Ltd
38. Tropical Commercial Bank Ltd
39. [illegible] Bank Ltd
40. [illegible] Bank of Nig. Ltd
41. [illegible] Bank of Nig. Ltd
42. [illegible] Bank of Nig. Ltd
43. [illegible]
44. [illegible] Commercial Bank Ltd
45. [illegible]
46. [illegible]
47. [illegible] Merchant Bank [illegible]
48. [illegible]
49. First [illegible] Merchant Bank Ltd
50. Grindlays Merchant Bank Ltd
51. ABC Merchant Bank Ltd
52. [illegible] Merchant Bank
53. [illegible] Merchant Bank
54. [illegible]
55. [illegible]
56. [illegible] Merchant Bank Ltd
57. [illegible]
58. [illegible] Merchant Bank
59. [illegible] Bank Ltd
60. [illegible] Merchant [illegible]
61. Great Merchant Bank
62. [illegible] Merchant Bank Ltd
63. [illegible] Merchant Bank
64. [illegible] Merchant Bank
65. [illegible] Merchant Bank [illegible]

PROLOGUE

Mr. J.K. Kolesanmo erstwhile Managing Director/ C.E.O of North - South Bank, is another classic case of [illegible] banking industry. He was in CBN for nearly two decades and when he left in 1988 to head NSB he came with only a Peugeot 505 car. Just like Arewa, [illegible] and bled it dry. [illegible] he was [illegible] he had a [illegible] with [illegible] Commodore and Chairman of the Bank who insisted Kolesanmo had to go. [illegible]

Infact the list of these "bank killers" is endless. What about the case of [illegible] of Alpha Merchant Bank Plc who disappeared with the bank's vault, containing over N500 million. Before he vanished from the Nigerian shores, he was said to have had fleet of cars, three posh houses in Ogunu GRA, two houses in Victoria Island and one in Ikoyi, Lagos.

In the case of Olumbe Femi Ajayi, he had all the chances to make both Financial Merchant Bank and Republic Bank a success story, but because he is a kind of man that took delight in "show off", his reckless spending killed whatever the banks had to offer.

Tall and muscular Ajayi went to Canada to study Accountancy and on his return, through [illegible] president [illegible] he founded The Republic Bank on [illegible] Street, Lagos [illegible] the bank spread its tentacles [illegible] streets of Lagos.

But because of [illegible] Ajayi's [illegible] ing his ego, he [illegible] tomers deposits [illegible]. The [illegible] puted for his [illegible] tration. [illegible] way [illegible] chart Bank, The Republic Bank [illegible] public [illegible].

Financial [illegible] the distressed banks to [illegible] tive fiat as [illegible] poor national economy which was further [illegible] by the military adventurism into the political leadership of the country.

According to Moses Odairo, Managing Director of Great Merchant Bank, one of the distressed banks, at a symposium organised by the chartered Institute of Bankers and Institute of Chartered Accountants of Nigeria recently in Lagos, he blamed the excruciating state of banks to poor economic performance in the last [illegible] years.

"With inflation currently estimated at high [illegible] is steadily [illegible] investors. [illegible] to buy things [illegible] money in the bank [illegible] the inflation plague [illegible]" he said.

[illegible] of these [illegible] Central Bank [illegible] Capital Merchant Bank [illegible] and was granted [illegible]

[illegible]

[illegible] deposit [illegible] given to the Mer[illegible] [illegible] could boost [illegible] the financ[illegible]

Despite the [illegible]

09

NOV. 8 1994
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OVER N200 BN FRAUD WERE UNCOVERED IN MORE THAN 70 BANKS AND FINANCIAL INSTITUTIONS. THE DETAILS OF THE SATANIC FRAUD AND THOSE INVOLVED

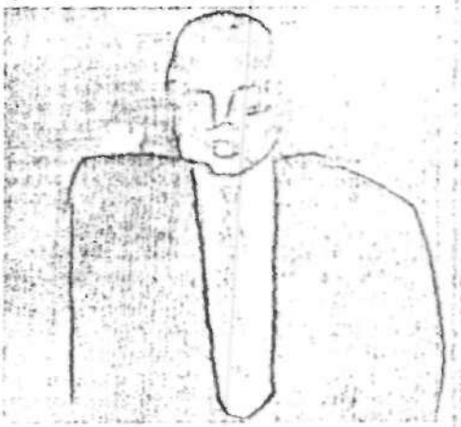




Photo: Tess Ajayi

Air Commodore [illegible] (rtd) Chairman, [illegible] PLC

...system that started ... 1960 with eight banks ... 106 branches, but today there are over 120 banks which have over 2,000 branches.?

With the increase in the number of banks, there was a resultant increase in assets' growth rates. "Total assets of the banking industry grew from N28.4 billion in 1985 to N155.5 billion in 1991. Before 1985 the average growth rate of assets of the banking system was less than 10 percent but it rose sharply to 30.4 percent in 1986 and has continued to rise since then.

Between 1990 and 1991 alone, it expanded by N43.9 billion or 39 percent. With the boom has not only ... but all the financial institutions ... finance houses, mortgage banks, community banks, etc. There now exists a do or die battle for funds with high performance ... and on treasury ... of these institutions.

The statistics revealed that over 55% ... of the old generation banks are ...

banks

Aside from the terrible situations in these banks, we discovered that some of them were involved in the drug trafficking business. For instance, when the liquidation of banks and other financial institutions (FIDFIs) was announced, all ... were expected ... to the CBN. Immediately ... they ... the remaining money laundered from hard drugs and other illicit business activities.



473325

KASHIM IBRAHIM LIBRARY

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FINANCE

The collapse of indigenous banks

• Dr. CREEN NWANKWO, Professor of Finance, Head, Finance Department UNILAG and chairman Union Bank of Nigeria PLC, here, among others, discusses the unsatisfactory operations of banks some decades ago.

NO cursory observer can fail to appreciate that indigenous banking has come a long way since modern banking was introduced in Nigeria nearly a century ago in 1892. There was, of course, no indigenous bank then; indeed it was not until 41 years later in 1933 that the first surviving indigenous bank, the National Bank of Nigeria Limited, was established. There was no central bank. That had to await five years later in 1958; nor was there any development bank. It was only in 1964 that one was established with the assistance of foreign partners; and only in 1973 were the first ever fully indigenous development banks established.

Today, nearly a century later, there were, as at the end of December 1989, a total of 28 indigenous commercial and 23 indigenous merchant banks, a Central Bank, a deposit insurance corporation, four development banks and the Federal Savings Bank. To these are added the People's Bank and the forthcoming Community Banks as proposed in the 1990 federal budget statement.

Many factors explain the above developments. As they have been catalogued in detail elsewhere, only a summary need be made here. They include the domination and unsatisfactory operation of the expatriate banks, the unsatisfactory currency situation, economic nationalism, government intervention and deregulation.

Until the establishment of the National Bank of Nigeria Limited in 1933, the banking system and banking operations in Nigeria were monopolised by the then Bank of British West Africa Limited established in 1894 now the First Bank of Nigeria PLC, and Barclays Bank Dominion Colonial and Overseas, now Union Bank of Nigeria PLC established in 1925.

Until the recent explosion in the number of banks in the aftermath of deregulation in the country, the expatriate, now the mixed banks, still dominated the banking scene in terms of the control of banking power.

