BANK RECAPITALISATION AND ITS EFFECT ON NIGERIAN BANKING INDUSTRIES.

A CASE STUDY OF FIRST BANK PLC ABUJA BRANCH

BY

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MBA/ADM/16844/98/99

BEING A PROJECT SUBMITTED TO THE DEPARTMENT OF BUSINESS ADMINISTRATION IN PARTIAL FULFILLMENT FOR THE AWARD OF THE MASTER'S DEGREE IN BUSINESS ADMINISTRATION.

FACULTY OF BUSINESS ADMINISTRATION
AHMADU BELLO UNIVERSITY ZARIA.
NIGERIA.

2002

DECLARATION

I hereby declare that this project for the Master in Business Administration is a product of my research work. It has not been presented for any other persons work referred to herein have been gratefully acknowledged by means of references.

ABUBAKAR ADAMU.

DEDICATION

This research work is dedicated to the bless memory of my late parent Alhaji Adamu Mohammed Sambo, Hajia Fatima Adamu Sambo and my immediate family Mrs. Amina Abubakar (wife) for her understanding and moral support toward the actualization of this dream.

CERTIFICATION PAGE

This Research work titled "BANK RECAPTIALSA TION AND ITS EFFECTS ON BANKING OPERATIONS IN NIGERIA " by Abubakar Adamu meet the regulation governing the award of Master Degree in Business Administration, Ahmadu Bello University, Zaria and is approved for its contribution to knowledge and literary presentation.

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DEAN: POST GRADUATE SCHOOL DATE

ACKNOWLEDGMENT

Let me first of all thank in a special way my God who from his infinite mercy and love saw of me through from the beginning of this course up to finishing. I want to thank him for giving me the knowledge, the wisdom and understanding in putting this work together.

May I in a special way acknowledge the contributions of some personalities whose contribution has made this project possible. Worthy of mention first is my able Supervisor Mallam Dalhat B. Imam who despite his tight schedule assisted immensely towards the actualization of my dream.

I would like to thank my Senior Brothers Engr. Muhammad A.K. Abubakar, Muhammad Adamu Sambo for their encouragement both financially and moral, also Abubakar Sadiq, Muhammad Hadi Sani, Abdul Rasheed Tafida Rafindadi and my Colleagues in the Business Administration Department for the encouragement I received from them.

I would not be fair to the following if mention is not made of them for the various role they played toward the success of this project. Let me thank Bashir and Bilkisu Mohammed who assisted immensely for the secretarial work. Mallam Sa'ad Amin Bamalli who contributed a lot toward the achievement of this goal.

I am also grateful to all those that have assisted me in one way or the other throughout my studies even if their names are not mentioned here. I am indeed grateful and may God bless each and every one of you abundantly. Amen.

Finally, I thank all staff and non-staff of First Bank of Nigeria Plc Zonal Office, Abuja. Who make this project a successful one. Thank you all.

ABSTRACT

This research is carried out on the problems that have pervaded the Nigerian Banking Industry in the last two decades, which eventually led to distress in the "Herculean" task of recapitalization.

The topic examines recapitalization from the point of distress and its causes in the financial system, taking cognizance of customer's unwillingness to save and the poor banking habit which is due chiefly to the fact that they have lost confidence in the Nigerian banking industry. The scramble for cash to meet up with the recapitalization requirement is also carefully looked at here.

The study also offer positive suggestion not only as to how they can consolidate their financial position to avoid being caught in a position of unpreparedness for future recapitalization increases.

Lastly, it tries to educate the readers on the ways recapitalization can help to address (if not totally eliminate) the problems in the banking industry and its numerous benefits to the national economy.

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CHAPTER ONE

INTRODUCTION

It is widely recognized that the financial system plays a vital role in the economic development of any country. This is done basically through certain institutions in the system, which include such sectors like the banks who are mostly concerned with separating the savings and investment function within the economy. Such that those that save at any particular time need not be those that have to invest at that same particular time. Therefore the financial system includes the banking institutions, which are very important in the payment and collecting systems.

An efficient financial system is very important and widely accepted as a necessary condition for the effective functioning of a nation=s economy. A responsive banking system is Central to the attainment of a sound economic base and its economic performance has far reaching political implications.

Banks facilitates economic transactions between various national and international units financial sector is usually aimed at ensuring a safe and sound system where depositors are protected.

The banking industry in Nigeria has been marked by periods of good and bad fortune, chequered and battered from the early periods of the introduction of banking culture. The periods between 1947 and 1952 witnessed rapid growth of indigenous banks in Nigeria. This increase in the number of indigenous banks, was followed also by a high rate of failure of such banks. By 1954, twenty one (21) out of the twenty five (25 banks established and operating in Nigeria had closed their doors or failed. The failures were attributed mainly to mismanagement of the banks, lack of adequate capital and inexperienced personnel. The country does not have a central bank at that time to monitor the

operations and capitalization of banks. Also there were no adequate regulations and 1egislation for the banking industry, not until the promulgation of the banking ordinance of 1952, which came into effect in 1954, and subsequently the establishment of the central bank of Nigeria (C.B.N) in 1959.

From this early stage, we discovered that the term distress has become synonymous with the banking industry while constituting a major addition to the growing wealth of banking and financial literature in Nigeria.

Distress appears to be a new development in the Nigerian banking industry because of its wide phenomenon effects in the 90's, but the fact is that this problem has been with the banks right from the inception of banking system in Nigeria. The reason for1his outlook is that such sick banks were always dealt with decisively either through liquidation or successive restructuring which returned them to healthy condition within a reasonable time frame.

It should be mentioned here that bank distress or failures constitute a high cost of doing business in an economy. The need to address squarely the banking system distress is particularly important in view of the fact that distress is a systematic risk i.e. there is a high degree of probability that the distress of one or more banks will result to the distress of some other banks particularly in the same financial market.

At this stage, I must state that the banking industry is once again witnessing another era of failure because of some administrative, bureaucratic, managerial and legalistic problems. The corporate suicide most of the banks committed that eventually led to their distress which now necessitate the recapitalization of the whole industry as is being witness now, is their inability to adhere strictly to the cannons of good lending or borrowing.

Thus a major issue we should be looking at is the question of what in the light of our various experiences should we do to sustain a healthy sector that will be relevant to this age of globalisation and swift information flow and thus stimulate economic growth? In responses to the disturbing level of distress in the Nigeria banking industry and in view of the urgent need to establish a frame work for a well functioning and properly coordinated financial system in the economy, the federal government of Nigeria (FGN) announced during the presentation of the 1997 budget speech, a number of major reforms and some failure resolution measures in the country's financial system.

The reforms include the increase in the minimum paid-up capital of banks. The failure resolution measure is aimed at decisively addressing the problem of distress in the country's banking system. Since banks in spite of their special status within the economy are regarded as any normal firm or business enterprises, they also depend on capital for survival and operational success within the financial system in particular and the total economy as a whole. So that availability of adequate share capital in any bank will be readily appreciated. We discover that the importance of capital to banking institutions goes beyond its significance as an economic sector, given that its stock in trade is money itself with all the inherent risks associated with such business, banks are mere empty vaults without adequate capital.

Capital lies at the very heart of banking operations and is therefore very vital to its existence. The level of equity indeed determines the amount or level of risk a bank can take and also the type and volume of business it can undertake.

In summation, the most important function of capital in a bank is to provide insurance against risk and losses. However in the search for ways of optimizing resources in the banking industry in the future, it is very important that we do not forget where we are coming from; indeed the awareness and motivation

should begin with revisiting the events leading remotely or directly to government's decision to increase the capital base of banks as stipulated in the 1997 budget.

This is necessary because, maintaining safety and soundness of the banking industry is not a one stop approach, It is a continuous process. Professionalism the interest of the industry and the over-all economy should be the watch-word if the banking industry wants to surge ahead.

1.7 STATEMENT OF THE PROBLEM

The service of banking is supposed to be hinged on the effective satisfaction of both the surplus units and the deficit units of the economy. The quality of banking is based on the manner and the environment in which such services are rendered quality service in banking must meet three basic requirements namely; competence reliability and credibility.

For banks to be able to function effectively and maintain high efficiency level in the economy and to contribute meaningfully to the economic growth and development of a country, then the industrial sector must be safe. sound and stable, being devoid of any economic problem that can tilt it off the rail of achieving its primary duty of satisfaction, such as distress.

In all indication what we are experiencing and witnessing in this country today is a far cry from the ideal state of stability expected.

Due to inflation and the general socio-economic decline and political uncertainties around us which have taken a large toil on the banking industry. Most banks have suffered from loss of business and this has resulted to loss of income. The banks were unable to pay customers on demand due to non availability of liquid cash. The public lost confidence in the banking industry.

How sensitive is the banking industry to this problem? Also the fraudulent activities associated with insiders, large volume of unscreened loans and unauthorized loans to top bank officials are of great concern as they help to make most of these banks in solvent.

There have been a number of increases on minimum capital at various times in the past but non was of this magnitude as witnessed in 1997. The current increase which is over one thousand percent (1000%) is seen by many banks as a very glaring of pushing way them out of business. Those who are still optimistic only see a survival of their business through merging with other banks or being acquired by a different company and operating under different condition(s). Even those banks that are sure of raising the required capital are faced with the problem of how best to invest this new capital to maximize the investor's interest.

1.2 OBJECTIVE OF THE STUDY

This research work is aimed at informing the readers on what the 1997 recapitalization policy is all about and providing a most appropriate option of raising the new minimum capital requirements to banks. It also intends to look at the relevance of the concept to the total economic development. It shall try to impact knowledge about the Nigerian banking industry in respect to business of banking, legal guides, history of banking in Nigeria, and the types and operations of banks in Nigeria. It shall shed light on the benefits of the recapitalization policy to the Nigerian banking industry and the Nigeria economy as a whole, circumstance that give rise to recapitalization and the credibility problem that pervaded the banking industry against the backdrop of the larger Nigerian macro-economic Environment. What has been the role of the regulatory bodies(CBN & NDIC) in distress resolutions. It should be pertinent to periscope issues like lending, distress and also dovetail into distress resolution.

1.3 SIGNIFICANCE OF THE RESEARCH

The significance of the research is base on the fact that the role of financial institutions in general and banks in particular on the economic stability, well being and development of any society cannot be over looked and as such, these institutions must be stable and operating well for economic developmnt of any society .It is in this effort that the federal government of Nigeria introduce the 1997 recapitalisation policy in its annual budget in order to stabilise the industry and eradicate the long existing distress problems in our banking industry.

The recapitalisation policy has a lot to offer as regards the promotion of the banking industry and the economy, but most banks are frowning at the policy because of the obstacles concerning banks implementation of the policy but if proper measures are taken this could eliminate most of the problems which looks seemingly difficult at the beginning because of the bleak out look of the Nigeria economy at present. This project among other things, will educate the readers on; what recapitalisation is all about, how best a bank can successfully recapitalise, benefits of the 1997 policy to .both banks and the general economy, laws regulating relating banking operations in Nigeria and various happenings in the Nigeria banking industry since inception.

1.4 SCOPE OF THE STUDY

The time dimension within which this study covers is from 1892 to early 1999 and this has been the period of time in which banking has been existing in Nigeria.

Basically, the study covers the early banking period in Nigeria so as to relate the problem of recapitalisation to performance of banks in this period and the period in which the first banking legislature was released, hence the introduction of

minimum capital requirements of banks until date.

The work features structure and types of banks, business of banking, legal frame work concerning operations of banks, the recapitalisation policy of the federal government of Nigeria as announced in its annual budget for 1997 and why government felt there is a need for this policy. Included in the work are the various options on how best banks can raise the required capital base and the benefit to be derived from having a large capital base by banks and the economy in general. This work will also look at problems existing in the Nigeria banking industry since its inception and problems faced by the banking industry within the 1990's. Not left out is the period of banking boom in Nigeria, reasons for this boom and what problems it left behind. Finally, how recapitalisation will help to resolve the current problems in our banking system. Since this policy concerns the whole banking system, it has been decided that no particular case study will be used in this work, but that not withstanding, some banks would be mentioned and used as example in certain situations.

1.5 LIMITATION OF THE STUDY

The major constraint to this study is the difficulty in getting the relevant data for the study. The area of study (recapitalisation policy of 1997) is a recent development in the banking sector, so that not much literature has been published on it and most banks are not ready to release needed data as they see it as an important business secret, this compounded the issue of scarcity of data.

Therefore the researcher has little option than to rely on textbooks (which were very scanty on the issue), newspapers reports, Journals, conference papers from N.O.I.C top management and C.B.N Governors. and the opinions of some staff and managers of few banks. Sources of information are quoted in the report proper where necessary and also in the reference section.

Other limiting factors include;

- Time Constraint-: as the available time has to be shared between academic work and extra-curriculum activities.

- Financial Constraint-: This was one of the greatest source of constraint or limitation of this work. Due to high cost of transportation to sources of primary data, photostatting relevant materials and obtaining relevant newspapers, journals and magazines.

- And finally, the inability to get vital informations from some of the banks, I went to as a result of some standing orders against the release of such information outside their corporate headquarters and by officer of a very high management level as witnessed especially at the first bank regional office and Habib Bank office in Abuja.