Nigerians found the operations of the expatriate banks very unsatisfactory. They complained bitterly that they discriminated against them, did not care to lend to them but rather concentrated on European traders, whereas they solicited the Nigerians for their deposits. The banks countered by arguing that Nigerians were not creditworthy and lacked the required collateral securities. No matter how the issue was argued, it was clear however, that the proportion of credit that went to Nigerians was insignificant in relation to their deposits.

The strong belief that the expatriate banks discriminated against Nigerians led to a spate of indigenous banking establishments to redress the situation and eventually to public policy intervention to support indigenous banking. The first successful indigenous bank, the National Bank of Nigeria Limited, established in 1933, illustrated objectives which animated subsequent indigenous banks.

These included encouraging any Nigerian likely to benefit by loans, advances and overdrafts; helping small as well as big businessmen to hold their own in the commercial field; and operating in such a way as to give Nigerians confidence to work effectively in the commercial and industrial fields. More indigenous banks were established subsequently and by the late 1940s there occurred an impetuous banking boom which collapsed in the early 1950s.

Between 1929 and 1952 a total of 18 banks were actually established during the period. Nwankwo (1980) quoted the financial secretary as reporting in the Federal House of Representatives that a total of 185 banking companies were registered between 1947 and 1952, of which 145 were registered in 1952. Brown (1966) recorded 18 banks established in Nigeria in the 15 months between February 1951 and May 1952 while the Central Bank (1979) recorded 22 between 1945 and 1952.

Whatever the number, the fact is that the spate of these banking establishments and the collapse of many of them moved government to set up a commission of inquiry (the Paton Commission) in September of 1947 to "enquire generally into the business of banking in Nigeria and make recommendations on the form and extent of control which should be introduced."

The Paton Commission revealed serious deficiencies in the banking boom characteristic of wildcat banking which made a crash inevitable. These included gross under-capitalisation; 14 of the banks had a paid-up capital of less than N.12,000 which was often swallowed up by the first year's losses'...; too rapid and indiscriminate branch expansion; one bank with a paid-up capital of around N.20,000 had 26 offices within a short time. Other causes of the collapse included bad management, persistent stealing, illiquidity, imprident lending, etc.

The collapse of the boom caused losses to depositors and loss of confidence in indigenous banking. Accordingly, Paton made a number of recommendations which include' a minimum



order to protect the public from mushroom banks. The result was the first ever banking legislation in the country — The Banking Ordinance 1951 — which became effective from 1952.

The ordinance defined bank and banking business, and prescribed minimum capital requirements for the expatriate and indigenous banks. It also required the banks to maintain a reserve fund and adequate liquidity. It prohibited banks from paying dividends before fully writing off capitalised expenditure and from making loans against the security of their shares. It imposed a ceiling on unsecured loans to directors and to companies in which directors had an interest. Finally, it provided for bank examination and supervision.

The ordinance was to become immediately operational for new banks while existing banks were given three years to comply. By the time the ordinance became operational for all banks in 1955 all the mushroom banks had collapsed except three:

- The Agbomagbe Bank (1945);
- The African Continental Bank Limited (1947) and
- the Merchants Bank (1952), failed in 1960). Added to the National Bank Limited incorporated in 1933, these were the only four indigenous banks which, along with the three expatriate banks, survived the banking boom of the late 1940s and early 1950s.

Political changes in 1960 and 1954 added a new dimension. Representative government in 1950 enabled nationalists to be more vocal for banking reform to promote rapid economic development and the regional constitution in 1954 enabled the regional governments in the Eastern and Western Regions to initiate public policy support for indigenous banks.

Accordingly, the Eastern region government injected funds into the African Continental Bank Limited and the Western Region government into the National Bank, Agbomagbe Bank and the Merchants Bank to enable them qualify for the 1952 ordinance. Indeed, without this rescue operation, the four banks would most probably have collapsed as the other indigenous banks.

The rationale for the support was part of the overall banking policy objectives of the regional governments, of which the Eastern Region's can be taken as representative, viz. to discourage monopoly of monetary transactions, liberalise credit facilities for Nigerian entrepreneurs, encourage the development of indigenous banking and plan for eventual establisment of a state bank.

It should be noted that it was the unsatisfactory operations of the banks inherent in their armchair rather than dynamic banking and their servicing rather than financing trade that forced the authorities to institute sectoral allocation of credit and in particular allocation to preferred sectors, Nigerian indigenes, and small business enterprises.

The unsatisfactory operations also left gaping financing gaps which the authorities stepped in to bridge through the establishment of the development banks, the rural banking scheme, the agricultural credit guarantee scheme and latterly the People's Bank and the forthcoming Community Banks.

As in other countries, the USA, the UK, etc, the unsatisfactory currency situation in Nigeria and the absence of a reserve force — a lender of the last resort, evident in the operations of the West African Currency Board 1912-1960, left a very serious lacuna in the financial arrangement in the country. This particularly proved very onerous in the economy during and after the banking boom and cash of the late 1940s and early 1950s.

To this, was added the absence of an independent currency and the non-existence of any machinery for monetary management. In these circumstances, it became necessary and indeed imperative, as it did in other countries, to establish an institution which could bring order to the system. The institution was the Central Bank of Nigeria, established in 1958.

Another factor in the evolution of indigenous banking in Nigeria, as in other countries, is nationalism. It is in fact the dominant factor. Nationalists wanted indigenous banks as a brake on the monopoly power of the expatriate banks and as an escape from the domination of foreign money markets. In its prospectus, the National Bank had categorically and emphatically appealed to Nigerians that "No nation can be respected or regarded as a nation unless it has its own national institution and the greatest of all national institution is the financial institution in the form of a bank."

In an advertisement in the *Nigerian Tribune* of February 1952, the National Bank, calling on Nigerians to patronise it, delivered the message unmistakingly by lamenting that the economic strangulation of the African "could not have been possible if the African had had a strong financial institution of his own. Patronise the National Bank of Nigeria and retrive your lost birth right."

Disappointed and annoyed at the treatment he received from one of the expatriate banks in the country, the Great Zik exclaimed that he was "treated shoddily ... naturally my pride was hurt and I was bitter ... he did not make me feel he was talking business with me. He left me under the impression that racial factors were at work ... that unless Africans establish their own banks in order to call off this bluff, the economic exploitation of Africa will continue with impunity. I told him I will yet own a bank of my own and that I am dreaming." Zik was not dreaming. He founded his own bank, the African Continental Bank Limited in 1947. Years later Zik explained that he established the bank "if for nothing else, to teach alien banks to respect African business in its own right and to reckon with African patronage of banks as a factor in the economy of the country ... this influenced me to insist that when freedom comes, all banks must be nationalised and I had to incorporate it in the party's manifesto when I drafted it for the Kano convention in 1951."

"I had no experience in banking, but I was determined to call off the bluff of alien exploiters who think that because we are a colonial territory, we have no economic power which can force those who benefit from our political bondage to respect us."

The above nationalistic fervours explain another factor in the evolution of indigenous banking — government intervention. This is the background to the then Western and Eastern Region Governments, injecting public funds to salvage the National Bank of Nigeria Limited and the African Continental Bank Limited respectively from collapse in the mid 1950s as a result of the apparent inability of the banks' private shareholders then to adequately fund them as required under the 1952 Banking Ordinance.

In this connection, the federal government's indigenisation measures with the declared objectives of enabling Nigerians to own and be seen to own and control the commanding heights of their economies is as much political as, indeed more political, than economic. So also is the intervention to establish the Central Bank of Nigeria and the four national development banks, already mentioned.