1.6 DEFINITION OF TERMS

In a study like this it is necessary to define at the beginning those terms and concepts that will be used in the study to avoid ambiguities. For the purpose of this stli,terms like business, industry, firm, and enterprises are used inter changeably. So also is bank and financial institution. Others are distress and failure or bank-run, Capitalization and Recapitalization.

i. **ASSETS**: These are properties of a business and its stock in trade or its stock of goods at any particular time.

ii. **ACCEPTANCE HOUSE**: These are financial institutions that specializes in the grants of acceptance facilities.

iii. **BANK**: Sec 2 and 61 of(BOFID) 1991 defines a bank as; "A duly incorporated company in Nigeria holding a valid banking license to receive deposit on current account, savings account or other similar accounts, paying or collecting cheques drawn by or paid in by customers. provision of finance or such other business as the government may order to publish in the gazette designated as banking business.

iv. **TO MARQUADUS**: Banking is signified by certain kind of dealings in money, approved by the state accordingly by which money is deposited with the bankers for the benefit of the depositor, so that the ownership of the money passes to them, and so that the creditors (i.e. depositors) get security; and the debtors (i.e. the bankers) get advantage. The condition is however implied that the depositor may whenever he pleases demand the money he deposited. Therefore a bank can simply be said to be an establishment where money is deposited in accounts, withdrawn and borrowed.

v. **BOFID**: Banks and other financial institution decree.

vi. **CAPITAL**: This refers to the sum invested in a business. It is also seen or used in business by a person, corporation, government etc. Capital can also be referred to as the net worth of a business; amount by which the assets exceed the liabilities.

vii. **CAPITAL BASE**: The total sum value of amount invested in a business.

viii **CAPITAL MARKET**: The market for sale of Securities. It is also refer to as a market where investment instruments mostly in monetary forms are exchanged either through long, short or medium term agreements.

ix **CAPITALIZE**: Convert into capital.

x. **DISTRESSED BANKS**: These are banks with problems relating to liquidity, poor marginal or total earnings and non-performing assets. The climax of it is that it could be a condition of insolvency, which implies inability to pay debtors or meet maturity obligations as they fall due.

xi. **FIXED INTEREST PAYMENT OR FIXED REDEMPTION**: These are investments that already have a fixed duration and interest rate.

xii. **HOLDING ACTION**: This refers to condition prescribed by Central Bank for the turn-around of distressed banks.

xiii **INFLATION**: A rise in the average price level of goods and services.

xiv. **LIABILITY**: This is what a business owe to outsiders.

xv. **LIQUIDATION**: To put a firm out of business or stop its operations due to insolvency.

xvi. **LIQUIDITY**: Money or near money (e.g. Bank drafts).

xvii. **MERGER**: The combination of two or more companies in which one firm survive as a legal entity.

xviii. **OPEN MARKET OPERATION (OMO)**: This is the sales and buying of government bonds in the market. The market consist of commercial banks and the public.

xix. **PAID UP CAPITAL**: The amount subscribed in a company share capital.

xx. **RECAPITALISATION**: Review of the require minimum capital and the process of adopting to the new requirement. It is also defined as the enhancement and restructuring of the financial resources of an organization with a view to enlarging the long term fund available to the organization.

xxi. **RETURN ON INVESTMENT (ROT)**: Gain received from money put into a business.

xxi. **SPECIAL DRAWING RIGHTS (SDR)**:- This is a device for increasing international liquidity to member nations of IMF. This was introduced in 1969. They are assets which are to be issued (i.e. created like commercial banks deposits) only by IMF. They are not to be regarded as borrowings from the fund, but are meant to supplement gold and convertible currency and so form part of members reserves.

xxiii. **SHARE CAPITAL**:- The value of a company's capital contributed by its owners.

xxiv. **STOCK EXCHANGE**:- Market for the issue and sale of new securities.

xxv. **PRUDENTIAL GUIDELINES**:- These are guidelines and practices which all licensed banks are required to adhere to in reviewing and reporting their performance, particularly in the areas of credit portfolio classification and disclosure, provision for non-performing facilities, interest accruals, classification of other assets and off balance sheet engagement.

xxvi. **TAKE OVER**:- The acquisition of another company which may (from the viewpoint of the acquired firms management) take the form of a "friendly" or "unfriendly" merger.

xxvii. **SECURITY OWNERSHIP**:- This is creditor interest in an organisation evidenced by a certificate.

xxviii. **CAPITAL ADEQUACY RATIO**:- this is defined as the total qualified capital to total risk weighted assets. The ratio is an indicator of appropriate level of capitalisation of a bank.

xxix. **LIQUIDITY RATIO**: This is defined as the ratio of total specified liquid assets to total current liabilities and reflects the liquidity position of a bank.

xxx. **LIQUIDATION**: This has been defined by Glenn G. Munn in Encyclopedia

of banking and finance as the termination or winding up of a business by conversion of its assets to cash and distribution of proceeds first to the creditors in the order of preference and the remainder, if any, to the owners in proportion of their holdings.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.0 DEVELOPMENT OF BANKING INDUSTRY IN NIGERIA

The financial system of any society is the framework within which capital formation takes place, whereby the savings of some members of the society are made available to other members of the society for productive investment. The process is made possible by the intermediation of financial institutions. The primary institutions concerned with this function are the banks.

The banking system mostly practiced in Nigeria is the branch banking system which is common in all commonwealth and European countries.

Banking development can be traced back as far as 1892. The development can be looked at from the evolutionary days of banking in Nigeria and this is classified into six major phases as identified below:

2.0.1 PHASE ONE 1892 - 1912

1892 marked the real beginning of banking activities in Nigeria with the establishment in January 1892 of the African Banking Corporation. This bank however, could not survive the Lagos trade recession of that period, and therefore had to surrender itself to Elder Dumpster and Company in 1893. The assets of the bank were finally taken over by the Bank of British West Africa (BBWA) established in 1894, now known as First Bank of Nigeria Plc. By the end of the decade 1899, a bank called Anglo-African Bank was established and it competed with BBWA. This competition could not last long, because Anglo-African Bank was absorbed by BBWA in 1912. It was therefore no surprise that

when the West African Currency Board (WACB) was established in 1912, BBWA became the sole agent for currency distribution in the whole region.

First and second decades of the evolution of banking in Nigeria was therefore dominated by only one bank, BBWA now called First Bank Plc".

PHASE TWO (1912- 1932)

The monopoly of the Nigeria banking sector by the BBW A was challenged in 1916 when the colonial bank was established this bank was however taken over by Barclays Banks in 1925, which upon amalgamation with Anglo Egyptian Bank and National Bank of South Africa, became known then as Barclays Bank Dominion, Colonial and over seas (Barclays Bank DCO). This bank has now metamorphosed into what is known as Union Bank of Nigeria Plc. Within this same period, the Post office savings Bank ordinance was enacted which resulted in the creation of post office savings bank in 1923. However, the bank could not operate due to lack of equipment and manpower. Another Bank that came into existence within this period is the industrial and commercial bank established in 1929, unfortunately this bank existed for only a short time before collapsing a year later in 1930. Then came the Nigeria mercantile Bank established in 1931, which was the first in four decades of banking in Nigeria within a period that is widely referred to as the free banking era, because there was no banking legislature per se.

PHASE THREE (THREE)

This period was an extension of the free banking era. Perhaps the most dramatic happenings in the history of banking in Nigeria occurred during this period. It was a period of banking boom and dooms. Many banks that were set up within this period also collapsed before the period ended. These include banks like;

Mercantile Bank established in 1931 and collapsed in 1936, Nigeria Penny Bank (1945) and collapsed in 1946. Also there were banks established within this period which survived into the next phase and some eventually collapsed.

The failure of this banks alerted the government to set up the Paton Commission in 1948, the result of which led to the first banking legislation in 1952, the commission attribute the failures in the banking sector to; Poor Management, illiquidity, lack of prudence in lending etc. However, there were still some surviving and thriving expatriate and indigenous banks that emerged within this period; for instance the National Bank of Nigeria established in 1933, Agbon Magbe Bank formed by Chief Okupe in 1945 (taken over by the western Nigeria Government in 1969 and renamed Wema Bank Nigeria Plc) African Continental Bank (ACB) in 1947, and one expatriate bank; British and French Bank (now United Bank for African) 1949. BBWA and Barclays Bank were still in existence.

PHASE FOUR (1952 -1972)

This period witnessed the emergence and collapse of many indigenous banks. This includes banks like the Nigeria farmers and commerce bank established in 1947, which collapsed in 1953, Pan Nigeria Bank, 1947 collapsed in 1954, Standard Bank of Nigeria, Premier Bank. Nigeria Trust Bank, Onward Bank and Central Bank of Nigeria (a commercial bank) were all established in 1951 but altogether failed in 1954. Others were provincial Bank of Nigeria, Metropolitan Bank of Nigeria, Union of British West Africa Bank, United Nigeria Credit Bank, Cosmopolitan Credit Bank, Mainland Bank, GROUP Credit Bank, Industrial Bank, and West African Bank, all emerged in 1952 but collapsed in 1954. Also there were merchant bank (1952 - 1960), Bank of Lagos (1959- 1965), Beirut Riyard Bank 1959 but merged with Standard Bank in 1965, Chase Manhattan Bank 1961 also merged with bank of West African in 1965. Banque de L' Afique Occidentale 1959 later I.B.W.A. now Afribank etc. it was in this era that the first banking

legislature was enacted in 1952 with its stiff regulatory clauses leading to the fall of many of the mushroom banks in existence then. Also in this same period, base on the Loynes' report of 1957 the Central Bank of Nigeria was established in 1959, and the first Nigeria Currency issue was made that same year. Also the investment company of Nigeria (ICON) now called Nigeria Industrial Development Bank (NIBD) was established in 1964, while the treasury bill ordinance was enacted in 1959, Lagos stock exchange also emerged in 1960, thus laying the foundation of a capital market in Nigeria. Other banks that were established within this period included; Bank of India (later changed to Allied Bank and was Liquidated in 1998) 1962, Arab Bank (1962) and two cooperative banks for western and Eastern Nigeria in the same year (1962). Between 1963 and 1970 no new bank was licensed. This perhaps was due to increase in the capitalization requirement which hindered indigenous bank sprawling and the political and economical problems occasion by the civil war of 1966 B 1970 which prevented inflow of expatriate banks and emergence of indigenous ones as a result of the total instability experience then. It was therefore no surprise to see such banks like Merchant Bank Ltd, Pan African Bank and New Nigeria Bank Ltd all coming up in 1971 after the civil war and with normalcy returned to the economy.

PHASE FIVE (1972 B 1992)

This marked the indigenization era of the Nigeria banking sector. In 1973 the Federal government of Nigeria in an effort to ensure that Nigerians own and control the commanding height of the economy took enough interest in the three biggest expatriate banks operating commercially then, this are: Union Bank, United Bank for Africa and the First Bank of Nigeria, to bring total indigenisation ownership to forty percent (40%). This was increased to 60% during the second indigenization process, this time around, including all other foreign owned banks. Banks that emerged within this period included the Nigerian Merchant Bank Ltd

(1973), Kaduna Cooperative Bank (1974), First National Bank of Chicago (now known as the International Merchant Bank (1974), Kano Cooperative Bank (1976), Societe Generale Bank (1977), Bank for Credit and Commerce International (1979), First City Bank of New York (1974) which pulled out of Nigeria in 1976 due to its inability to comply with the operating guidelines for merchant banks then, Chase Merchant Bank (1975) etc. More specialized banks also emerged this included the Nigeria Bank for Commerce and Industry (NBCI) (1974), Federal Mortgage Bank (FMB) 1977, the Urban Development Bank (1992) and the Nigerian Export Import (NEXIM) Bank (1991). Others included the People=s Bank of Nigeria (1989), Community Bank (1991) and the Profit the Profit and Loss (Islamic) Sharia Bank (1992).

The introduction of the Structural Adjustment Programme (SAP) in 1986 which used interest rate deregulation, trade liberalization, Privatization and Commercialisation, etc. as a fulcrum led to an upsurge in Banking and emergence of more banks. With SAP, licensing policy was liberalized, therefore between 1986- 1988). Thirty-three (33) new banks emerged (3 in 1986, 10 in 1987 & 20 in 1988), The number of newly registered banks was eleven, twenty, eight and zero in 1989, 1990, 1991 and 1992 respectively, bringing total new banks from 1986 - 1992 to Eighty (80).

Within this same period the Nigeria Deposit insurance Corporation was established in 1988 to protect Depositors' interest. Also Central Bank of Nigeria (CBN) Decree 24 and the Banks and other financial institution Decree 25 both of 1991 were promulgated. This measures were adopted because some banks were reported to be technically insolvent. The number of distressed banks as at 1992 was put at sixteen (16).

PHASE SIX (1992- DATE)

This period witnessed serious distress in the banking sector of Nigeria. The number of distress banks further increased from (16) sixteen in 1992 to twenty-four (24) in 1993, and to thirty-four in 1994. Many factors were identified as being responsible for this trend of events. This includes capital in adequacy, over-staffing, imprudent lending, mismatching of resources, use of outdated equipments, supervisory lapses, competition, poor management etc. The period further witnessed effort by the government to maintain stability in the sector. For instance, the failed bank decree was promulgated in 1994 to deal with bank staff, managers, or any other person or body of persons who contributed to the failure of any bank".

In 1994, the banking practice in Nigeria clocks one hundred years, the period the sector was experiencing crises of insolvency, illiquidity and eventual failures of many banks, just as it witnessed similar calamity when it was fifty years in 1954.

Also in line with this policy of maintaining stability, government liquidated twenty-six distressed banks in 1997 base on there inability to meet up with the minimum capitalization requirement of N500 million.

Also in the 1999 budget speech, government made a pronouncement granting the Central Bank of Nigeria autonomy. Thereby giving it more powers to carry out its regulatory and controlling function of banks without undue interference from government, especially the presidency and the ministry of finance. Yazin (1999).

2. 1 TYPES OF BANKS IN NIGERIA AND THEIR BUSINESS

Various banks operate in Nigeria and each of them has a basic function or role as regards its business. A brief outline is given below of the type of banks in Nigeria

and the forms of business they under take.

2.1.1 THE CENTAL BANK OF NIGERIA

A Central Bank stands at the apex of the banking system of every country. It is the government representative in the banking sector and act mainly as the government bank (i.e. banker to the government). It has a very close association with the government on monetary policy and implementing the policy on behalf of the government. This bank is established by an act of parliament. Central banks go by different names in different countries, in the United State of America (USA) it is called the Federal Reserve System, Bank of England in the United Kingdom and in Nigeria it is called the Central Bank of Nigeria (CBN).

OBJECTIVE OF THE CENTRAL BANK OF NIGERIA (CBN)

The main objectives of the Central Bank of Nigeria as spelt out in section (4) of the 1958 ordinance, are as follows:

1. Issuing of legal tender currency in Nigeria.

2. Maintaining external reserves in order to safe-guard the international value of the currency.

3. Promoting of monetary stability and sound financial structure in Nigeria.

4. Acting as a banker and financial adviser to the federal government

FUNCTIONS OF THE CENTRAL BANK OF NIGERIA

The central bank of Nigeria perform the function of creating money and other monetary instrument, it supervises the operations of other financial institutions

(especially those in the banking sector), it acts as a banker to the federal government, and lender of last resort, it also carries out banking advisory agency, financial, promotional, regulatory, directional and monetary policies.

All its commercial activities have been transferred to commercial banks and other financial institution as at the end of 1997. But it still maintain and keep the federal governments account. In 1989 (May 26th) all federal parastatals and ministries accounts were transferred from the commercial banks to the central bank, but this decision was reversed in the 1999 budget speech thereby retransferring all federal parastatals account to normal banks.

COMMERCIAL BANK

These are banks which deal in short-term loans. They take money in deposit and return same on demand and advance loans and also invest in certain profitable ventures.

FUNCTIONS OF COMMERCIAL BANKS

Commercial banks carry out the following functions

1. Acceptance and safe keeping of deposits.
2. Provisions of loans, advances and over draft to customers.
3. Money transmission on behalf of customers.
4. Provision of foreign exchange facilities to travelers.
5. Providing services to importers and exporters,
6. Provide facilities for safe keeping of important documents and title deeds and locker services.
7. Provides business status reports and references.
8. Acting as agents for buying and selling of stocks and shares on behalf of

their customers.

9. Providing of night safe facilities.
10. Acts as advisers to their customers.
11. Undertake the function of under writing.
12. Help to maintain domiciliary accounts.

Examples of commercial banks operating in Nigeria are;

First Bank Plc, Union Bank Nigeria Plc, Afribank Nigeria Ltd., United Bank for Africa Nigeria PIc, Bank of the North Ltd., Savannah Bank Plc, etc.

MERCHANT BANKS

Merchant banks are financial institutions providing specialist services like acceptance of bills of exchange, corporate finance, portfolio management or equipment leasing. Their principal function is the provision of medium and long-term lending as opposed to short-term lending in commercial banks. The banking ordinance 1969, allows merchant banks to engage in all banking activities except keeping of current accounts, although they are still allowed to offer cheque accounts for their large corporate customers.

FUNCTION OF MERCHANT BANKS

Their role in the economy is to provide medium and long-term finance by engaging in such activities like, equipment leasing, Loan syndication and departmental factoring and project financing. Other functions are Remittance of funds over seas, domestic and international banking services, corporate finance, issuing house: debt and equity issues, treasury/financial service (money market activities), portfolio management and advisory services.

Merchant banks operate under the same regulatory framework as commercial

banks with a few exception in same cases. They do not have wide spread branch network like the commercial banks owing to the nature of their operations.

Examples of merchant banks in Nigeria include; NAL Merchant bank, Rims Merchant Bank, international Merchant bank of Nigeria etc.

DEVELOPMENTAL FINANCIAL INSTITUTIONS (DFIS)

Development banks were first thought of in the Nigeria financial system before the coming of the central bank in 1959. But with the setting up of the Central Bank the idea was mooted. The need for financial institutions capable of providing medium and long-term capital to fill a serious gap in the financial structure led to this idea being brought back on course again after independence in 1960. It was recognized that the commercial banks were traditionally providers of short-term finance for working capital purpose, although they did entertain some medium term financing, but only in exceptional circumstances. Similarly, the central bank confined its activities to the normal functions as discussed earlier that is, the financing activities of the banks ended with granting day to day advances to the government and acting as lender of last resort to the commercial and merchant banks. It was initially thought that merchant banks could fill the gap and provide medium and long term financing to industries, but they were later discovered to be ill-equipped to carry out this function. Merchant banks are by tradition small though they deal with a large amount of money and they depend almost solely on short-term funds. Thus, the need for development banks devoted solely to stimulating the private sector of the economy and some specific sector of the economy as well. They are concerned with the promotion and financing of enterprises by the provision of long-term and medium-term finance. With the support and encouragement of the International Banks for Reconstruction and Development (World Bank) the first development bank -the Nigeria Industrial Development Bank (NIDB) was established in 1964. Other

development banks which followed later included the Nigeria Agricultural and cooperative bank (NACB), the Nigeria Bank for Commerce and Industry (NBCI) and the Federal Mortgage Bank (FMBN). It is worth noting at this point that these institutions are not directly under the supervision of the Central Bank of Nigeria and as such are not affected directly by the Central Banks. Monetary and Credit Policies guidelines.

SPECIALISED BANKS

These are banks established by the federal government to Carter mainly for the banking needs of some segments of the society such as petty traders, peasant farmers and deprived communities. Among these banks are; The people's bank, Community Banks and Urban Development Banks. A list of the presently operating banks in Nigeria especially those in the commercial and merchant banking sector has be given in Appendix 1.

2.2 DISTRESS SYNDROME IN THE DEVELOPMENT OF BANKING IN NIGERIA

The issue of the problems in the Nigerian banking industry is not a recent development but a phenomenon that has existed in the industry right from the beginning of banking in Nigeria, only it has been in different forms at one time or the other.

Between 1892 and 1952, the issue of dominance of the industry by expatriate banks and that of setting up of a viable and strong indigenous bank was the main problem. As many as 25 indigenous banks were set-up between 1927 and 1952 with only3 surviving beyond 5 years of their inception. Most banks failed in this period as a result of inadequate capital, poor management, fraud, rapid expansion of branches and over trading, aggressive competition by expatriate banks and inadequate supervision by the government. This period has come to

be known as the first fall of banking in Nigeria. However, because of our limited scope time and the issue at hand we shall limit our study of distress to the recent events in the Nigerian banking system. Since the 1960's bank failure seemed to have no doubt become a Siamese twin of the critical economy effects on the banking industry in Nigeria. However the number of banks officially classified as problem banks, especially in recent times have continually to be of serious concern to the government and the regulatory authorities. By the end of 1991 for example, 8 banks (more than 6% of the insured banks in Nigeria) were officially classified as distressed (i.e. technically insolvent). By the end of 1996, the number of banks have increased to 50. A situation which was in no doubt a visible expression of a complex set of inter-related problems. This pathetic situation led to the Recapitalisation increase in 1996, and eventual liquidation of about 26 of these banks in 1997, among whom were financial merchant bank, Alpha Merchant Bank. Kapital Merchant Bank and United Commercial Bank whose licenses were withdrawn even before the liquidation date. This calamity has created fear not only on the customers of the banks affected but also on all banks customers about the general instability and illiquidity threatening the sector which has led to loss of confidence in the sector.

CAUSES OF DISTRESS IN THE BANKING SECTOR

Many factors have been identified by different writers and Academics as militating against a sound banking business, and paving the way for illiquidity, insolvency and eventual collapse. For instance, Okoduwa (1995) focuses on the scramble to meet new minimum capitalization requirement, indiscriminate recruitment of Unqualified staff, interest rate deregulation, Macro-economic, changes, Unethical banking practices, collapse of inter bank market, fluctuation in foreign exchange and erosion of the share holders fund as the factors responsible for the distress.

1. According to Olugun (1994), the attitude of the colonialists, inadequate legal framework, and structure, Ownership, inadequate capital, poor management, dearth of experienced and qualified personnel, societal problems, lack of transparency, political instability, explosion in the number of financial institutions, illiquidity, and insiders abuse and frauds the contributory factors that led to bank failures in Nigeria.

2. Ojo (1994) on the other hand, stated that bank distress is connected to the prevailing economic recession, micro-economic instability, poor and deteriorating asset quality, mismatching of assets and liabilities, over trading, bad management and insiders abuses. His parameters seems to be similar to that of CBN (1993 annual report) in which the prevailing economic recession, policy induced shocks, poor and deteriorating assets quality arising from large portfolio of non-performing credits, mismatch of assets and liabilities, overtrading, bad management and insiders abuses, were revealed.

3. Olufon (1993) however, blamed the authorities inconsistent fiscal and monetary policies on interest and foreign exchange, for such failures.

4. Upon inspection, it is very clear that this writers' ideas are not conflicting, we can therefore add over-indebtedness of bank staff and the use of out dated equipment by most banks and against this background explain distress in the Nigeria banking sector as caused by the following;

a. **Capital Inadequacy**: Despite the measures taken by the Banks and other financial institutions decree 25 of 1991 to ensure capital adequacy in Nigerian Banks through stipulating minimum paid up capital of N40 million and N5Omiloin for merchants and commercial banks respectively, capital

inadequacy continue to be a prime factor causing distress in the banking sector. This is because partially, the minimum capital requirement is being eroded by inflation and again by series of losses that erode the shareholders funds (SHF). In fact the present new requirement of N500 million is seen by some people as rather compounding rather than alleviate the problem. Many of the banks were grounded in a scramble to meet up with the new minimum recapitalisation requirement.

b. **Poor Management**: Some of the banks failed as a result of poor management of assets. Management and board members have been accused of being consistent in granting large unsecured loans to themselves and their companies or relatives. Again, there are instances where board members approved loans and disbursed funds even before such loan application reaches the bank because of their special interest and "deep involvement" in such loans. Thus one important consideration for most loans has become connection. This has resulted in board members guarantee of loans even to known bankrupts and fraudsters in the society, loans grants are now dependant on whom you know or how much you know "the system". The result is the eventual provision for bad loans that may have to accumulate over the years up to the point where the bank cannot sustain the pressure and therefore surrender itself to the insolvency or illiquidity list or even both.

c. **Indiscriminate Recruitment of Inexperienced And Unqualified Staff**: Most of the academically qualified personnel lack practical knowledge of modern banking that may qualify them to restore normalcy in their banks in event of sharp politico-economic changes. Also the conflicts between inexperienced and unprofessional staff who rose to top positions has cause banks a lot of problems while the later are conservative and are incapable of making changes to suit modem banking, the former lack the necessary banking expertise. Also the "placing of the wrong peg in the right hole" has cause some

problems too e.g. a situation whereby a graduate of Fine Arts, Music, Hausa, Islamic Law etc. is given the Job of Cashier, Accountant or even a Branch Manager and a lot of money is being spent on him as salary & allowance, there is no doubt that this staff productivity can not off-set the expenses on him and hence a loss to the banks.

d. **Economic And Policy Changes**: Some banks went into liquidity problems when the government decided to transfer its account from the commercial banks to the central Bank of Nigeria. Again economic depression associated with high reduction of productivity and inflation has made many borrowers unable to service interest on their loans let alone repaying the principal amount. This calamity has lessened the earnings of most banks. Also the continuous mopping exercise engaged in by the Central Bank, and the increase of interest rate on borrowing has also thrown many of these banks into deeper illiquidity problems.

e. **Unethical Banking Practices**: Bank staff violated the basic ethical code of practice i.e. trust and efficient services. They vigorously engaged in many sharp practices, such as banking collecting bribe before granting loans, deliberate distortion or manipulation of records, taking pride in dribbling customers before getting them served, engaging in fraud and forging of many kinds etc. These collectively contributed to the collapse of many banks.

f. **Over Indebtedness of Staff**: Most staff when employed were given series of loans at inception, ranging from furniture loans, housing loans, car loans etc. The bank has to repay this loan together with the interest out of his salary (a salary already depressed by inflation). By having a car for example which is an additional liability to him, and at the same time having his salary lowered through deduction of interest as well as inflation, the staff will have no

other way of making ends meet than to develop measures to revive his income through demanding for bribe, engaging in fraud and forgery etc. the end result of these is loss of confidence by the customers as well as the general public in the banking practice leading to their making massive withdrawals in disregard of banking services, thereby compounding the illiquidity problem of banks.

g. **Mismatching of Resources**: Liquidity is only achieve through effective management of assets and liabilities, illiquidity problems mostly occurs as a result of mismatching of assets and liabilities. This may lead a bank to source additional liabilities at rates which may be quite exorbitant, thereby compounding the already existing liquidity problem and thus turn itself out of operation.

h. **Induced Shock**: According to Muhammed (1993), instability in the banking industry is caused by scaring of the public from banks by some people, particularly reporters, by classifying banks as healthy and unhealthy. These actions make the public to have suspicion of the banks and therefore withdraw massively. However some of these banks reported to have problems have withstood the stress and pressure for a number of years without failing. The duration of their problem could have been shortened if the public would not have been panicked into making massive withdrawals for fear of collapse.

i. **Conservatism or Using Outdated Equipment**: Most of the banks have no innovative capability and remain stitched to outdated equipment in rendering services to customers. Due to poor equipment and tools customers suffers a lot before getting served. It is however surprising to see that the regulatory authority remain silent on stipulating the minimum modern equipment (especially computers & other communication gadgets) a bank must possess before opening a branch. This has led to delays in withdrawals mostly and its likely to make customers go back to their traditional banks e.g. asusu, barn, adashe, etc. which are easily withdrawable.

j. **Insider Abuse and Fraud**: According to Ologun (1994), banks' property could be ruined by the management or even staff. Unviable branch offices have been opened in the towns of insiders because of their special interest and to the detriment of the bank. Also cases of approval of loans by the directors to themselves at lower interest rate, maintenance of guest houses built for the use of Director, at high cost with no benefit to the bank, approval of luxury cars, office furniture etc. to non-executive chairman; upgrading unqualified people to sensitive offices etc. These actions collectively depressed banks resources and caused some banks to close down due to losses.

k. **Competition**: With the deregulation of interest rate under the structural adjustment programme, many new banks were registered. This caused more competition among the banks in their sector. Many banks within this period had to result to speculative investment, imprudent lending and other unprofessional activities all in an effort to withstand the competition and to make ends meet as banking business then and even up till date has become a "do or die" affair. These has resulted in serious losses which has led to the elimination of about 30 banks out of the system so far since 1997 -1998 and ten more on the "Dearth row".

l. **Collapse of the Inter-bank Market**: lnter-banks market where banks place funds and trade with each other collapsed because of series of default by banks that are having liquidity problems and therefore could not meet the pledges made to other banks. With the collapse of this market, many banks sources of alternative finance are blocked and therefore have to face the problem of illiquidity.

m. **Ownership**: Government ownership of some banks also contributed in no small measure in wrecking havoc on the banking sector. It has been observed

that management and board appointment have been based on connections rather than being on suitability. These professionally and academically incompetent government appointees have gone a long way in grounding many banks due to their policies and practices which were unethical in banking institutions.

n. **Inadequate Prudential Regulation and Supervision**: Distress and technical insolvency of some banks were attributed to mismanagement and speculative behaviour which was very rampant since the inception of the structural adjustment programme. These malpractices continued because of supervisory lapses, until 1997 when a few strict regulations were implemented to check bad banking practice.

Base on these causes, the question that now beg for an answer is, what measures should be taken in order to solve the distress syndrome that has eaten into the Nigeria financial system, especially the banking sector?

It is worthy at this stage to note that unless distress in our banks are addressed, there would be loss of confidence in the system, lack of effective and efficient intermediary, gravitation of economic depression, escalation of social vices etc.
Many writers have proposed solutions to bank failures in Nigeria. for instance, Okoduwa (1995) suggested that there should be adequate capitalization requirement, sound auditing of accounts, bank examination, good management etc. Ojo (1994) holds the view that capitalization should be raised, the risk return characteristics in the composition ofbank's portfolio be improved, risk of outside agents be distributed, and merger and acquisition option be considered wherever necessary or appropriate.

I) EFFECTS OF DISTRESSED BANKS ON THE BANKING INDUSTRY

The following are notable effects on the banking industry;

a. There are large volumes of.non-performing loans and advances.
b. Difficulty in paying depositors.

Inadequate cash reserves or readily marketable assets to cover short term liabilities.

d. Large volume of volatile deposits.
e. Accumulated losses, which have nearly or completely eroded the shareholders funds.
f. Very high staff turn-over.
g. The banks in most cases always require financial assistance from the regulatory authorities.

II). EFFECTS ON INDIVIDUALS:

These are the most affected group since banks started having problems. The following are some of the notable effects on individuals.

a. Loss of Confidence in the Financial System: Banking is based on trust and confidence. Once a bank is illiquid its ability to meet up with customers withdrawals is threatened, the resultant effects being loss of confidence in the bank and the financial system generally.

b. Loss of Income: Most depositors have the tendency of losing their money especially those who have more than the insured deposit of

WSO,OOO in their accounts.

c. Poor Banking: Habits: the degree with which people accept banking services has declined tremendously as most people now prefer to invest in capital projects rather than savings. The current crises of confidence in the banking industry is not helping the situation.

d. Inconvenience: depositors who have money with many of these failed banks waste a lot of time going to these banks in an attempt to claim their monies. Time, which would have been used on other business ventures, is spent at the bank.

e. Unemployment: the number of people at the labour market has increased since this phenomenon distress started. Most of the employees of these banks have been left jobless and employees of local industries whose monies are trapped leading to there close down are not left out of the unemployment bite.

III). **EFFECT ON THE GOVERNMENT**

The government is also affected by the closure of this banks. The major effect is loss of income. The banks like any other company pays taxes. A lot of income which would have been generated from these banks had they been solvent will no longer be available since they have been liquidated.

2.3 EFFECTS OF DISTRESSED BANKS ON THE NIGERIA ECONOMY

As earlier stated 70% of all business activities are carried out through the banking sector. Many business organizations as well as individuals preferred saving money in banks due to the risk involved in holding cash. But since this phenomenon of distress started almost six years ago, a lot of people have lost

interest and confidence in the Nigeria banking industry and people's banking habits are fast declining every day as most people now prefer investing their monies on capital projects and goods.