When, towards and at the end of the Nigerian civil war, the Bendel State and the then South Eastern State Governments set up their own banks — the New Nigeria Bank and the Mercantile Bank Limited — the motive was as much state nationalism as it was economic — to catalyse the development of the respective states. In this way, they blew the clarion call for stateism that is now a feature of banking in the country in which every state owns or plans to own its own bank.

There is finally the issue of indigenous banks catalysing the development of the country. In this connection, the nationalists, to all intents and purposes, were probably the Friedmanist, even before the advent of Milton Friedman on the economic landscape.

PUBLIC NOTICE

REVOCATION OF BANKING LICENCES AND WINDING UP OF THE AFFAIRS OF 26 (TWENTY-SIX) BANKS

The Central Bank of Nigeria (the Bank) in exercise of its powers under the provisions of the Banks and Other Financial Institutions Decree (BOFID) No. 25 of 1991 as amended hereby announces the revocation of the banking licences and the commencement of the winding up of the affairs of the underlisted 26 (twenty-six) banks with effect from Friday, 16th January, 1998:

S/No.	Commercial Banks
1.	Allied Bank of Nig. Plc
2.	Amicable Bank of Nig. Ltd.
3.	Commerce Bank Ltd.
4.	Commercial Trust Bank Ltd.
5.	Cooperative & Commerce Bank Ltd.
6.	Credite Bank Ltd.
7.	Highland Bank of Nigeria Plc.
8.	Lobi Bank of Nigeria Ltd
9.	Mercantile Bank of Nigeria Plc.
10.	North-South Bank (Nig.) Plc.
11.	Pan African Bank Ltd.
12.	Pinacle Commercial Bank Ltd.
13.	Progress Bank of Nigeria Plc.

S/No.	Merchant Banks
1.	Abacus Merchant Bank Ltd.
2.	ABC Merchant Bank Ltd.
3.	Century Merchant Bank Ltd.
4.	Continental Merchant Bank Plc.
5.	Crown Merchant Bank Ltd.
6.	Great Merchant Bank Ltd.
7.	Group Merchant Bank Ltd.
8.	ICON Ltd (Merchant Bankers)
9.	Merchant Bank of Africa Ltd.
10.	Nigeria Merchant Bank Plc.
11.	Prime Merchant Bank Ltd.
12.	Royal Merchant Bank Ltd.
13.	Victory Merchant Bank Ltd.

2. This ultimate regulatory intervention has become necessary in the face of the grave financial conditions of the affected banks. The capital bases of the banks have been totally eroded and they are both illiquid and insolvent. Consequently, they continue to default in meeting their obligations to depositors and creditors. Furthermore, the various actions taken by the Regulatory Authorities to halt the deterioration in the financial conditions of the banks, including Holding Actions and calls for recapitalisation, did not yield the desired results. The banks have failed for all practical purposes and are terminally distressed.

3. Although exogenous factors such as macroeconomic instability, economic recession and policy-induced shocks have played a part in the prevailing financial sector distress, it should be stressed that the failure of a bank is largely the result of Management ineptitude and insider abuses. Indeed, badly led and managed banks would fail in spite of the best endeavours of the regulatory/supervisory authorities. In this connection, it should be noted that under the same macroeconomic and regulatory environments, various banks have thrived.

4. This intervention is an intensification of the policy of liquidating terminally distressed banks, initiated by this Administration in 1994, which involved the liquidation of 5 failed banks. With effective execution, it would enhance the cause of restoring full viability and confidence to the banking industry and thereby put it in a position to adequately service the economy. Given that the terminally-distressed banks had since been isolated by the regulatory authorities and that their mass liquidation had long been anticipated by industry participants, this latest action should be well-received and would not have any significant adverse systemic repercussions. Meanwhile, the supervision of the banking industry is being strengthened while the prompt identification and resolution of banking failure will be improved upon and sustained.

5. All depositors are assured that their insured deposits would be promptly settled by the Nigeria Deposit Insurance Corporation (NDIC) after due verification.

6. All those indebted to these 26 failed banks are urged to pay their debts to the liquidator without further delay failing which they shall be dealt with in keeping with the provisions of the law, including the Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Decree No. 18 of 1994 as amended.

7. In furtherance of the above decision and in exercise of its powers under the BOFID No. 25 of 1991 as amended, the Bank has appointed the NDIC as the liquidator of the 26 banks.

CENTRAL BANK OF NIGERIA,
GARKI,
ABUJA.

16TH JANUARY, 1998

NIGERIA DEPOSIT INSURANCE CORPORATION

NOTICE TO DEPOSITORS OF KAPITAL MERCHANT BANK LTD UNITED COMMERCIAL BANK LTD AND REPUBLIC BANK LTD (IN-LIQUIDATION)

1. PAYMENT OF DIVIDEND

The Nigeria Deposit Insurance Corporation (NDIC) in its capacity as the Liquidator of the closed Kapital Merchant Bank Limited (KMB), United Commercial Bank Limited (UCB) and Republic Bank Limited (RBL) is pleased to announce that it has completed arrangements to pay dividend to depositors with excess uninsured deposits from funds realised from the assets of the three closed banks. This payment will bring cumulative dividend paid to date to 70 kobo per naira for KMB, 31 kobo per naira for UCB and 34 kobo per naira for RBL.

Depositors in this category who had filed claims and received payment of the maximum insured deposit of N50,000.00 from the Corporation or the First Bank of Nigeria Plc (paying Agent appointed by the NDIC) and have been issued Liquidator's Certificates evidencing their excess deposits in the three closed banks are hereby advised to contact the Corporation at its Lagos Office in the case of Kapital Merchant Bank and the under-listed branches of First Bank of Nigeria Plc (in the case of the other two banks) for their dividend cheques withelect from 1st April, 1997 during the normal banking hours on all working days (i.e. Monday - Friday).

CLOSED BANK		AGENT/PAYING BANK
a) United Commercial Bank Ltd.	—	**First Bank of Nigeria Plc**
i) Victoria Island Branch/ Head Office	—	Abibu Adetoro Branch, Plot 5, Imam Abibu Adetoro Street, Off Ajose Adeogun St., Victoria Island, Lagos.
ii) Broad Street Branch)	—	Obun Eko Branch 126 Nnamdi Azikiwe Street, Lagos.
iii) Enu-Owa Branch)		
iv) Ikeja Branch	—	Oregun Industrial Estate Branch, Plot 2B, Adeyemi Close, Ikeja.
v) Aaba Branch	—	Navy Town Ojo Branch, B. M. U. Complex (Road 8)
vi) Onitsha Branch	—	Onitsha (Main) Branch 19 New Market Road, Onitsha
vii) Port-Harcourt Branch	—	Port-Harcourt (Main) Branch Port-Harcourt.
b) Republic Bank Limited	—	**First Bank of Nig. Plc**
i) Ikeja and Maryland	—	Oregun Industrial Estate Branch, Plot 2B Adeyemi Close, Oregun Industrial Estate, Ikeja.
ii) Marina, Oka-Akri, Ojo-Giwa and Balogun (Head Office)	—	Victoria Island Branch, Plot 5, Imam Abibu Adetoro Street, Off Ajose Adeogun Street, Victoria Island.
iii) Ataba	—	Navy town Branch B. M. U. Complex (Road 8) Festac Town.
iv) Kano	—	Kano (Main) Branch, 10, Lagos Street Kano

However, depositors of Kapital Merchant Bank and ex-staff of the closed United Commercial Bank Limited and Republic Bank Limited who maintained deposit accounts with the banks are to collect their dividend cheques directly from the Corporation at its Lagos Office i.e. Nigeria Deposit Insurance Corporation, Receivership & Liquidation Department (8th floor), 23A Marina, Lagos.