Distressed bank has a lot of effects on every aspect of the economy. Some small local industries and even medium scaled enterprises have been forced top close down because their monies were lodged in some of these banks that have now been liquidated.

The banking industry itself is having its own hard time. So also are the individuals government and government parastatals affected by the failure of these banks.

Here we shall look at few of the effects of distress especially on the banking industry, the individuals in the economy and also on the government itself and its parastatals, (though most of these parastatals were not really affected as much of their monies was in the CBN accounts for most of this period of bank failures.

According to Ologun (1994) the supervisory agencies should be strengthen CBN's powers over banks should be expanded and strengthen improve laws to deal with defaults, banking education should be provided, all terminally distressed banks should be removed from the system; as witnessed in 1998, etc.

Magaji (1994) in his own submission suggested that, there should be individual bank's advisory committees, personnel efficiency, application of modem equipments, adequate government funding of students and programmes of banking, and urgent need to wage war against indiscipline among bank staff.

Ekundayo (1994) on his part suggested the maintenance of macro economic stability, bank ownership structure, management capitalization, and greater dynamism the Central Bank.

We will at this point accept one important fact from all those writers and others whose suggestion cannot be fully treated here because of time constraint; and that is the fact that they all agreed on the need for capitalization, that is an increase over what was stipulated as minimum capitalization requirement in the Bank and other financial institutions decree 25 of 1991, where commercial banks capitalization was put at N40,000,000 million (40 million Naira) and merchant banks, was put at N50,000,000 (50 million Naira). Also there is the need for such government control banks whose activities has now become a cause of worry to the Nigeria public to be brought under the control of CBN since it is now autonomous of government control of such banks include Nigeria Agriculture.

2.4 HISTORICAL DEVELOPMENT OF BANKING REGULA TIS

There have been a number of banking legislatures since the promulgation of the first banking ordinance in 1952. A list of the relevant laws on banking in Nigeria are.

1. The 1952 Banking Ordinance.
2. The 1958 Banking Ordinance
3. The 1962 Amendment Act.
4. The 1969 Banking Decree.
5. The 1970 Amendment Decree
6. The 1972 Banking Amendment
7. The banking Amendment Act of 1979
8 The 1984 Amendment
9. The Introduction of SAP and DEREGULATION POLICY 1986

10. The CBN Decree and BOFID Decree 1991
11. The Recapitalization Policy 1997
12. The 1999 Budgets Monetary Policy Statement on Central Bank=s Autonomy and Federal Ministries and Parastatals Accounts.

It is worth mentioning here at this point that due to limited resources and the time constraint, this study shall be restricted to only areas relating to this research work and these are areas concerning the various legislatures relevant to banks licensing. Capital requirement, reserve requirement, areas concerning payment of dividends.

A critical element of the reform process is the need to ensure that banks are reasonably sound, competitive and Able to respond flexibly to monetary conditions to facilitate effective conditions for transmitting the effect of monetary policy to the real sector. In this regard, the strengthening of prudential regulations and the supervisory framework for banks are very important, to ensure that banks are adequately recapitalised and in most cases restructured financially in order to ensure there solvency, Liquidity and profitability and thereby promote confidence in the system.

Banking regulations also have a major impact on the payments system and the orderly development of money market which raise a number of fundamental policy issues that bear on the efficiency of monetary management.

We shall examine the frame work of the Nigeria banking regulations right from the inception in 1952 up to date

THE 1952 BANKING ORDINANCE

The first banking legislature in Nigeria was enacted in 1952. Prior to this time it

was a period of free for all banking which culminate in several banks failures and losses to depositors. The need for laws and regulations to control the activities of banks led to the Patton Commission being set up in 1948. The report of the commission led to the enactment of the first banking legislation -the banking ordinance, 1952.

Although this ordinance has since been repealed, we shall nevertheless briefly examine the main provision of this historical law to enable us to understand the development of the law of banking in Nigeria.

The ordinance restricted for the first time, the establishment and practice of banking to companies holding valid licenses. To qualify for license, the amount of paid up capital for indigenous banks was fixed at N25,000 (,12,500) and N200,000 (,100,000) for expatriate banks. Banks were also expected to maintain a reserve fund (Statutory reserve) to which 20% of annual profits had to be paid until balance on the reserve was equal to the paid-up capital. Adequate provision also had to be made for liquidity.

The above stipulations were aimed at strengthening existing banks in order to void further failures and also to stop the proliferating of banks. The financial secretary, a Briton, was given wide powers and sole authority to grant banking licenses after all conditions have been fulfilled.

The ordinance became effective immediately for new banks, while existing banks were given up to three years to comply with its main provision. About a year after the regulation came into effect, six banks (3 expatriate and 3 indigenous) had been registered these were:

(i) **FOREIGN**: The British bank of West Africa (now first bank Nigeria Plc.) Barclays Bank D.C.O. (now Union Bank Nigeria Plc.) the British and French

Bank (now United Bank for West Africa-UBA).

(ii) **INDIGENOUS**: The National Bank of Nigeria (now liquidated) Agbomagbe Bank - Now Wema Bank and African Continental Bank.

The regulation also introduce for the first time the periodic examination and supervision of all banks by government bank examiners. They were mandated to sanitize the books of licensed banks and ensure that they complied with the regulations.

While it is generally admitted that the 1952 Banking ordinance contributed immensely to the development of banking in Nigeria, the following defects were apparent;

i) The ordinance did not make any provision for assisting banks in need, as there was no central bank then to act as lender of last resort.

ii) The investment avenues for the banks surplus funds were limited, so banks were compelled to keep their liquid resources idle. The indigenous banks were more seriously affected than the foreign banks as the later had free access to the London money market and also seek assistance from their London head offices.

iii) Although the minimum capital requirement clause in the ordinance helped reduced the number of banks, dubious practices and other abuses were not all prevented due to the lack of effective supervision by the government bank examiners.

THE BANKING ORDINANCE 1958 (AS AMENDED 1962)

The necessity for licensing a bank was retained in the new ordinance. However, the responsibility for the issue of the licenses moved to the minister of finance or a person acting under his direction in consultation with the central Bank of Nigeria after its establishment in July, 1959.

STATUTORY RESERVE

The reserve requirement of 1952 was raised by 5% to strengthen the capital base of existing banks. Every Licensed bank in Nigeria was expected to transfer a minimum of 25% of its net profit before any dividend was declared to a statutory reserve. This transfer had to be every financial year until the balance on the reserve fund becomes equal to the paid-up capital of the bank -where the amount of the reserve fund is equal to or is in excess of the paid -up capital or share capital, 12.5% of the net profit are to be transferred to the reserve fund. No transfers are to be made until any past losses have been made good.

MINIMUM PAID-UP CAPITAL

The minimum paid-up capital as stipulated in the 1952 ordinance for the indigenous banks (i.e. N25,OOO) was retained in 1958 as it appears to have curbed proliferation effectively. However, the capital requirement for foreign banks was raised to N400,000 (,200,000). Since it was easier for foreign banks to mobilize capital, the figure was raised to avoid domination of the banking sector by expatriate companies.

LEGAL LENDING LIMIT

The maximum lending to one borrower was limited to 20% of the sum of the

paid-up capital and the statutory reserve although inter bank lending, international banks or other trade activities and lending to marketing boards were excluded. This was a new provision aimed at ensuring a reasonable spread in the loan portfolios of banks rather than a concentration of loans in a few hands which would make banks vulnerable. The provision was also expected to contribute towards the capital adequacy of banks.

OTHER MAJOR PROVISION IN 1958

The following additional restrictions (which was the beginning of tight official control over the activities of the banks in Nigeria) were imposed on the activities of banks.

i. The granting of advances or credit against the security of the banks own shares was prohibited.

ii. The granting of unsecured credit facilities in excess of N 1000 to any of the directors jointly or severally or to any company or firm in which any director had an interest was prohibited.

iii. The granting of unsecured advances to the officials or employees of banks in excess of the one year emoluments was also prohibited.

iv. Banks could not engage in trade, acquire or hold shares in other companies or purchase, acquire, or lease real estate except as may be necessary for the purpose of conducting their business, housing their staff or held as security.

APPOINTMENT OF EXAMINER

The ordinance specified the appointment of an examiner by the minister of finance or the central bank to examine periodically under secrecy, the books and affairs of each and every licensed bank up to the opening of the Central Bank of Nigeria, bank examiners were on the staff of the Federal Ministry of Finance.

1962 AMENDMENT

The 1958 ordinance was amended in 1962 as follows;

i. The paid-up capital of indigenous banks was revised from N25,000 (□12,500) to W500,000 (□250,000). The aim of the authorities was clearly to restrict the number of new banks as existing banks were given up to seven years to comply with the new regulations.

ii. Foreign banks were required to keep assets of at least N500,000 (□250,000) within Nigeria to help the development of a money marked and capital formation.

iii. The composition of liquid asset as earlier specified was slightly changed.

iv. Banks were allowed to own real estate for the purpose of future development.

There is no need to provide a detailed discussion and analysis of the 1962 amendment as both the 1958 ordinance and its amendment in 1962 were repealed in 1969 by the banking act of 1969 which remained the banking legislation for Nigeria banks for a very long time, that is until 1991, except for

minor amendments in 1970, 1972, 1979 and the deregulation policy of 1986.

CENTRAL BANK OF NIGERIA ACT 1958

A review of banking legislature in Nigeria would be incomplete without some comments on the Central Bank of Nigeria Act, 1958. Here, we shall look closely at the main provision of the Act.

OBJECTIVE

The principal objective of the bank as stated in Section A of the act are;

i. Issuing of legal tender in Nigeria.
ii. Maintaining external reserve and safe guarding the international value of the currency.
iii. Promoting monetary stability and a sound financial structure in Nigeria.
iv. Acting as banker and financial adviser to the federal government

CAPITAL RESERVE

The banks' authorized capital was fixed at □1.5million (N3million) and was held by the federal government. The bank maintains a general reserve fund. Each year 1/8th of net profits of the bank was allocated to the fund until it was equal to the paid-up capital. There after 1/6th of the net profits of the year was to be allocated.

THE REMAINING PROFITS WAS APPROPRIATED AS FOLLOWS:

i. One half w as to be applied to the retirement of any outstanding obligations of the federal government to the bank arising from the financing of the cost of the printing and shipment of the initial stock of the bank's notes and coins.

ii. The remainder of the net profit was to be paid to the federal government.

BOARD OF DIRECTORS

The Board consist of a Governor, Deputy Governor, three Executive Directors and eight part time Directors. It is responsible for the policy and general administration of the affairs and business of the bank.

The Governor or his deputy (in his absence) are in charge of the day-to-day management of the bank and are answerable to the board for their acts and decisions.

SOLE RIGHT TO ISSUE CURRENCY

The bank has the sole right to issuing notes and coins throughout Nigeria and neither the Federal Government nor any State government nor any person shall issue currency notes and coins. Notes and coins issued by the bank are legal tender in Nigeria at their face value for the payment of any amount.

GENERAL POLICIES OF THE BANK

The main banking functions of the bank are;

i. Issue demand draft

ii. Regulate and sell gold coin or bullion.

iii. Open account for, and accept deposits from the federal and state governments, or corporation and institutions of such Governments banks aid and other financial institutions.

iv. Purchase and sell securities of the federal government maturing in not more than 5 years.

RELATION WITH THE FEDERAL GOVERNMENT

The bank is entrusted with the federal government banking and foreign exchange transactions in Nigeria and abroad, including payments to, or in respect of the International Monetary Fund. However, the federal government may maintain accounts in Nigeria with other banks with the approval of the minister of finance and the Central Bank. The bank is also entrusted with the issue and management of federal government loans publicly issued in Nigeria.

RELATIONS WITH OTHER BANKS

The bank may act as banker to other bank in Nigeria and abroad. The banks are permitted to seek the cooperation of other banks in Nigeria in order to;

i. Promote and maintain adequate banking services for the public; and

ii. Ensure a standard of conduct and management throughout the banking system. The bank may also regulate advances by prescribing a minimum ratio to be maintained by each bank in respect of total loans, advance and discount grants to indigenous persons.

It can also issue directives in respect of cash reserved and liquidity ratios etc. The direct control of banks by using the tool of monetary contt6!is frequently

applied.

BANKING ACT 1969 (AS AMENDED BY BANKING AMENDMENT)

Banking business is defined in the 1969 Act as "The business of receiving money from outside source as deposits irrespective of the payment of interest, and the granting of money loans and acceptance of credits or the purchase of bills and cheques or the purchase and sale of securities for account of others or the incurring of the obligation to acquire claims in respect of loans prior to their maturing or the assumption of guarantees and clearings, and such other transactions the Central Bank, by order published in the Federal gazette designate as business'

Upon the enactment of the Banking Act of 1969, the banking ordinance of 1958 was repealed.

The 1969 banking ordinance contains much of the following;

LICENSING

As mentioned earlier, banking in Nigeria is restricted to companies duly incorporated in Nigeria and in possession of a valid license granted by the Minister of Finance. To apply for a banking license, the 1969 Acts stipulates that an application should be made in writing, through the Central Bank, to the Federal Minister of Finance. The applicant must submit:

i. Memorandum and Articles of Association
ii. A copy of latest balance sheet of the company and
iii. Other particulars called for by the CBN.

MINIMUM PAID-UP CAPITAL REQUIREMENT

The minimum capital requirement for indigenous banks was increased from N6OO,OOO to N600,OOO while that of banks directly or indirectly controlled from abroad was raised from its existing level of N400,000 to N1,500,000 an increase of 275%. It was believed that the aim was to curb the proliferation of foreign banks.

MAINTENANCE OF RESERVE FUND (STATUTORY RESERVE)

The 1958 provision regarding statutory reserves discussed earlier were retained, without any amendment. The provision in respect of disclosure of interest by directors, as contain in the 1958 ordinance, was also retained in 1969.

CASH RESERVES AND LIQUIDITY RATIO

The act stipulates that the CBN shall from time to time stipulate minimum holding of cash by licensed banks, specified liquid assert, special deposit and stabilization securities. Each bank should ensure that its holding of these asset are not less than the amount prescribed by the central bank (These ratios are specified every year in the CBN monetary policy guidelines).

RESTRICTION OF CERTAIN ACTIVITIES OF LICENCED BANKS

The maximum lending to one borrower, which was limited to 20% in 1958, was revised upward to 33.3% of the sum of the paid-up capital and statutory reserve of the bank. The other restrictions stipulated in 1958 were retained in 1969.

In addition, the 1969 Act provided that no bank should own any subsidiary company which is not base on banking business, except a nominee company dealing in stocks and shares for or on behalf of the bank=s customers or clients.

BANKING AMENDMENTS ACT OF 1979

The act was promulgated in September, 1979 as an amendment to the Banking Act 1969, it contains three major principal amendments.

REQUIREMENT AS TO MINIMUM PAID-UP CAPITAL

i. The minimum paid-up capital requirement for the indigenous banks should not be less than N600,000 which that of banks with foreign interest should not be less than N1,500,000. The paid-up capital for merchant banks should not be less than N200,000.

ii. The Central Bank was given authority to specify the minimum ratio which licensed banks should maintained between their respective paid-up capital, plus reserves on the one hand and their loans and advances on the other.

iii. A bank, which fails to maintain any ratio as specified may not increased its loan and advances with the approval of the Central Bank of Nigeria.

AUTHORITIES LENDING LIMIT

The Act restated the authorized lending limit of 33.3% of the sum of the paid up capital and statutory reserves of a commercial bank and in the case of merchant

banks, not more than the sum of its paid-up capital and statutory reserves. Other statutory restrictions in respect of the bank shares as securities loan to directors, loans to staff all remained unchanged.

MERCHANT BANKING

The following new provisions were made in respect of merchant banks.
A merchant bank should not accept any deposit withdrawable or cheque, except from its corporate client, nor accept from a deposit total interest bearing deposit of an amount lower than N50,000. Similarly, except with the prior approval of the Central Bank, a merchant bank may not last or keep for more than six months any equity interest acquired in a company while managing an equity.

1984 BANK AMENDMENT ACT

The government in 1984 among other things reviewed bank capital requirements and prohibited merchant banks from accepting deposit withdrawable by cheque except from corporate clients and it also pegged the minimum deposit of merchant banks to N50,000.

DEREGULATION OF THE BANKING SECTOR 1986

In 1986 the then federal government of General Ibrahim Babangida adopted the Structural Adjustment Programme (SAP) which has economic deregulation as one of its main objectives.

The financial sector has been one of the most regulated industry in the country. Such regulations covers licensing interest rate regime, liquidity ratio, credit ceilings, sectoral allocation, minimum paid-up capital, dividend distribution ratio of reserve fund and general supervision. Deregulation in essence mean the removal of control or regulations and generally refers to the use of market forces

to determine the cause of action in the affected industry. Some of the significant deregulation measures introduced into the banking system as a result of SAP since 1986 include the following;

1. Relaxation of the licensing of new banks
2. Complete deregulation of the investment rate structure
3. Establishment of foreign currency account (domiciliary account)
4. Introduction of inter bank foreign exchange market (IFEM)
5. Withdrawal of public sector funds from commercial banks to C.B.N.
6. Full privatization of all commercial and merchant banks, in which the federal government had the largest share holding.

One of the immediate consequences of SAP was the emergence of vibrant financial sector complete with new entrants like finance houses and several new merchant banks. New challenges and opportunities were created which, the operators and government seized with relish. New decrees were promulgated to enable the emergence of yet another set of institutions to cater for the financial needs of particular segment of the market, this include the primary mortgage institutions (PMI), Peoples Banks, Community Banks & Bureau de Change. Other effects of deregulation includes;

1. Interest rates shot upward and kept on rising
2. Profitability rose to unheard levels
3. License applications continue to be submitted to the CBN,
4. Other non banks institutions especially finance houses started looming large in the financial horizon.

All the above clearly spelt a boom in the financial sector. There was a catch. Though the boom over-stretched the sector's manpower thereby putting some of the institutions in precarious condition of near collapse due to their poor

management decisions.

The supervision capability of the Central Bank was also eroded with a large number of fraud and a large number of institutions serious liquidity problem in the banks resulting in failure on their parts to honour their obligations to other banks and some, even to their customers.

THE NIGERIA DEPOSIT AND INSURANCE CORPORATION (NDIC)

A deposit insurance is simply an arrangement where the deposit liability of banks are insured such that in the event of failures, the depositors could be reimburse for the deposit of their money.

The scheme is especially meant to prevent the occurrence of a bank run or failure and have the advantage of protecting depositors of insolvent banks.

Deposit insurance scheme originated first in the U.S.A. in 1829 but this scheme did not cover the whole country but was limited only to a section of U.S.A. However, in 1934, the Federal Deposit Insurance Corporation (FDIC) was established which cover the whole country. Soon after it establishment, the reoccurrence of chain of failure among USA banks came to a stop. Other countries soon follow the United State example by establishing their own deposit insurance scheme. Some of these countries includes, Turkey in 1960, India 1962, Philippines 1963, Canada 1967, Lebanon in 1967 etc.

In 1988, the Nigerian Deposit Insurance Corporation was thus established in response to the imminent collapse of the banking system. It is a regulatory institution charged with the:

1. Responsibility of insuring banks deposits
2. Ensuring sound banking practice through effective supervision and examination of banks, and assisting the
3. CBN in formulating banks policies

All the licensed banks in Nigeria are required by the NDIC Decree to participate in the insurance scheme. A cut off point of N50,000 which adequately covers small savers was arrived at for the scheme at a flat rate premium but was decided to be the main source of funding for the scheme. The premium will be given by the banks insured.

In addition, the NDIC was charged with the responsibility of handling any distressed bank by either granting facilities to prop it up, taking over management of the bank until the financial can react whenever it detect distress in any bank.

BANKS AND OTHER INSTITUTIONS AND CENTRAL BANK OF NIGERIA DECREE 1990

The rapid growth in the number of other financial institutions and banks created serious problem within the sector, these liquidity problems which was one of the major cause of the distressed fever that grip many of the banks later, was also accompanied by capital inadequacy, management incompetence etc.

The existing decree could not adequately handle the situation. This led to the promulgation of CBN Decree No.24 and the Banks and other Financial Institutions (BOFID) Decree No.25 of 1991. These two decrees conferred vast powers on the CBN for the control and supervision of the entire banking and finance industry. In addition, the CBN was made autonomous and given a free hand to deal with the insolvent banks and other financial institutions. These two decrees were therefore the most far reaching banking legislation in the country.

The BOFID decree No. 25 introduced certain significant changes for the banking sub-sector, this include:

1. New minimum requirement for both commercial and merchant banks of N50 and N40 million respectively.
2. The Decree made CBN solely responsible for the granting of licenses to both banking and non banking financial institutions.
3. It prohibits any person from being a director in more than one bank and empowers the CBN to scrutinize all persons to serve as directors.
4. It empowers the CBN to handle any distress bank in any way it deem fit, this provision compliment the NDIC Decree of 1988.
5. The decree also made provision for penalties including imprisonment to erring bank directors, officers and employees and other staff for the violation of any banking laws and regulation.
6. The decree made it compulsory for banks and other financial institutions to comply with or implement the banking regulations
7. It also allows banks to acquire equity in industrial enterprise, this marked a significant departure from the provision of the earlier decrees and amendments.

These two decrees are so comprehensive that the government decided to repeal both the 1958 banking ordinance and the 1969 banking decree along with their various amendments.

The two CBN and BOFI decrees are the most current banking legislation in the country (Apart from the 1997 Recapitalisation Policy that addressed the issue of change in capital requirements) the two covers the entire financial industry.

THE RECAPITALISATION POLICY 1997

The minimum paid-up capital requirement of banks was last fixed in mid 1991 at N5O million and N40 million for commercial and merchant banks respectively. In the light of Naira exchange rate depreciation, the persistence of inflationary pressure, the erosion of capital funds of banks by non-performing credits as well as the need to ensure consistency with international standards, the federal government in its 1997 budget decided to increase the minimum paid-up capital requirement of both commercial and merchant banks to a uniform level of N500 million. Existing banks were all required to meet this requirement over a transitional period of two years, expiring by December 31, 1998. Banks that failed to meet the requirement by that date were to forfeit their licenses while new banks must fully comply with the condition before they can be granted licenses. By the middle of 1998 precisely around May/June not less than 31 banks have been caught in the dragnet of liquidation due to their inability to meet up with the minimum requirement. Also as at 30th April 1999 only ten (10) banks were yet to be fully recapitalised and are likely to also face the judgment hammer of liquidation exercised by the C.B.N being assisted by NDIC.

So far no any other serious Act on banking has been introduced apart from some government monetary policy changes being put in place especially those witnessed in the 1999 budget.

The policy changes include;

- The granting of CBN autonomy from the Federal Ministry of Finance and the presidency.

- The revoking of the 1989 policy of transfer of Ministerial and Parastatals accounts from commercial and merchant banks to the Central Bank of

Nigeria (CBN). This reversal of policy has now created a wider source; of account for the banks. This policy is already being implemented by CBN which has already transferred about W 100 million as at 30 April 1999 to various commercial and merchant banks.

This ministerial and parastatal accounts are needed by the various banks to help in cushioning the distress effects resulting from illiquidity in the sector.

The criteria used for this transfers includes;

1. N500 million minimum share capital compliance
2. Year 2000 computer (Y2K) compliance
3. Efficient banking service
4. Network of branches (including Abuja)
5. Sound management team
6. Two to five years financial performance

Also, as at 30 April 1999 it was apparent that the Central Bank of Nigeria (CBN) has suspended the liquidation of the remaining ten (10) distress banks still operating alongside the seventy recapitalized under the 1997 recapitalization policy which initially was expected to have ended by 31st December 1998 save for the three (3) months extension granted to these ten (1a) banks which were yet to be fully recapitalized.

Also the NDIC was stripped of its regulatory functions by the CBN base on the autonomy granted to it in 1999. The NDIC was empowered under Sec 23c of the NDIC decree 22 of 1998 as amended in 1997 to regulate the banking system where the corporation determine that a critically under capitalised institution (banks) cannot be rehabilitated or that the deterioration in its financial condition is as a result of frauds, forgeries, and other financial malpractices. The

corporation may recommend to the CBN or any appropriate regulatory authority to revoke the license of such banks for subsequent liquidation. Sub section 2 of the decrees provides that where no response was received from the CBN within 30 days the corporation should go ahead and apply to the Head of State for consent to liquidate such bank and thereafter apply to the Federal High Court for a winding up order.

But with the new twist in favour of CBN, the NDIC can only recommend their observation to the CBN and awaits its actions.

1.5 THE CONCEPT OF CAPITALISATION

The period between 1892-1952 was one of free-for all banking with no licensing requirement and no regulation of any kind to control the operation of banking in Nigeria.

This was a period when we saw banks being established with very little funds. These can be seen in the establishment in 1931 of the Nigerian Merchant bank (an indigenous bank) with as little as N3,400 as it limit paid-up capital, its total deposit did not exceed N5,000 before it voluntarily liquidated in 1936.

The failure of many of these early banks (mostly the indigenous ones) and the consequent losses suffered by a large number of small depositors was the immediate cause of the appointment of the Patton=s Commission enquired generally into the business of banking in Nigeria with a view to determine the cause of failure of banks and the need for controls being introduced into the system. Patton=s report form the basis for the banking ordinance of 1952 which introduced for the first time the issue of a minimum paid up capital requirement

for licensing operation of banking business in Nigeria.

Apart from boosting the already failing credibility of the Nigerian banking industry, the introduction of the minimum capital base was to ensure some other functions which includes:

a) Provision of fixed assets of banks i.e. provides funds for furniture, building, operational tools, and vehicles for banks.

b) It serves to conform to the requirements of the supervisory authorities of the Central Monetary Authority.

c) It serves to provide cushion to absorb possible losses so that depositors will be fully protected at all times.

d) It serves to assure the public, including business enterprises and other banks of its solvency and to continue to serve the community even under conditions that cause losses on loans and sales of investment at a loss.

e) Where liquidation becomes unavoidable, bank capital is still important, because it helps to reduce the losses which depositors and other creditors would otherwise bear fully.

f) Bank capital also provides some regulatory functions. A bank inspires confidence in depositors and the regulatory authorities if it successfully obtain a banking license of which a paid-up minimum capital is one of the most important pre-requisite, like under the Nigeria Banking Decree. Minimum paid-up capital has come to be recognised and accepted as an important element for a strong, stable and successful banking business.

2.6 **BANKS RESERVES AND WHY BANKS KEEP RESERVES**

In any well managed business, there is usually an annual sum of money taken out of profits and kept apart as a liability contingent. These liability contingencies are called reserves.

In banking, these reserves are merely an over statement of the value of assets due to possible default in loans and advances repayment, or due to depreciation in the market value of securities. If no losses are experienced, the reserves are transferred to undivided profits or maybe accumulated to provide for, say, future tax repayments.

There are various types of reserves in banking business;

- First the reserve (i.e. cash shown on the asset side of the bank's balance sheet e.g. cash with other banks). This type of reserves is aimed at keeping the bank in liquid so as to meet its liability promptly.

- Secondly, there are the reserves shown on the liabilities side of the banks balance sheet, i.e. statutory, capital/or general reserves. This type of reserve is meant to keep the bank solvent so that in case of liquidation it can meet all its obligations completely.

- Thirdly, there is what is called the banks primary reserves. This reserve, which is essentially currency in the banks vault is created in the course of the banks acquisition of sources of deposits. The reserves consist of actual deposits into bank of coins and notes. It may sometimes be in excess of the amount legally stipulated (i.e. the statutory reserves), or regarded by banking tradition to be adequate for its operations (i.e. capital and general reserve).

- Fourthly, the Central Bank of every country is required by the law of the land to maintain external reserve adequate to meet the needs of the country's international transactions and safeguard international integrity of the country, s currency. This consist of foreign currency, International Monetary Fund (IMF) gold subscriptions, Special Drawings Regulations (SDR) and quasi money such as short-term bills, medium and other long-term foreign government security which can be readily monetized or converted into liquid money for transactionary purpose.

REASONS FOR KEEPING RESERVES

All types of banks maintain one form of reserve or the other to enable them grow and own in respect of maintenance of reserves. The law and banking tradition require them to keep adequate reserves for the following reasons:

They have the singular capacity of influencing the volume of money in any economy through demand deposits creation. They are also primarily profit making organizations and the amount of deposits they can create i.e. the amount of debt they can monetize, rest on the bedrock of banks primary reserves. So the major reason why banks keep reserves is to enable them create deposits.

Other reason may include:

- To maintain their solvency so that they can meet all of their obligations in case of liquidation;

- Generally, to be able to maintain corporate growth, protect the interest of

the shareholders and depositors and retain customers confidence in them.

- Usually, the equity capital used to start a new bank is very small in relation to the amount of the deposits that soon come under its command these deposits are other people's money (debts of the bank). It is, therefore, crucially important that the bank must continuously reinforce this original capital through reserves to reassure the depositors, the monetary authorities and the general public that it is alive to its grave responsibilities to the generality of its interest group.

The capacity of commercial banks, therefore, to create demand and deposit rest entirely on the volume of primary reserves within their possession. Left alone, the banks could go on creating demand deposits goaded by the profit motive. This trend would be ruinous for any economy. Happily, however, there are forces that control the behaviour of banks in this regard.

These forces are represented by:

THE HAWK-EYED AUTHORITIES:

a. The Central bank (CBN) and the Nigerian Deposit Insurance Corporation (NDIC), who are there ever ready to control the volume of the reserves in the bank's possession.

b. The bank's realization that their inability to redeem their demand deposits in currency when required to do so would amount to loss of confidence in them and consequently, precipitate their economic death.

MAINTENANCE OF EXCESS RESERVES AND EFFECTS:

These are situation where banks may not lend up to the limit permitted by reserves (i.e. may maintain excess reserves) because of the following reasons:

- Depositors may for one reason or the other loss confidence in a bank and initiate a run on the bank and other banks.

- The banks lack of faith in some borrowers ability or unwillingness to repay in time or repay at all.

- The banks fear of decline in the prices of assets and securities pledge or purchased.