Individual claimants are to collect their dividend cheques in person while those wishing to collect cheques on behalf of firms/corporate bodies are to be properly authorised in writing by the signatories who endorsed the claim forms for insured deposits originally filed by such firms/corporate bodies with the NDIC or the agent bank. Dividend would continue to be declared as and when assets of the closed banks are realised.

2. EXTENSION OF THE PERIOD FOR FILING CLAIMS FOR INSURED DEPOSITS

All depositors of the five closed banks are hereby informed that the extension previously granted by the Corporation to the period within which claims for insured deposits are to be filed terminates on 30th June, 1997. Consequently, depositors who are yet to file their are urged to do so without further delay with the Corporation in respect of Kapital Merchant Bank and Financial Merchant Bank and with the branches of First Bank of Nigeria Plc listed above in respect of the remaining three banks.

Depositors of the closed Republic Bank Limited in particular are therefore advised to note the final date for filing claims.

LIQUIDATOR-IN-CHARGE
NIGERIA DEPOSIT INSURANCE CORPORATION
(LAGOS OFFICE)
MAMMAN KONTAGORA HOUSE
(8TH FLOOR)
23A MARINA
P.M.B. 12881
LAGOS.
TEL: 2647840-45

for safety, soundness & confidence in banking

NIGERIA DEPOSIT INSURANCE CORPORATION

NOTICE TO DEPOSITORS OF FINANCIAL MERCHANT BANK LTD UNITED COMMERCIAL BANK LTD ALPHA MERCHANT BANK PLC AND REPUBLIC BANK LTD (IN-LIQUIDATION)

PAYMENT OF LIQUIDATION DIVIDEND

The Nigeria Deposit Insurance Corporation (NDIC) in its capacity as the Liquidator of the closed **Financial Merchant Bank Limited (FMB), United Commercial Bank Limited (UCB), Alpha Merchant Bank Plc (AMB)** and **Republic Bank Limited (RBL)** is pleased to announce that it has completed arrangement to pay liquidation dividend to depositors with excess (uninsured) deposits **from funds realised from the assets of the four closed banks.** This payment will bring cumulative liquidation dividend paid to date to **38 kobo per naira for FMB, 37 kobo per naira for UCB, 16 kobo per naira for AMB and 68 kobo per naira for RBL.**

For example, a depositor having an outstanding balance of *N34,782,134.00 as at closure in FMB who had hitherto collected the sum of N10,400,175.00 before the* proposed payment is entitled to receive the sum of N2,925,834.00 as liquidation dividend thus bringing the cumulative payment to him to N13,326,009.00. So also, a *depositor in RBL having outstanding balance of N2,214,962.00 at closure and who had been paid the sum of N909,489.00 to date shall receive the sum of N587,462.00* as liquidation dividend thereby bringing cumulative payment to him to the sum of N1,496,951.00. These examples should lay to rest the **erroneous impression that a *depositor can only receive a maximum amount of* N50,000.00 from the Liquidator** in the event of a bank failure.

Depositors who had filed claims and received payment of the maximum insured deposit of N50,000.00 from the **Corporation or the First Bank of Nigeria Plc** (paying Agent appointed by the **NDIC**) and have been issued Liquidator's Certificates evidencing their excess deposits in the four closed banks including those who failed to file claim for their insured deposits in the closed banks before the expiration of June 30, 1997 deadline are hereby advised to contact the **Corporation at its Lagos Office, Nigeria Deposit Insurance Corporation, Receivership & Liquidation Department (8th Floor) 23A Marina, Lagos** in the case of Financial Merchant Bank and the **underlisted branches of First Bank of Nigeria Plc** (in the case of the other three banks) for their dividend cheques with effect from 15th September, 1997 during the normal banking hours on all working days (i.e. Monday - Friday).

CLOSED BANK		AGENT/PAYING BANK
a) United Commercial Bank Ltd.	-	**First Bank of Nigeria Plc**
i) Victoria Island Branch/ Head Office	—	Abibu Adetoro Branch, Plot 5, Imam Abibu Adetoro Street, Off Ajose Adeogun Street, Victoria Island, Lagos.
ii) Broad Street Branch) iii) Enu-Owa Branch)	—	Obalende Branch, 126 Nnamdi Azikiwe St. Lagos
iv) Ikeja Branch	—	Oregun Industrial Estate Branch, Plot 2B, Adewunmi Close, Ikeja
v) Ataba Branch	—	Navy Town Ojo Branch, B.M.U. Complex (Road 8), Festac Town
vi) Onitsha Branch	—	Onitsha (Main) Branch, 19, New Market Road, Onitsha
vii) Port Harcourt Branch	—	Port Harcourt (Main) Branch, Port Harcourt.
b)Alpha Merchant Bank Ltd.	—	**First Bank of Nigeria Plc**
i) Head Office Branch	—	Abibu Adetoro Branch, Plot 5, Imam Abibi Adetoro Street, Off Ajose Adeogun St., Victoria Island, Lagos.
ii) Kano Branch	—	Kano Main Branch, 10 Lagos Street Kano
c) Republic Bank Limited	—	**First Bank of Nig. Plc**
i) Ikeja and Maryland	—	Oregun Industrial Estate Branch, Plot 2B, Adewunmi Close, Oregun Industrial Estate, Ikeja.
ii) Marina, Oke-Arin, Ojo-Giwa and Balogun (Head Office)	—	Victoria Island Branch, Plot 5, Imam Abibu Adetoro Street, Off Ajose Adeogun Street, Victoria Island.
iii) Alaba	—	*Navy town Branch,* B.M.U. Complex (Road 8) Festac Town
iv) Kano	—	Kano (Main) Branch, 10, Lagos Street, Kano

However, ex-staff of the closed **United Commercial Bank Limited** and Republic Bank Limited who maintained deposit accounts with the banks are to collect their liquidation dividend cheques **directly from the Corporation at its Lagos Office** i.e. Receivership & Liquidation Department Mamman Kontagora House (8th floor), 23A Marina, Lagos.

Individual claimants are to collect their liquidation dividend cheques in person while those wishing to collect cheques on behalf of firms/corporate bodies are to be properly authorised in writing by the signatories who endorsed the claim forms for insured deposits originally filed or to be filed by such firms/corporate bodies with the NDIC or the agent bank. Liquidation dividends would continue to be declared as and when assets of the closed banks are realised.

LIQUIDATOR-IN-CHARGE
NIGERIA DEPOSIT INSURANCE CORPORATION
(LAGOS OFFICE)
MAMMAN KONTAGORA HOUSE
(8TH FLOOR)
23A MARINA
P.M.B. 12881, LAGOS.
TEL: 2647840-45

for safety, soundness & confidence in banking.