- The banks unwillingness to accept low rates of interest on loans to borrowers and investment made by the bank.

Maintenance of excess reserve can result in the following:

- Fluctuation in money, supply which can affect employment, productions and incomes.

- It tends to neutralize the efforts of the monetary authorities to use monetary weapons effectively, e.g. the banks would not feel the effects of open market operation when embarked upon by the Central Bank. A situation of excess reserve was experience in Nigeria especially during the oil boom of the early 1970s.

2.7 REASONS FOR INTRODUCTION OF BANK CAPITALISATION

The failure of many banks and the consequent losses sustained by the depositors and the waning trust in the banking system by the populace was the immediate cause of the appointment of the Patton's Commission in 1948. The commission enquired generally into the business of banking in Nigeria with a view to determine the need and the nature of control that should be introduced in the banking industry. Patton's report formed the basis for the banking ordinance of 1952, which {or the first time introduced the issue of capitalisation as a pre-requisite for opening and operating a bank in Nigeria.

The ordinance restricted the establishment of banking to companies with valid licenses. To qualify for a license, the amount of paid-up capital for indigenous banks was fixed at N25,000 and N200,000 for expatriate banks. Banks were also subjected to other regulations such as maintenance of reserve into which a minium of20% of annual profit had to be paid until the balance on the reserve account was equal to the paid-up capital. Subsequently, all banking ordinance, amendments and regulations has always addressed the issue of capitalisation. This stipulation was aimed at strengthening existing banks in order to avoid further failures in the industry and also to stop the proliferation of banks. Apart from this, the stated objectives of this policy includes:

1. Protection of depositor's interest.
2. Encouragement of sound banking practices in Nigeria.
3. Discourage the entry of any unserious person(s) or corporation into the industry.
4. The nurturing of an industry that is vested with public interest.
5. Ensure adequate capital for the running of the banks business.
6. Prevention of expatriate banks from dominating the industry i.e. by fixing a higher capital requirement for them.

A sound capital base is a necessity for a sound effective and efficient banking system to exist in any economy, and the importance of the banking sector to any economy cannot be over-emphasised

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

The main aim of this research is to look at the prospects and effects of the Federal Government recapitalisation policy on the banking sector.

In any research work, there are always certain methods employed to arrive at the actual fact of the problem, the nature of the study often determines the method to be employed in carrying out the research work

There are basically three methods popularly used for most research work. These are;

i. Historical Research Method
ii. Descriptive Research Method
iii. Experimental Research Method

Historical research deals with the determination. evaluation and explanation of past events essentially for the purpose of gathering information that will enhance a better and clear understanding of the present and making more reliable prediction of the future.

Descriptive research on the other hand is concerned with the collection of data for the purpose of describing and interpreting existing conditions. The descriptive research can be presented in three ways; general description, analysis and classification.

This research work shall mainly use the two methods of historical and descriptive

research in gathering, analysing and presenting the necessary data.

3.1 DATA COLLECTION TECHNIQUES

The instruments used in this research work were mostly tools collected through Primary and secondary data collection methods. The main tool used was the interview method.

a. Primary Source of Data Collection

The primary source of information for the purpose of this research was mainly through the interview method

FACE-TO-FACE INTERVIEW

Face to face interview with banks executives NDIC officials, Central Bank officials and staff of the Abuja Stock Exchange was an indispensable tool in gathering the needed information for this work. This people helped to provide information on their present level of recapitalisation, effects on their operations and the general trend in the financial industry as a result of the recapitalisation policy, especially as it effects the banking sector.

This group of people were able to provide such valuable information which cannot be easily gotten from documents and publications.

In using this tool suitable time and appropriate venue was an important criteria that was taken into consideration.

b. Secondary Sources of Data Collection

The secondary sources of data collection were mainly from the information

developed other than for the purpose of solving the problem at hand. These sources included the following;

- ´Information from organizations journals, magazines e.t.c
- Related text books, journals on financial and banking reforms.
- Business dailies, such as Business Times, Punch, Guardian e.t.c
- Also some unpublished projects in the Departmental Library and President Kennedy Library (PKL) were invaluable in getting past records and reports.

3.2 JUSTIFICATION OF THE TECHNIQUES USED

The interview method provides an opportunity for the researcher to meet with the interviewee face to face, thereby, creating room for every question to be asked and answered in detail. The method is highly specialised and systematic in nature because the time, venue, structure and purpose of the interview was well prearranged in advance.

The interview method was able to help the researcher in clearing every doubt as it provides first hand information resulting from contact between the data collector and the data supplier, and therefore, it was a very attractive and straight forward method used for this work.

DISADVANTAGES OF THE RESEARCH INSTRUMENT USED

Despite the attractiveness of the interview method, which was used here, the researcher was always at the mercy of the interviewee. For if the interviewee is embarrassed by a misunderstanding of the proffered question, he or she can easily get annoyed and this may lead to their refusal to give satisfactory answers and thereby defeating the aim of the research findings.

Another major disadvantage was that most interviewee hate inquisitive questions and thus feel or see the researcher as trespassing into corporate secrets.

Also the method involves a lot of cost and is time consuming on the part of the researcher.

3.3 POPULATION AND SAMPLING

This research work generally focuses on the financial industry and is basically constrained to the banking sector.

The researcher shall examine the effects of recapitalisation mainly on the banking sector. In doing this, we shall be making use of as many banks as possible as example since the effects spread allover the whole banking population.

Since this work cannot be strictly limited to only the healthy banks, mention will have to be made of some of the distressed and liquidated banks in the sector.

3.4 SAMPLING PROCEDURES USED

Sampling is carried out from a population for any of the following reasons;

i. Limited resources
ii. Limited data available
iii. Destructive testing

The sampling procedure used in this research was the simple random sampling. This was determined by two of the above mentioned reasons i.e. limited resource and limited data available.

A random sampling is one in which each individual in the population is equally likely to be chosen. It is a method that ensures an unbiased selection from a

population and also ensures a careful design of the research procedure.

This method enabled the researcher to be able to pick banks from both the healthy and distressed group for data collection and analysis. The use of this method ensures that the work was not limited to just a few banking institutions especially those of the first and second generation cadre (First Bank Plc, Union Bank Plc, United Bank for Africa, etc.) as has always been the case with most other similar research work.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.0 INTRODUCTION

This chapter unlike the preceding chapters, would be centered exclusively on the 1997 recapitalisation policy. It will enlighten its readers on what recapitalisation policy is all about and why the government felt that the Nigerian banking industry needed injection of additional capital to broaden its capital base. Primary method is used in collecting data for the research work.

This chapter would also inform the readers about the various options available to banks on how to raise the additional capital to meet the given deadline and implications.

Here also the writer will try to identify the problem that banks are facing as a result of the policy as well as the benefits that banks and the economy in general would realise from the policy and the prospects of the banking industry in Nigeria if they are adequately capitalised.

At the-end of this chapter, it is the researcher's believe that every thing about the recapitalisation policy and other related occurrence regarding the issue in recent times shall have been addressed and all information that needs to be known about this policy will have been provided.

Also we will take a peep at the lending process in the banks and its administration, as the general believe among the populace is that bad loans administration are the main causes of banks runs leading to liquidation and the need for recapitalisation. Furthermore, I conducted verbal interview with some

senior officers in the Bank.

4.1 BANKS LENDING AND CREDIT ADMINISTRATION

Apart from accepting deposits from customers, the bank also grants credit to its customers in the form of loans and overdraft. As such, the banker can only give loans to a customer if it is convenient for him to do so.

Before any loan or overdraft is given to a customer, it must be properly screened to ensures that such a customer complies with all the necessary requirements and that all forms and documents are properly signed. In most cases, the credit administrator at the branch office approves any loans given out.

One of the reasons banks always have problems is because most loans are not properly screened before they are being granted to customers and this has resulted in the bank having large amount of non performing assets and low level liquidity which in extreme case may result in bank runs.

However, before any loan is given out, the following must be noted;

a) Purpose of the Loan
b) Amount Required
c) Repayment of the Loan (method and time)
d) Terms of the loan, and finally
e) Security for the Loan

Great care should be taken while administering credit to customers and a lot of things should be taken into consideration to avoid loss of income which if not properly controlled could lead to a bank's failure or banks-run.

The board of directors of the company must make a resolution on the amount of

credit required by the borrower. This will go a long way to guide the bank in its lending decisions. If the board however resolved over the credit request, then the bank has to look into other conditions, which are necessary for the security arrangements.

Another important factor to consider as' security arrangement, is that of the authorised paid- up capital of the company or business of the borrower. This need to be authenticated in terms of the genuineness of the mortgage and the valuation. This is to avoid the vogue of fastness or 419 (advance fee fraud) and to check the over-valuation by the professionals for the purpose of the loan.

Status enquiry could be sought from other banks to make sure that the customer does not enjoy similar or same facility from another bank.

Also the deed of partnership/memorandum and article of association submitted to the bank should be carefully studied in order to give adequate security to the loan request. If in the process of careful study of the deed of partnership any clause is found which may not guarantee the security of the loan, then one will advice that such security is very faulty and decision on the grant must not be hasty but delayed.

On status enquiry, it is beneficial to the bank to know more about the customer and for this reason the bank has to communicate to all bank branches within the locality in order to know the character and capability of the customer. In this regard, if the response from other banks is that the customer is not owing and the character of the customer is good or even in situations where the customer is owing certain amount of money but that he does not default in repayment of his facility, one is bound to advice for reconsideration to some extent of the security arrangement. If on the other hand, the customer's status reports is faulty; that is non-servicing of credit as at when due (principal, interest, commission and other

charges), then one is duly bound to advice for the non-acceptability of the security arrangement through the status enquiry. The mortgage given to the bank must be thoroughly studied to make sure that the properties exist and that the company is the rightful owner. This has to be properly put in place so that the company can fall back to this mortgage in case of default in repayment.

Another important aspect to consider is the level of commitment of the board of directors over the repayment of the request. If the directors of the company are fully committed toward servicing of the facility as at and when due, this means that the facility will be-highly protected. If the reverse is the case then one will give a contrary security advice because the repayment of the facility will be faulty.

4.2 DEBT RECOVERING PROCESS OF BANKS

Debt recovering is one of the most difficult tasks ever faced by the banking industry. For companies and other business organisation, credit is given to customers as a result of transaction of goods and services. But for banks, credit is given to customers in form of loans and advances. The banks by virtue of its operation is suppose to try as much as possible to minimize its level of. This is because apart from unsecured debts, before any loan is granted, there must be enough collateral to back up such loans. In case the customer defaults in payment, the bank can bad debt recover its money from the sales proceeds of the collateral usually caused by political or other forms of connections with banks officials and board members.

Most loans tends to be given out without enough or no collateral and in most cases this is usually caused by political or other forms of connections with banks officials and board members which enable some people to pass through the "back door" to obtain loans. This loans form the bulk of depositors money. When

such loans are not recovered and they pile up, the bank start having problems such as bank-runs which will make it difficult for the banks to pay their customers on demand. And this really marks the beginning of the type of failures that can in most cases only be corrected by recapitalisation.

Some of the legal and other machinery for recovering debts as they apply to banks and other financial institutions in Nigeria includes;

4.2.1. UNSECURED DEBTS RECOVERY

The first best way or approach at recovering an unsecured or clean loan is for the managers to first draw the attention of the customer to the irregularity of his/her account, and requesting him to put in funds. Thereafter, if the debtor customer fails to respond, then the matter of recovering could be referred to the bank's solicitors for 1egal process which will involve a letter of demand made by the bank's solicitors. The customer may reply and put up a repayment programme. This type of install mental repayment programme should be accepted so as to save cost of litigation which is normally charged on the account and thereby reduces the debt to be recovered.

To really recover unsecured debt by court action, the manager has to ensure that the account concerned has been left dormant for more than six years after last the advance. Otherwise the banker cannot recover the debt if the limitation act or statute of bankers has been added to the principal from time to time becomes part of the sum of the principal due.

4.2.2 SECURED DEBTS RECOVERING

A secured creditor need not proceed against the debtor on his personal obligation to pay before enforcing his security. Once the debtor default in repayment, after a demand has been made for it, the creditor takes appropriate

steps immediately to enforce his security.

Furthermore, the instrument constituting the security usually provides that even without a demand for repayment it shall immediately becomes enforceable on the happening of certain events as stated below;

a. If a distress or execution or other process is levied or enforced upon or issued out against any part of the asset charged as security and shall not be withdrawn or discharged within a stated period of time.

b. If the debtor enters into a composition with his creditors or is adjudged to be bankrupt.

c. If the debtor company or any subsidiary ceases or threatens to cease and preventing the carrying on of its business.

d. If the debtor company or any subsidiary is unable to pay its debts within the meaning of that phrase as explained above i.e. forced to compulsorily wind up.

E. If in the opinion of the lender the security is in jeopardy.

4.2.3 ENFORCEMENT OF SECURITY

Enforcement of security has been described by Adetunji as a process whereby the value of the property charged whether it is land, shares, life policy, the under taking of assets of a business, is realized in money. This is by means of sale or other disposition or by direct payment of the sum insured under life policy or its surrendered value, or by direct payment by a surety under a guarantee or indemnity entered into to secure the loan for sale.

This position holds that, the procedure for sale may be varied as it all depends on the type of property charged and the nature of the charge, that is, whether it is legal or an equitable charge. The type of securities held here in respect of the account may consist of one or more of the following.

Equitable mortgage, legal mortgage, mortgage Debentures, stocks and shares, life policies, personal Guarantees, Overseas- Trust deeds and Bill of sale. If any of the above procedure fails to bring the anticipated result to recover debts, it may result in illiquidity in the banks leading to banks runs and the only way to solve such illiquidity problems and keep the banks in business is to implement proper capitalisation procedures. And for banks already experiencing such illiquidity problems, the answer to resolving this is through Recapitalisation.

4.3 RECAPITALIZATION POLICY OF THE FEDERAL GOVERNMENT NIGERIA (1997)

On 18th February, 1997, the then head of state, and commander- in- chief of the Armed forces of the federal Republic of Nigeria, General Sani Abacha (GCON), in a policy thrust statement, announced the federal government budget allocation for the year 1997. It was 'in this same speech that he addressed the issue of recapitalisation of the banking industry so as to check the persistent cases of distressed being witnessed in the banking sector at that particular time.

According to the Head of State, "The minimum paid up capital requirements of both commercial and merchant banks of 50 million Naira and 40 million Naira respectively which were last fixed in Mid 1991 are no longer sustainable. In view of the exchange rate and the inflation rate developments, the erosion of capital funds of banks by non-performing credits and the need to conform with the minimum capital requirement of international standards, the minimum paid up

capital of both commercial and merchant banks is hereby increased to a uniform level of 500 million Naira. Existing banks shall meet the requirement over a period of two years expiring on December 31st 1998, for avoidance of doubt, banks which fail to meet the requirement shall have their licenses revoked, while new banks shall comply fully with the condition before they are licensed. Also the government, through the Nigeria deposit insurance corporation (NDIC) intends to put into liquidation all banks presented and classified as distressed as at the end of 1996 which are not recapitalised before March 31, 1997. These are some of the measures introduced to check the distress recently witnessed in the banking system. It is worth mentioning that some banks whose offices were sealed following the expiration of the March 31 51 1997 deadline given to them to raise their capital base had to be reopened to enable them protect their properties and assets from being looted or destroyed by angry depositors until they were fully liquidated. Also because of the severity and scope of the distress, a mass liquidation of about 45 (forty-five) banks was planned for the end of 1997, this had to be shelved because of the implications on the economy as considerable amount of resources will have to be committed to such an exercise. Some of this banks had to start their process of capitalisation immediately to get themselves out of the dragnet of liquidation. But in 1998, in spite of the time lag since the policy was announced, it was still apparent that given the slow pace at which some of thes: banks were going about their recapitalisation exercise, they may never be able to really meet up with this required capital level and their continuous existence was casting a lot of distrust on the banking system as a whole. This led to the liquidation of twenty-six (26) banks on Monday 18th January 1998, by the federal government of Nigeria. This comprised of thirteen merchant banks and thirteen commercial banks.

As at December 315t 1998, only ten banks were yet to be fully recapitalised out of the eighty nine (89) banks operating in the country then. Some of this banks i.e. the 10 undercapitalised banks, have started recapitalising a step which of

course must have informed there not being liquidated at the end of 1998 by the government through the NDIC and also an assurance to the members of the public especially their customers, that sooner or later there may be light at the end of the tunnel.

With the recent return of ministries and parastatals accounts back to commercial banks, there is every likelihood that the needed capital to fully recapitalised by some of these banks can easily be gotten now. Some of the criteria outline for the banks to qualify for these accounts includes:

- 500 million Naira minimum share capital compliance
- Year 2000 computer compliance (Y2k)
- Efficient banking services
- Network of branches (including Abuja)
- Sound Management team
- Two-four years financial performance.

Note: See appendix II for performance profile of the 26 liquidated banks on 18th January 1998.

4.4 RECAPITALISATION: THE NEED AND REASON FOR A STRONGER CAPITAL BASE

The federal government gave a number of reasons for the increase in the bank capitalisation requirements, among these reasons are;

1. TO REDUCE THE EFFECT OF HIGH EXCHANGE RATE:

The exchange rate is the rate at which a country's currency is exchanged for another's. The high exchange rate being experienced by the Naira in recent

times (i.e. N86 to $1 (1986 -1996), N89 -$1 (1996- 1998), N90 to $1 (1999) has to a great extent reduced the activities of indigenous bank concerning business involving hard currencies like the dollars, pounds, Dutch Marks etc. The business of international trade financing and investment in exchange rate and business abroad has, been reduced as a result of low or in adequate capital structure. The new capital requirement will enhance enough capital bases for investment requirements in those areas that have received inadequate attention in the past. This would have a multiplier effect on the Nigerian economy.

2. CURB THE EFFECT OF INFLATIONS

The new available funds in the banking system will enable banks to provide more funds to the productive areas of the economy, areas like the manufacturing and the agricultural sectors which will lead to a subsequent increase in the production of the major commodities produced by these sectors to meet the high demand and hence reducing the level of inflation in the economy.

3. THE EROSION OF THE CAPITAL BANKS BY NON-PERFORMING LOANS

Unlike in the previous situations that when a bank give out loans as large as say, 40 million Naira to 60 million Naira, they have nothing or very little left to run the every day business of the banks. The new level of capitalisation ensures that even if a bank gives as much as 300 - 400 million Naira loan it still has a reasonable amount to run other business of the bank.

4. THE NEED TO CONFORM WITH THE MINIMUM CAPITAL REQUIREMENT AT INTERNATIONAL STANDARDS

Generally, there is a level of fund at a bank=s disposal that gives them the recognition of meeting international standard. The international banking scene, requires banks to be adequately capitalised. Banks of this standard have capitals of over one billion Naira and above as the capitalisation fund and for any Nigerian bank to be internationally accepted, it has to improve to this level of capital. And the new capital requirement even though still not sufficient to be regarded in the parameters of the actual standard according to some analysts, but it is a stepping stone to getting closer to the required standard.

5. TO ENHANCE COMPETITIVENESS IN THE INTERNATIONAL STOCK MARKET

The new level of capital requirement would increase the general standard of banking in Nigeria and as a result, foreign investors will be attracted to the sector. Currently, ban on bank licensing is still on to some extent as the restriction base on the guidelines for licensing banks has not been liberalised to the level obtainable during the SAP years. But with the economy policies presently in place, there is high expectation of foreign investment in this area as soon as the civilian government and all other democratic structures are fully in place.

6. RESCUE THE ISSUE OF DISTRESS IN THE BANKING INDUSTRY:

The issue of distress is the main issue that prompted the recapitalisation policy of 1997. Distressed was caused by factors like inadequate capital, fraud, non-performing loan, incompetent personnel, and bad management among other factors. With enough funds available in banks, most banks can now employ competent personnel, the impact and effect of non performing loans and fraud

would be reduced on banks to a great extent.

4.5 RECAPITALIZATION OPTION

Basically, there were two options as regards the recapitalisation policy; either a bank raises its capital to the required amount and continue in business or: alternatively, do not increase its capital to the required amount and be put out of business by December 31, 1998. All the banks that wanted to stay in business after this deadline date had to raise their capital base to the required level of five hundred Million Naira, while those who .were not able to do that then, were given up to 31 March, 1999 to meet up which they have done.

There were a number of methods and opportunities which were used by most of these banks to meet up the requirement on or before the deadline given. Some of these methods included;

1. ISSUING OF NEW STOCK:

This was one method that most banks adopted to raise capital base. The process involves banks raising capital through the issue of new shares for sale in ,the capital market. The process involves the board of directors coming to a consensus to go public to raise capital. After the resolution, it is conveyed to the selected house that must be a member of the stock exchange. It is the issuing house which also acts as the bank's cooperate adviser that will analyse the report and determines its conformity with the listing requirement. Having satisfied or confirmed its conformity with the listing requirement, the issuing institutions is then advised to select the other parties to the issue of registrars, stockbrokers, solicitors and trustees in the case of debt issue.

An application has to be prepared and forwarded to the council of the exchange

by the stock broker issuing house on behalf of its issuer. The application is to be made in the prescribed format to the council of the exchange. The quotation committee (a committee of council) will then examine and recommend to the council for ratification. If this is ratified the issuing house can then go on with the primary market activities after the security and exchange commission (SEC) has determined the offer prices of the securities. With the approval of the council of exchange and the condition given by the security and exchange commission (SEC), the issue can then be packaged into prospectus. The prospectus may be detailed, containing various information or the issuer can obtain a certificate of exemption to publish only a very small or abridge prospectus.

A prospectus has been defined as "any notice, circular, advertisement or other invitation offered to the general public for subscription or purchase of any shares or debentures of a company.

The prospectus contains all the pertinent information about the issue and the issuer as provided in the proposed application. Among the information contained in the proposed application includes;

1) History and business of the company
2) Board of directors names and the company secretary
3) Management and staff
4) The capital structure since incorporation
5) The share holding position
6) The proposed issue
7) Indebtedness of the company
8) Subsidiary and associated companies, if any.
9) Material contract and litigation if any.
10) Financial summary and projections

After the board of directors and the parties to the issue have approved the documents, signed the final print of the prospectus, approved the form of advertisement, date for opening and closing of the subscriptions and public acknowledgment of liability in case of wrong information by the board of directors are obtained, the issue will then be advertised. The advert will run for about two weeks before subscription is opened. Allotment follows subscription and certificate will be issued and sent to successful share holders/applicants. The unsuccessful ones will get a refund of their moneys a month or there about after the close of subscription usually with a little interest. After all these processes, the issuing house will issue a letter of compliance to the exchange and the security will then be listed for trading.

There are two types of securities that banks can use in this method of raising fund; the debt security and the equity security. The debt security instrument is financial claims with an obligation by the issuer to pay interest at stated intervals and to redeem the issue at a stated future date. Example of this instruments are; industrial loans, Preference stocks and bonds. While equity securities are ownership securities. They receive no interest on the amount paid rather they are paid dividend. The owners have right to benefit from its stipulations in the memorandum and article of association. Equity securities are in the form of ordinary shares.

Savannah Bank which in 1997 had a paid up capital of 53 million Naira and was said to be grossly under capitalised had to go to the capital market with issues worth about 600 million Naira in order to reach, the required minimum capital level and above, this new issues was able to propel its capital base up at the second quarter of 1998. Trade bank also used the same method to raise its capital to 500 million Naira by the issue of 350,000,000 ordinary shares of 50k each to be offered at N 1.20k. other banks such as Inland Bank Plc, First Bank Plc, and international Merchant Bank Plc (1MB) all had to result to the capital

market to meet up with capitalisation drive. Most shareholders frowns at this method of raising capital as it increases its number of owners, thereby leading to a reduction in the average earnings per shareholder and also making decision process a difficult task at the general meetings as a result of the diversified number of interest.

2. MERGERS AND ACQUISITION:

A merger is a combination of two or more companies in which only one firm survives as a legal entity. The merged corporation goes out of existence, leaving its assets and liabilities to the acquiring corporation. A merger must be distinguished from a consolidation, which involves the combination of two or more corporations whereby an entirely new corporation is formed. All of the old companies cease to exist, and shares of their common stocks are exchange for shares in the new company. When two companies of about the same size. combine, they usually consolidate. When two companies differ significantly in size usually a merger is involved. Though it is important to understand the distinction, the terms merger and consolidation tend to be used interchangeably to describe the combination of two companies as it is used in this research work.

A merger or consolidation usually begins with negotiations between the management of the two companies. Usually, the board of directors of the companies are kept up to date on the negotiations. When initial agreement is reached as to terms, the respective boards must ratify these terms. Upon ratification, the agreement is submitted to the common stock holders of both companies for approval. Depending on the corporate charter, an established majority usually 75% of the total shares is required. After approval by the common stock. holders, the merger or consolidation can take place once the necessary papers are filed with the states in which the companies are incorporated.

Apart from just consolidation of capital operating economics can also be achieved through a combination of companies. Duplicate facilities call be eliminated, marketing, accounting, purchasing and other operations can be consolidated. In addition to operating economies, economies of scale may be possible with the merger of two companies. Economies of scale occurs when average cost declines with increase in volume. The idea is to concentrate a greater volume of activity into a given facility into a given number of people, into a given distribution system, and so on. In other words, increase in volume permits a more efficient utilisation of resources. Like anything else, economies of scale has limits, beyond a point increases in volume may cause more problems than they may solve, and a company may actually become less efficient.

NICON Insurance Company at one time was said to have acquired the federal government 60% state in Nigeria Arab Bank. NICON Insurance, Nigeria's largest insurance company in terms of premium and assets was geared towards injecting about 750 million Naira to raise the bank capital base from its former 100 million Naira so as to meet up with the minimum recapitalisation requirement and above. This was published in Monday 12th May 1997 edition of the business times. Although this was on the government side, the same thing has happened and is still of money into such institutions in the distress throes like Broad bank and Crystal bank, as it was base.

3. CAPITALISATION OF BANK RESERVES

As mentioned before in chapter two, reserves are sums of money taken out of net profits annually and kept apart as liability contingent, such as possible defaults in loans, and advances repayments, or due to depreciation in market value of securities. If no losses are experienced then the reserves are accumulated to provide for future obligations. The various banks regulations

made it compulsory for banks to keep certain percentages of its profit in reserve accounts. For this reason, some banks have reserve accounts worth several hundreds of millions and even running to billions of Naira in some cases e.g. First Bank, Union Bank and UBA have reserve accounts worth hundreds of millions and billions of Naira.

To this effect, banks that have adequate money in their accounts as reserves and retain earnings could capitalise part of this money and thus use it to increase their capital base to meet up with the required minimum capital base.

This was the case with first bank Plc (FBN) in 1997, it used its huge reserve in capitalising so as to meet up with the requirements of the recapitalisation policy of 1997. Also Federal Savings Bank International also adopted this method. This method formerly was mostly frown at by the banking authorities and even now some banks authorities still do because it is believe to have the effect of reducing the money available for banks to meet future contingency and this have a long term effect on banks.

4. **CAPITALISATION AFTER PROFIT**:

This is a situation where a bank capitalise its after tax profit for the business year to increase its capital base. Instead of using its revenue (after tax profit) to pay dividends to its share holders, a bank can capitalise part of its revenue or everything to increase the capitalbase and now issue bonus share to its shareholders as earnings for that business year. This method was used by citizens international bank in early 1997. According to Mr. Onazi a staff of the Kano branch of Citizens international bank, previously the bank had a capital base ofW275 million, its after tax profit for the 1996 business year was put at N323,3 72,000, the bank capitalised 225 million Naira out of this amount to increase its capital base to 505 million Naira in order to meet up with the

recapitalisation policy of 500 million Naira minimum requirement.

5. SALES OF STOCK AND SECURITIES IN OTHER ORGANISATONS:

This is another method of raising funds for capitalisation by banks. Some banks have ownership equities and debt securities in other organisation. This sort of investment could be sold so as to raise the capital requirements. Such securities are traded in the Nigeria Stock Exchange Market. The proceeds of such a trade is then converted into the bank capital structure.

6. SALES OF IDLE ASSETS:

This is a situation in which a bank sells part or all of it non-performing assets, that mayor may not still be in use. For example equipment bought for leasing by some merchant banks that are lying fallow for sometime and do not have a foreseeable market could be sold. Also the bank can sell some of its landed property that are not being used or that they feel they can conveniently do without. The money realise from such deals can be capitalised.

7. COMBINATION OF TWO OR MORE OF THE ABOVE METHODS

A bank may not necessarily raise all the required fund from only one of the methods mentioned so far .It may be convenient for some banks to apply two or more of the methods so far listed. For example a bank could rise part of its funds from the capital market, capitalisation of reserves and the remaining from the after tax profit. This method tries to limit the problems encountered from the use of only one method. A bank raising all its capital from the stock exchange may have more investors than it may actually want, converting reserves to capital may endanger the future business of the bank and if a bank converts its after tax profits, it is denying its share holders of their dividends. Merger and acquisition

may result to a bank loosing its name and being dominated by another. In fact almost all the alternative methods have their disadvantages, and therefore "it becomes advisable for a bank to combine the use of more than one method. Inland Bank (Nigeria) Plc adopted this method by capitalising some of its profit after tax and also using the Nigeria Stock Exchange to raise the balance. Prudent Merchant Bank also adopted the same method by raising 240million ordinary (equity security) shares of N1:00 each and 200 million Naira cumulative, convertible redeemable, non-voting preference shares (debt Securities) of Nl:00 each to add to its existing authorised capital of60 million Naira as at 1996. (Redasel Publications, 1998/99 edition).