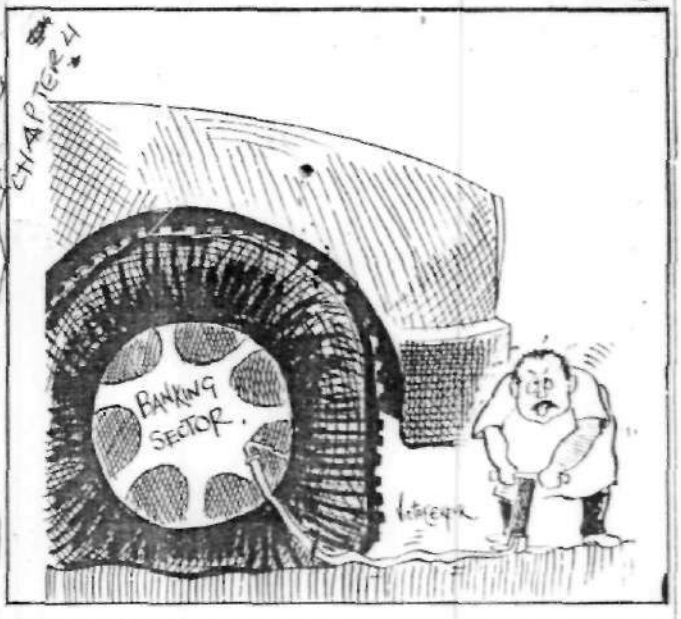
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DEVELOPMENT

Improving performance in the banking sector (1)

• CHIEF FEMI ACEKANYE, former president, Chartered Institute of Bankers of Nigeria (CIBN) and vice-chairman, chief executive officer, Commerce Bank Plc reflects on bank's performance, highlights what should constitute the focus for banking regulations and recommends members for banks' stability and continuity in the country.



AT various times over the past five years of the Structural Adjustment Programme (SAP), the banking industry had to cope with different types and forms of difficulties, all in a bid to record and sustain what one may call impressive performance. We have for instance, seen at different times, the removal and later re-introduction of ceilings on interest rates. The seemingly notorious and dreaded stabilisation securities have also become one source of treasury management policy derailment that banks have learnt to live with. The later-play of cut-throat competition between banks, finance houses and, of recent, mortgage institutions, and the continued erosion of the stock of well-trained and qualified manpower are also hard pills which the banks now have to swallow.

One of the challenges arising out of this situation has been the question of adequate capitalisation for banks. I remember vividly being among the proponents of increased share capital for banks, a view I believe had the full backing of both banking regulators and banking practitioners. The monetary authorities consequently increased the share capital of commercial banks initially to N20 million and subsequently to N50 million. For merchant banks, the increase was to N12 million and later to N40 million. Compliance with these minimum capital requirements has been quite challenging. Less than two months to the expiration of the deadline, many banks, are yet to mobilise adequate capital to meet the statutory requirements.


• Chief Adekanye

Interestingly, it is doubtful if this call which made capital adequacy the most prominent determinant of bank performance in Nigeria was based on a research oriented and conclusive study. The same was the case in many of the developed countries, especially the United States, where the view had been held over many years that banks should be heavily capitalised in order to survive, thus suggesting that capital adequacy is fundamental to bank performance. It has, however, been validated by a myriad of researchers that the strongest capital ratios do not necessarily guarantee or ensure liquidity and solvency. Not only has this been the case, there has also been the very important question of how much capital is adequate. As has been aptly put, no amount of capital would save a badly managed bank.

As a result of these findings, there have been attempts, especially in developed countries, to re-examine the question of bank capital adequacy along with related concepts of liquidity, profitability, management quality and risk as they relate to bank performance. Their findings have been startling.

However, experience has shown that we cannot always rely on, or even accept, foreign views on issues which have direct bearing on our domestic environment. Unfortunately, we are seldom known to have taken it upon ourselves to establish or refute such views as they border on our peculiar situation. For instance, we should expect that the performance of a typical Nigerian bank of today could also be affected, positively or adversely, by its ownership and the composition of its board and management. While these factors can be important in a developing country, they are not likely to be significant in a developed economy.

Also, by virtue of the differences in rural-urban development, even the location of a bank's head office and the number and distribution of its branches may be significant factors in a developing country environment. One can recall a pertinent pronouncement by a top Nigerian banker in one of the predominantly state-owned banks that any bank in Nigeria without its head office in Lagos cannot remain profitable for long. It has, therefore, become necessary to go beyond the convention, and explore further what peculiarities define the Nigerian situation.

In view of the dearth of reliable data and research on commercial banks in Nigeria, the questionnaire approach was adopted for obtaining vital information and statistics which are important for assessing the financial condition of banks. The questionnaire was also used to determine the views of top bank management concerning the factors they consider to be significant performance determinants and why. Those factors were found to include capital adequacy, asset quality, liquidity, managerial efficiency, loan portfolio, revenue sources, revenue application, branch location, bank size, liability match, regulation and national economic variables. Thus, the questionnaire became our basic survey instrument. Twenty-four banks were covered.

The questionnaire sought information on the corporate background of the respondent banks, branch network and performance indicators, and also on the views of management concerning other significant variables which determine bank performance. The corporate background information required include: year of incorporation, year licence was applied for, year licence was granted, the existence or non-existence of technical partners, (or partnership agreements) and ownership composition. In addition, information was required on certain well known performance measures including: net income before taxes, total operating expenses, total assets, total deposits, operating income, etc.

In compiling the list of these variables and computing the relevant financial ratios, we relied largely on previous studies. We were able to obtain comprehensive raw data through the questionnaire from which relevant financial ratios were computed. These ratios were used for assessing the trends in the financial condition of the banks relative to industry performance, and consequently, for classifying them.

The questionnaire was made fairly close-ended to ensure unambiguous answers and consistency in responses. Returns were later analysed and compared with results of further rigorous analysis using univariate tests, multivariate discriminant analysis (MDA) and logit analysis.

Bank performance has attracted so much investigation essentially due to the fact that banks occupy a special place and play a significant role in the economy. As such, in the history of banking and economies of many nations, banks have been the most widely regulated of all businesses. What has particularly captured the concern is the understandable commitment of regulators to the minimisation of incidence of bank failures and distress.

In the process, both researchers and policy makers have, in the past, been saddled with the task of evolving what has come to be known as Early Warning Systems (EWS). Essentially, in developing an early warning system, the bank regulator's primary desire is to minimise the misclassification of problem banks as non-problem banks. The development of such signal systems involves the identification of significant factors determining the health status or financial condition of the banks and, based on the basket of factors identified, attempting a prediction or classification of any set of banks. With respect to the latter, further attempts are made to improve the predictive ability of the early warning system. Such models are commonly developed, updated and employed by the supervision departments of Central Banks as well as deposit insurance institutions all over the world, and they are meant to classify banks into problem and non-problem categories.

In fact, the classification of banks has been the most important step in bank performance related research efforts. This is more so due to the fact that bank performance can be measured by using different proxies. It has been based on the net profit after tax or profit before tax or even the magnitude of loans and advances, total assets or total deposits. These measures, being magnitudes have, however, been criticized for their inability to remove "scale effects" in interbank comparison. Financial ratios have, therefore, been more commonly used as measures for comparing the performance of banks.

With respect to the classification of banks, while some prominent contributors in the literature, such as Sinkey (1975) have used the problem/non-problem classification, some adopt the vulnerable/resistant classification and others such as Hunter and Srinivasan (1990) and Arshadi and Lawrence (1987) adopt the financially successful non-financially successful classification. The problem/non-problem classification is based on the classification by the US Federal Deposit Insurance Corporation (FDIC). A problem bank, going by this classification, is one that, in the eyes of the federal banking agencies, has violated a law or regulation or engaged in an unsafe or unsound banking practice to such an extent that the present or future solvency of the bank is in question.

Problem banks are usually identified during bank examinations, the aim of such bank examination being to determine the nature of liabilities; ascertain compliance with laws and regulations; evaluate controls, procedures, accounting practice and insurance; evaluate management and its policies, and determine capital adequacy. Evidently, a problem bank is, in the light of these, of significant interest to the regulatory authorities since it poses a great risk to the depositors and the level of confidence in the system. No less important is the drain that such problem bank may cause on the financial resources of the FDIC itself.

For an analysis of bank performance in Nigeria today, the adoption of the vulnerable/resistant bank classification would be the most appropriate. In this regard, one could adopt a modification of the basis for such classification as was contained in a very recent study by Hunter and Srinivasan (1990). They defined as a financially resistant bank one whose return on assets (ROA) is at least 80 per cent of the median ROA for established banks with less than $100 million in assets in the same bank's state of charter. This definition is essentially based on profitability of each bank in the industry compared with the industry's average profitability.

> *"In general, the conclusion has been that those factors critical to a bank's performance are endogenous to the bank and that factors do not in themselves exert sufficient impact to cause bank failures. This is perhaps due to the fact that such exogenous factors, more often than not, affect all existing banks. Also, managerial efficiency or management quality has been observed by many as critical to bank performance."*

The issues of performance classification aside, most studies have depended heavily on financial ratios for assessing the significance of such broad factors as capital inadequacy, managerial efficiency, asset quality and liquidity as determinants of bank performance. Other ratios can be categorized under such other factors as match of liability, bank size, branch structure, as well as source and application of funds. In addition to these, some indices have also been adopted to investigate the effect of economic and demographic conditions on bank performance. Furthermore, more recently, there have been attempts that have shown market information such as bond and stock prices of quoted banks as important indicators of bank performance. Most of these identified factors can be classified as either endogenous or exogenous factors. This implies that the financial condition of banks could be determined by either factors under or outside its control or better still, as combination of both. One of the major high points of bank performance-related research has been to determine the relative importance of these categories of factors. State economic variables such as disposable personal income, residential construction index, unemployment and population have also been examined as possible determinants of bank performance. Interestingly, in one study, of these economic variables which are exogenous to banks, the change in residential construction was found to be a significant factor which determined the performance of most banks within the local economy.

Regarding the analysis, complicated techniques such as multivariate discriminant, probit, logit and canonical correlation techniques are in general interchanged, although minor differences exist in their characteristics and assumptions. Also, conclusion about which factor or group of factors are the most important for predicting bank performance are not unanimous. It does seem that the identified significant factors vary with the economy and thus the economic environment, the selected accounting, economic, demographic or market indices. Some similarities can, however, be observed. In general, the conclusion has been that those factors critical to a bank's performance are endogenous to the bank and that factors do not in themselves exert sufficient impact to cause bank failures. This is perhaps due to the fact that such exogenous factors, more often than not, affect all existing banks. Also, managerial efficiency or management quality has been observed by many as critical to bank performance. This, when viewed ordinarily, seems plausible for the case of Nigeria and we shall further examine it in subsequent sections.

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national concord
TRUTH IS CONSTANT


* Dr. Oso-Afiana


* Mr. Latif Muse


* Alhaji M.S. Nanono


*Mr. David Drumm


* Mr. Tunde Kolawole


* Mr. Paschal Dozie

BANK-SOUNDNESS & RECAPITALISATION

Special Report
MONEY MARKET
1997

Edited and Co-ordinated
by NNAMDI ORAEGBU

- Issues At Stake
- Key to the Future
- Task of the moment
- Reality of crisis
- Day after doom



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Special Report

ISSUES AT STAKE

Hard Road To Soundness

Banks that are well focused and managed will reap long-term gains of success. By NNAMDI ORAEGBU.



Mr. Latif Muse Adegbite



Dr. Lawrence Osa-Afiana Citizens Bank MD

"Even so, he was confident that most banks would be able to scale the new re-capitalisation huddle, and settle down to do more serious business."

"But, whether it would get tougher or not for banking in the country, it is the price that the industry has to pay to walk its way towards earning a reputation of soundness."

"THE beauty of banking", proclaims the black lettering on a white response sheet that had been sent in *in connection with a* questionaire on banking.

Another uses the word, "quality", to define a related meaning, from a market point of view. A third, speaks in terms of the "pursuit of excellence" - certainly, not so different from what had been meant to describe an interesting book of the same creative evocation.

But, what in the whole wide world is this subject that had earned these eloquent descriptions. What in banking could have attracted such passionate expressions?

Well, you do not need to think further. What else, but, "bank-soundness"?

The concept itself is not new. But it has earned the *recognition throughout the* history of banking as the cornerstone of the profession, often times viewed, as the institution of the tradition of "genuine wholeness" of the practise of financial intermediation.

Of course, a tradition of such enchantment, could only radiate warmth and charm, that would make it difficult for it to be hidden totally from view, even for an industry, or trade, that prides itself as conservative, and cautious.

The financial intermediation function is the main reason why banks are established, both here in Nigeria and elsewhere. But the extent to which the banks themselves are able to perform this function creditably well, *under constantly* changing economic and financial environments would go a long way to stand as the critcal measurement of their basic soundness as institutions of lending.

In other words, they stand out as the accummulation of their financial worth, expertise and experiences. And, come shine, or rain, soundness entails that banks are well-capitalised for safety, efficient in financial services delivery and responsible as any good organisation, could possibly be.

For banks, this is actually, the basis of the trust and confidence, it earns from its customers who are scattered far and wide.

In Nigeria, the issue of bank-soundness had recently revebrated throughout the industry and beyond with the new policy requirement of the Federal government jerking up bank's paid-up capital base to N500,000,000 level, which is significantly much higher than what it used to be for both commercial and merchant banks.

The policy initiative which was flagged off as a way of engendering some bank reform, had set the target date of next year for banks to meet the requirement.

The policy itself, did not come as a total surprise to the bulk of the industry. Rather, what had seemed to have rattled very many top bankers was *the fact that* there was no attempt to give consideration to banks' individual capital requirements, given the disparity in the kind of services that they render and the market areas within which they operate.

In other words, banks are assumed to belong to a single league with the same capital requirement. Mr. Lateef Musa, Access Bank managing director, while *supporting the general* principle of the initiative, noted that the government should have accorded a kind of graduated levels for banks, depending on their levels of financial intermediation.

Dr. Lawrence Osa-Afiana, the managing director Citizens International Bank Limited, while expressing the same feelings, argued that recapitalisation is a phenomenon which banks continually have to address, whenever such is deemed necessary, as they might wish to strengthen their financial resource base, in the face of expanding commitments, or erosion of their capital position due to changes in their operating environment.

Even so, he was confident that most banks would be able to scale the new recapitalisation huddle, and settle down to do more serious business.

But then, the government's recapitalisation move, was intended to send very clear signal to the banks, that it expects to see a further strengthening of the financial system, as a form of up-grading, deriving from the gains that had been achieved with the relative systemic stabilisation after the period of the widespread distress and failures.

The problems of distress in the system, which initially had begun with National Bank of Nigeria Limited, had spread so quickly with the aggrevation of the liquidity position of many banks between 1991 and 1994; and, again, particularly, with the proliferation of banks, that had come *with deregulation*.

Even with regards to the monitoring and supervision of the system, the monetary authorities were in for a hell of a time, much of which they did not expect, as the systemic pressure of deregulation had build up, and letting loose unhealthy practises and speculative trading.

The bottom line, was that, everything had seemed to have gone out of control, leaving a very substantial number of the 130 banks then in existence, in the throes of terrifying distress.

The whole experience for the authorities was like a delicious soup that had gone sour. Or better still, turning the issue of bank soundness into filthy rags.

And, on the other hand, for very many bankers, some good, some not really good, and some down-right reckless, it was like, "the beauty of banking" lost to the wind.

Alhaji M.S. Nanono, managing director, African International Bank Limited, just like very many other bankers believed that the industry has learnt a lot of lessons from the recent crises that had befallen banks. While insisting that the industry is not yet totally out of the woods, he was confident that the lessons already learnt by banks would lay the framework for future gains.

Most of the top bankers interviewed by National Concord for this special report, including Mr. S.E. Ereola Kolawole, managing director, Trade Bank Plc, Mr. Lateef Muse, managing director, Access Bank, Dr. Lawrence Osa-Afiana, managing director, Citizens International Bank Limited and Mr David Drumm, executive director, First City Merchant Bank Limited agreed that over the next five years a lot *would be achieved in the* banking sector on account of the cummulative efforts being made to manage banks more effectively and the increasing trend towards technological improvement in services delivery, often referred to, as electronic banking.

Even so, Mr Drumm, who has worked in Nigeria for about four years now and whose job at his bank embraces strategic thinking and resources development, predicts that the task facing banks over the short and medium term would, infact get tougher: "It would get very tough for bankers, I must say," he noted, even as the industry and bank customers stand to gain from the anticipated consolidation over the next five years or so.

But, whether it would get tougher or not for banking in the country, it is the price that the industry has to pay to walk its way towards earning a reputation of soundness.



Balance Sheet

As at 30th September, 1994

Assets	Notes	1994 N'000	1993 N'000
Cash and short term funds	1	5,331,047	5,434,252
Balances with other Banks & Financial Institutions	2	15,945,847	17,397,421
Bills discounted	3	10,433,686	1,237,053
Investments	4	77,973	77,870
Loans and advances	5	7,105,544	4,218,678
Other assets	6	2,593,483	2,074,805
Equipment on lease	7	114,945	83,103
Fixed assets	8	1,912,208	1,484,914
Total Assets		43,514,733	32,008,096
Financed by:			
Liabilities			
Deposits, current & other accounts	9	28,037,838	20,114,764
Taxation, dividend and other liabilities	10	13,453,946	10,215,980
		41,491,784	30,330,744
Capital and Reserves			
Called-up share capital	11	158,760	79,380
Statutory reserve	12	258,745	195,715
Exchange difference reserve	13	476,773	456,119
General reserve	14	860,356	717,513
Reserve for bonus issue	15	39,690	—
Shareholders' Funds		1,794,324	1,448,727
Asset revaluation surplus	8	228,625	228,625
Capital Funds		2,022,949	1,677,352
		43,514,733	32,008,096
Contingent liabilities and other obligations on behalf of customers and customers' liability thereon	23	4,046,317	2,941,311

Prof. Green Onyekaba Nwankwo — *Chairman*

Muhammed Imam Yahaya — *Managing Director & Chief Executive*

Olusegun Olusanya — *Executive Director*

The notes on pages 17 to 27 form part of these financial statements.

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Profit and Loss Account

For the year ended 30th September, 1994

Income	Notes	1994 N'000	1993 N'000
Gross earnings	16	5,794,505	3,937,714
Interest paid	17	(1,494,175)	(1,224,806)
		4,300,330	2,712,908
Expenses			
Overheads	18	(2,492,873)	(1,530,914)
Depreciation	7 & 8	(352,474)	(215,067)
Provision for performing and non-performing accounts:			
— Interbank placements	2	(160,000)	—
— Investments	4	(9,597)	—
— Loans and advances	5 . 4	(540,834)	(212,232)
— Sovereign debts and sundry accounts	6 . 3	(140,726)	(109,607)
— Claims and contingencies	10 . 2	2,483	(30,329)
		3,694,021	(2,098,149)
Profit before taxation		606,309	614,759
Taxation	19	(186,110)	(162,392)
Profit after taxation		420,199	452,367
Appropriations:			
Transfer to statutory reserve	12	63,030	67,855
Proposed dividend	21	95,256	47,628
		158,286	115,483
Retained profit for the year transferred to general reserve	14	261,913	336,884
		420,199	452,367
Earnings per 25k share (adjusted)		66.17k	71.24k
Dividend per 25k share (adjusted)		15.00k	7.50k

The notes on pages 17 to 27 form part of these financial statements.

GROUP BALANCE SHEET

AT MARCH 31

	Notes	GROUP 1994 N'000	GROUP 1993 N'000	COMPANY 1994 N'000	COMPANY 1993 N'000
USE OF FUNDS					
Cash and short term funds	1	6,462,560	4,867,029	6,461,917	4,863,349
Cash reserve deposits		613,136	437,351	613,136	437,351
Stabilisation Securities		3,042,103	3,826,088	3,042,103	3,826,088
Bills discounted	2	1,946,945	999,413	1,946,945	999,413
Investments	3	890,051	1,433,331	868,201	1,429,481
Loans and advances	4	4,317,846	5,428,590	4,317,846	5,428,590
Other assets	5	5,461,790	4,865,678	5,449,063	4,847,930
Fixed assets	6	1,548,048	1,117,690	1,545,446	1,117,393
		24,281,979	**22,975,170**	**24,244,657**	**22,949,595**
LIABILITIES					
Current, Deposits and other accounts	9	18,353,987	18,627,500	18,353,987	18,627,500
Accounts payable, including items in transit, taxation and dividends	10	4,350,600	3,608,521	4,327,299	3,599,515
		22,704,587	22,236,021	22,681,286	22,227,015
CAPITAL AND RESERVES					
Share Capital	7	100,000	100,000	100,000	100,000
Reserves	8	1,477,392	639,149	1,463,371	622,580
Shareholder's Funds		1,577,392	739,149	1,563,371	722,580
		24,281,979	**22,975,170**	**24,244,657**	**22,949,595**
Acceptance, guarantees and other obligations for account of customers (and customers' liability thereof)	11	**3,273,000**	**3,903,748**	**3,273,000**	**3,903,748**

Mr. S.A. Adewusi (CFR, NPM))
Mr. L.E. Okafor) Directors
Mr. G. Hoyami)

The accompanying notes form an integral part of these financial statements

PROFIT & LOSS ACCOUNTS

FOR THE YEAR ENDED MARCH 31

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	NOTES	GROUP 1994 N'000	GROUP 1993 N'000	COMPANY 1994 N'000	COMPANY 1993 N'000
Gross earnings	12	3,643,441	2,930,899	3,629,066	2,908,394
Interest expenses	13	(813,456)	(789,533)	(813,456)	(789,533)
		2,829,985	2,141,366	2,815,610	2,118,861
Overhead expenses	15	(1,554,449)	(1,124,104)	(1,541,631)	(1,119,908)
Depreciation on fixed assets		(77,085)	(61,548)	(76,254)	(61,352)
Net Income before provision		1,198,451	955,714	1,197,725	937,601
Provision under Prudential Guidelines on Loans and Advances	16.1	(456,167)	(741,424)	(456,167)	(741,403)
Net Income after provision		742,284	214,290	741,558	196,198
Exceptional Income	17	131,976	153,787	131,976	153,787
Net Income after exceptional income		874,260	368,077	873,534	349,985
Provision for dimunition in value of Fed. Govt. Sovereign Debts	3.1	(661,027)	-	(661,027)	-
Net profit before taxation		213,233	368,077	212,507	349,985
Taxation	18	(79,730)	(102,640)	(79,730)	(95,903)
Net Profit after taxation		133,503	265,437	132,777	254,082
APPROPRIATIONS					
Statutory reserve		(19,917)	(38,112)	(19,917)	(38,112)
General reserve		(62,586)	(186,556)	(61,860)	(175,201)
Dividends		(50,000)	(40,000)	(50,000)	(40,000)
Profit retained for the year		1,000	769	1,000	769
Unappropriated profit brought forward		1,700	931	1,700	931
Unappropriated profit carried forward		**2,700**	**1,700**	**2,700**	**1,700**
Earnings per 50k share	20	67k	133k	66k	127k
Dividend per 50k share	20	25k	20k	25k	20k

The accompanying notes form an integral part of these financial statements

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Balance Sheet as at 31st March, 1994

	Notes	1994 ₦'000	1993 ₦'000
Assets:			
Cash and short-term funds	1	**3,590,991**	1,038,639
Investments	2	**890,809**	599,859
Loans and advances	3	**1,022,054**	960,532
Advances under finance lease	4	**10,147**	55,576
Other assets	5	**195,625**	260,921
Fixed assets	6	**374,188**	230,469
		6,083,814	3,145,996
Liabilities:			
Deposit, current and other accounts	7	**4,399,203**	2,336,852
Taxation, dividend and other liabilities	8	**1,132,414**	527,678
		5,531,617	2,864,530
Net Assets		**552,197**	281,466
Financed by :			
Share capital	9	**115,000**	60,000
Share premium	10	**53,476**	10,024
Statutory reserve	11	**144,313**	67,429
Capital reserve	12	**100,000**	15,000
Retained earnings	13	**61,992**	51,597
Shareholders' Funds Before Revaluation Reserve		**474,781**	204,050
Revaluation reserve	6	**77,416**	77,416
Capital and Reserves		**552,197**	281,466
Contingent Liabilities: Acceptances, guarantees and other obligations for the account of customers (and customers' liability thereon)		**144,563**	257,300

Dr. S.O. Omobomi - Chairman
Chief S.I. Adegbite - Managing Director/Chief Executive Officer
Mr. S.A. Raji - Executive Director of Finance.

Approved by the Board of Directors on 23rd June, 1994.

The accompanying notes form an integral part of these balance sheets.

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Profit and Loss Account for the year ended 31st March, 1994

	Notes	1994 ₦'000	1993 ₦'000
Gross Earnings		**1,003,699**	526,917
Interest and Discount Income	14	**844,909**	449,247
Interest expense	15	**(243,761)**	(172,410)
Loan loss expense	16	**(66,648)**	(52,880)
Net Interest Margin		**534,500**	223,957
Other banking income	17	**158,790**	77,670
		693,290	301,627
Operating expenses		**(318,180)**	(159,372)
Profit on Ordinary Activities Before Taxation	18	**375,110**	142,255
Tax on Profit on Ordinary Activities	8	**(118,831)**	(40,159)
Profit on Ordinary Activities After Taxation		**256,279**	102,096
Appropriations:			
Transfer to statutory reserve	11	**(76,884)**	(30,629)
Dividends	8	**(69,000)**	(24,000)
Transfer to capital reserve	12	**(100,000)**	(15,000)
Retained profit for the year	13	**10,395**	32,467
Earnings per share (adjusted)	20	**135k**	68k
Dividend per share (unadjusted)	21	**30k**	20k

The accompanying notes form an integral part of these profit and loss accounts.

Appendix E: Financial Statements of Savannah Bank

Balance Sheet

as at March 31, 1995

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	Note	1995 ₦'000	1994 ₦'000
ASSETS			
Cash and short-term funds	2	2,264,383	2540001
Investments	3	33,861	41931
Loans and advances	4	1,484,864	1570528
Other assets and deferred charges	5	1,265,107	1024215
Fixed assets	6	374,807	351667
		5,423,022	5608342
LIABILITIES			
Deposits & other accounts	7	4,686,807	5052114
Taxation	8	2,660	11182
Dividends	9	7,557	8046
Other liabilities & charges	10	957,218	603385
		5,654,242	5684727
Debenture Stock	11	32,000	40000
		5,686,242	5724727
CAPITAL & RESERVES			
Share capital	12	52,383	52383
Share premium		2,583	2583
Statutory reserve		47,603	47603
Debenture redemption reserve fund		8,000	8000
Retained loss		(449,931)	(830096)
Deficit Capital		(339,362)	(112527)
Revaluation reserve	13	76,142	76142
		(263,220)	(116385)
		5,423,022	5608342
Acceptances, guarantees and other obligations on behalf of customers and customers' liabilities thereof	14	394,347	368004

JEROME C. EZEGBU

MUKHTAR A. MAHAMUD

} DIRECTORS

See notes to the financial statements

Profit and Loss Account

for the Year Ended March 31, 1995

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	Notes	1995 N'000	1995 N'000	1994 N'000	1994 N'000
Gross earnings	15		1,911,534		1385963
Interest and similar charges	16		(299,471)		(479772)
Net earnings			1,612,063		906191
Operating expenses	17	757,303		577307	
Provision for losses on loans and other assets	18	947,533		610796	
Depreciation	6	53,977		46652	
			(1,758,813)		(1234755)
Loss before taxation			(146,750)		(328564)
Taxation	8		(85)		(5822)
Retained Loss for the year			(146,835)		(334386)
Loss per share	19		(140k)		(314k)

See notes to the financial statements

LION BANK

Appendix F: Financial Statements of Lion Bank

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BALANCE SHEET

AS AT 31ST MARCH, 1994

	Notes	1994 N'000	1993 N'000
ASSETS			
Cash and short term funds	1	508,031	491,623
Bills discounted	2	96,700	26,500
Loans and advances	3	182,870	99,593
Other assets	4	304,432	304,982
Assets on lease	5	298	637
Fixed assets	6	48,808	31,579
		1,141,139	954,914
LIABILITIES			
Deposit and current accounts	7	582,835	526,818
Taxation payable	8	14,999	11,175
Other liabilities	9	437,965	330,047
		1,035,799	868,040
CAPITAL AND RESERVES			
Called up share capital	10	60,266	60,266
Share premium	11	-	12,057
Statutory reserve	12	17,377	11,837
Reserve for bonus issue	13	20,089	-
General reserve	14	7,608	2,714
Shareholders' funds		105,340	86,874
		1,141,139	954,914
Confirmed credits and other obligations on behalf of customers (and customers' liabilities therefor)	19	42,894	6,373

Chairman

Managing Director

The notes on pages 23 to 32 form part of these accounts

PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31ST MARCH, 1994.

	Notes	1994 N'000	1993 N'000
INCOME			
Gross earnings	15	199,990	130, 241
Interest paid	16	(79,033)	(47,193)
		120,957	83, 048
EXPENSES			
Overheads	17	(83, 276)	(52,837)
		37, 681	30, 211
Provision for bad and doubtful accounts	18	(11, 104)	(8,812)
Profit before taxation		26, 577	21, 399
Taxation	8	(8,111)	(6,915)
Profit after taxation		18, 466	14, 484
APPROPRIATIONS:			
Statutory reserve	12	5, 540	4, 345
Dividend		-	8, 437
Reserve for bonus issue	13	8, 032	-
General reserve	14	4, 894	1, 702
		18, 466	14, 484
Earnings per share		15k	12k
Dividend per share		-	7k

The notes on pages 23 to 32 form part of these accounts.