4.6 PROBLEMS ASSOCIATED WITH RECAPITALISATION

This part of the research shall try to examine the expected and resultant problems of the recpitalisation policy. We shall look briefly at these problems as it affects the banking sector and the economy of the country. Some of the problems faced by banks in their attempt and processes of recapitalising included;

1. THE PROBLEM OF ADOPTING THE RIGHT RECAPITALISATION METHODS:

Schism has set in between the shareholders and the management of some banks were the governments directive that banks should raise their minimum capital base to 500 million Naira before December 1998 (which was later extended till march 31st 1999) or have their operating licenses revoked. Whereas the chief executive officers of some banks embrace going to the Nigeria capital market to source for the required funds, some influential share holders of the banks object to such arrangements on the grounds that increasing the shareholders though public offer of the banks equities may dilute the current

ownership structure of their banks. The share holders fear that such move will lead to their lose of controlling power and influence. They contend that instead of going public, high network individual investors should be approached for private fund placement. But when the difficulty involved in getting congenial private investors was pointed out to them by some of the chief executive officers, it was learnt that the shareholders then opted to organise themselves into groups to mount pressure on the government to allow them to adopt a phased recapitalisation programme instead of the two year deadline given to them to shore up their capital base.

Mr. Aigbojie Higo, a stockbroker and the head of counter trust securities limited Lagos said ignorance was the cause of the worries of most of this bank owners. He explained that offering of a bank's securities to members of the public as a way of raising capital fund does not make the original owners of the bank to lose controlling power in anyway.

But Dr. Adewale Stephen Bakare an economics lecturer at the university of Lagos, said that the share holders are afraid of accommodating more investors into their fold because such will definitely reduce the dividend they will get at the end of any financial year. Moreover, increase in the number of shareholders also means increase in liabilities to the organisation. However, he agreed that since banking is a free market, more investors should be allowed into the market by means of acquiring equities in the banks.

2. **REDUCTION IN THE NUMBER OF BANKS**:

By 1997 the Nigeria Banking population was projected to shrink by at least 33% as at the end of the year, and by 75% by the end of 1998, given the new capital requirement of about 500 million Naira for each bank. By August 1997, I) no

fewer than 12 banks had adjusted to the new minimum requirement largely by recapitalising their reserves and issueing of new shares at the capital market. By December 31st 1998, the total number of fully recapitalised banks rose to 79, among these fully recapitalised banks were; Nigeria International Bank, City Bank,. UBA, First Bank, Union Bank, Afribank, Wema Bank, Guarantee Trust Bank, Zenith International Bank, Equitorial Trust Bank, Citizen Bank International, Nigeria Arab Bank, Comet Bank, Nigeria International Merchant Bank, Federal Merchant Bank etc. at present only 10 banks are yet to be officially declared as fully recapitalised but are showing encouraging signs of full recapitalisation.

These market projection emerged from a scenario analysis encased in a paper "vision 2010 and the new generation commercial banks" presented by a risk rating consultant Mr. Bode Agusto of Agusto and company, at a strategic marketing seminar organised by Equitoral Trust Bank (ETB) in Lagos.

With the revocation of the licenses of about 26 banks in 1997, most banks that were, remaining had to rise up fast to meet up the new recapitalisation challenge or face the liquidation hammer of the NDIC.

Today only about 89 banks are fully operating in Nigeria due to the distress fever that claimed the life of all the others.

3. TIME CONSTRAINS FOR THE RECAPITALISATION:

The banking and Finance group of the Lagos chamber of commerce and industry (LCCI), in March, 1997, resolved to send a memorandum to1he government to extend the deadline of the recapitalisation policy or bring down the capital base to 250 million Naira. The issue, it was also understood, has been dominating the

bankers committee meeting right from when the government announced the minimum recapitalisation rate in 1997. The banker's committee is an association of chief executives of banks and the Central Bank of Nigeria, (CBN). At one of such meetings, it was said that some impressed on the CBN representatives the need to spread out the recapitalisation programme over a period of five years. The CBN representatives have replied that the government is not comfortable with such thinking as this will not bring about the required effect of sanitizing the banks within a short period, and also due to the fact that a lot of banks were not likely to survive through the programme (e.g. the 26 liquidated b:in 1997).

Other problems likely to be experienced as a result of the recapitalisation policy are in the areas of difficulty in making decisions at board-meetings as a result of diversified interest of shareholders, and maintenance of idle cash in banks as a result of excess cash available to banks caused by inadequate investment opportunities to meet the level of fund at the banks disposal, likely disappointment by the CBN in transferring the promised ministries/parastatals accounts to some of these banks who are cash starved.

4.7 ADVANTAGES OF A STRONG CAPITAL BASE

It will be quite important at this point for us to enumerate the various benefits that the recapitalisation policy of 1997 has brought to the banking sector and the national economy in general. This is important, as some people believe the policy was only one of those excesses of a military dictatorship to unsettle the banking system. The benefits so far derived from this policy includes:

1. **Increase in Lending Capacity of Banks**: With the new level of funds available to banks as a result of an increase in their capital base, there has been a commensurate increase in banks lending capacity, this has a positive effect on the nations economy as such loans are now being put into productive areas of

the economy and this has also reawaken the entrepreneurship skills in most Nigerians.

2. **Increase in Banks Investment and its Capacity to Diversify Investment Areas**: Bank have now increased their size and areas of investment with the level of funds now available to them. With the liquidation of some banks, the buoyant ones have moved into their areas of operation quickly so as to consolidate their hold on the banking system and gain more market share. This has a positive effect on the economy as they can now take advantages of areas in which financial incapacity had hitherto prevented them from going into; some of such areas now involves joint investments with other banks. And even some now undertake certain classes of insurance, which they will not have attempted in the past e.g., fire and marine, as can be seen in such the operations of banks like first bank Plc. and Diamond Bank Plc. Also most banks now participate strongly in the areas of international trade and foreign exchange investments.

3. **Boost the Image of the Nigerian Bankin2 Sector and also Elevate Position in International Standardization**: the Nigeria banking sector in the recent past has become unattractive to investors both at home and abroad as a result of the distress situation in the industry. Customers fear to keep large sums of money in the banks as they don=t know which bank will be declared distress soon and foreigner interested in investing in this sector were discouraged by the unsettled situation. With the announcement of the recapitalisation policy in 1997 about eight foreign investors applied for licenses to operate in the country. By October 1997 when the government through the Central Bank of Nigeria issued out new modalities for licensing new banks, more foreign and local investors were out resulting from the return of most government parastatals and ministries accounts to commercial banks" more and more investors have become over interested again in the banking sector.

4. **Capital Adequacy**: this is a measure of solvency in terms of ability of the capital of a bank to meet asset requirement and ability to offset liabilities when due by the banks.. With the new level of funds at the bank's disposal, most of the operating banks today are able to meet up with their obligation as at and when due.

5. **Improved Bank's Standard of Service and Competence**: Banks can now employ well qualified personnel and acquire up to date facilities for their services, this has helped to improve the standard of banks services and also boost the management of their affairs. Most banks because of their adequate funding have now gone into total computerisation of their operations to improve and hasten customer's services e.g. UBA Plc.

6. **Curb the Issue of Distress in the Systems**: the issue of distressed witnessed in the Nigerian banking industry caused by poor asset quality, poor management, poor economic environment, low capital base etc has been reasonably checked to a great extent as a result of the recapitalisation programme.

7. **Improvement of the Nigerian Economy**: the financial system in any economy has always determined the welfare of that economy. The Nigeria situation was not an exception. With the improvement of the financial sector as a result of the increase in capital base of banks, there has been more funds available for investment in the economy, prospects for enhanced employment opportunities, and improvement in the productive sector of the economy, this is no doubt a welcome change to a transitional economy like Nigeria's and a positive sign of better things to come and a vibrant economy in the nest millennium.

CHAPTER FIVE

5.1 SUMMARY/CONCLUSION AND RECOMMENDATION

Distress was first recorded between 1892 -1952 when the first set of banks in Nigeria owned indigenously collapsed as a result of several factors, which centered around management deficiencies and poor capital base. In chapter one, I took a look at the history of indigenous banks that were established then and what brought about their failure. This goes a long way to show that distress is not a new concept in the history of banking in Nigeria.

In chapter two, attention was focused on the main topic of the research, here using related literature I tried to examine banking development in Nigeria, effects and major causes of distress (taking into consideration diverse opinions of the various writers), some of the causes were found as itemized included poor banking habits, loss of income from both government and individuals, unemployment etc. Also here I examined the various policies and efforts made by the government regulatory bodies (C.B.N and NDIC). Mention was also made of the concept of recapitalition, its introduction and the reason for its introduction. And finally I briefly talked on Bank reserves and its importance to modern banking practices. Chapter three was mainly concern with the sample was used.

It was necessary to include the issue of lending and credit administration of banks in chapter four. What are the process and machineries used by banks to recover some of these loans and other forms of advances? Also examines here by the researcher was the content of the 1977 recapitalization policy of the federal government of Nigeria, its relevance at this stage of banking development in Nigeria. Because of its urgency in implementation and the fact that it took most banks by surprise, while the few who were not really shocked

still had to consolidate their hold on the banking market.

The researcher enumerated options opened to most of these banks during their critical time of sourcing funds, the problems most of them encountered and finally the gains and advantages realized from a well re-capitalized base.

5.2 CONCLUSION

At one time in Nigeria history, the banks were seen as the most viable Investments A venue in the economy. But today because of the distress syndrome that swept through the sub-sector from 1992 -1998, the public has lost confidence in the banking sector, this has posed a problem for viable banks in the economy today in the area of attracting good investments.

The fact to bear in mind is that banking is a dynamic industry, which changes with and adapt to changes in the economy in line with requirements for its services. Recently, there has been a turn of even since this phenomenon of distress which brought about the need for recapitalization set in. Therefore a banker must adapt his operations to the wind of change or loss out in the competitive banking arena.

It was in regard to this problem that the Nigeria government in its 1997 budget speech introduced the minimum Recapitalisation requirement policy, which ran for two years and three months (January 1st 1997- March 31st 1999). Though the programme was actually supposed to end by 31 SI December 1998, it was extended for three months to (31st March 1999) to allow for the ten banks which were not fully capitalized as at 31st December 1998 to do so, and with the release of the federal ministries and government parastatals accounts from the central bank back to the commercial banks (A reversal in thel991 policy of transferring all government parastatals and ministries accounts to the C.B.N),

most of the fully recapitalised banks along with these last ten are now free of the "Murky waters" of distress.

Though at the beginning of its introduction the programme was not fully welcome by some banks, today most of these banks have the Federal Government to thank for the gains accrued from the Recapitalisation policy of 1997.

It should be stressed here that, the Recapitalisation policy is not only important to the banking sector alone, but to the entire economy of the country , as such banks should not stop at their present level, but should continue to find new ways and means by which they can increase money market.

Note that a standardize bank is an economy booster to any society anytime any day and this should be the goal of any bank operating in Nigeria.

5.3 RECOMMENDATION

In the light of the problems being encountered in the Recapitalisation programme by some banks and the need to eliminate distress in our economy, the following measures would help to address or reduce the problem and also help the already Capitalized banks to consolidate their position in the money market and banking sector as a whole.

1. The customer must play his role in reducing the problem of distress in banks. He must understand that financial institutions are for profit and not charitable organizations or philanthropic institutions or a channel for sharing the "National Cake". Therefore, customers must show that they are credit worthy, financially trustworthy and able to repay loans as agreed.

2. Commercial banks should have a code of conduct and a powerful disciplinary board should be set up to tackle staff misdemeanor. They should put a total stop to unauthorized lending of money to managers and top management officials.

3. A policy should be put in place for future purpose, so tat banks will not have to go headlong into once and for all Recapitalisation, rather there should be a programme that allows for the amount to be broken down within a longer period and the banks therefore would make efforts to raise the amount allocated for a specific period and the sum total of the periods would make up the total amount required. This will help to eliminate the idea of abrupt liquidation as was experienced in 1997 when the Twenty Six banks (Thirteen Commercial and Thirteen Merchant banks) were liquidated because they were believed to be too deeply down into the distress tunnel.

This banks I believe if they had been given the chance to recapitalized over a given period on installmental basis, will have been able to get back on their feet and compete favourably with the so called giants in the industry today.

4. Banks should put off selfish interest like their unwillingness to easily allow new shareholders to take up majority shares and thereby share more in the dividends accruing to shareholders. Most banks always drag their feet to come up with this decision and it really affected them during the last Recapitalisation exercise.

5. Banks who are already fully recapitalised, should seize the opportunity now open to them by the central bank to return back all the Federal government parastatals and ministries account to the commercial banks

(which has already started with the release of N100 million at the end of April 1999) to build up the capital reserves and embark on high interest yielding short term investments to boost their capital base so as to be prepared to meet any future challenges from further recapitalisation.

6. The need for improved banking services, the introduction of Electronics and Computerize facilities and the training of highly skilled personnel cannot be over emphasized here, as banks needs very much to win back the confidence of their customers.

7. There should be an extended network of branches especially to the rural areas so as to imbibe the banking culture into individuals which will in turn increase the funds available to the banks at any particular time, there by helping to eliminate illiquidity problems.

8. With the autonomy granted to the central bank of Nigeria (CBN), the time has come when both the CBN and other monetary authorities should come together to formulate an appropriate banking structure for the Economy.

9. There should be an improvement on the present system used by banks inspectors in which accounts of the banks.

10. A solid capital base, which will be constantly reviewed in line with the trend of global requirement of N500,000,000 should be made to undergo a three yearly upward review say up to N1 billion by the year 2003.

11. Operational procedures should be reviewed and made speedy and flexible to meet the customer's taste. Banks ethical and moral behaviours in their dealings with customers must be improve upon. Because in the next

millennium strategic focus of banks to customer will be very critical.

12. Re-engineering and staff restructuring should be made the watchword to have highly skilled staff on hand for disposition of bank products and services. Base on this, there is a need for harmonizing the salaries and other benefits received by bankers through out the country. After all, it is said that, a hungry worker is an angry contributor (if he ever contributes at all and if he does not contribute negatively). Here, there is a need to provide functional infrastructure.

13. Finally, the regulatory authority (CBN) should be made to understand the need to regulate the banker=s and the customer=s operations rather than the present situation where by regulation and control is only concerned on the banks which is not fool proof or adequate to check mismanagement, fraud and other forms of internal practices that could lead to large scale distress as just experienced in the last few years gone by.

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APPENDIX I

Total Number of Commercial and Merchant Banks operating in Nigeria as at 31st March 1999 with minimum paid-up capital of N500 million.

S/N	Name of Bank	S/N	Name of Bank
1	Access Bank of Nigeria Plc.	25	First Bank of Nig. Plc.
2	Afribank Int'l Ltd (Merchant)	26	First City Merchant Bank Ltd.
3	Afribank Nigeria Plc.	27	First Interstate Merchant Bank
4	Broad Bank Nigeria Ltd.	28	Fountain Trust Merchant Bank
5	AIB Ltd.	29	FSB International Bank Plc.
6	All-State Trust Bank Ltd.	30	Gamji Bank of Nigeria Plc.
7	Assurance Bank Nig. Ltd.	31	Gateway Bank of Nig. Plc
8	Bank of the North	32	Guaranty Trust Bank Plc
9	Centrepoint Mech. Bank Ltd.	33	Gulf Bank of Nigeria Ltd.
10	Chartered bank Ltd.	34	Global Investment Bank Ltd.
11	Citibank Nigeria	35	Habib Nigeria Bank Ltd.
12	Citizens Int=l Bank Ltd.	36	Hallmark Bank Ltd.
13	Comet Merchant Bank Ltd.	37	Hill Crest Merchant Bank Ltd.
14	Co-operative Bank Plc.	38	Inland Bank Nigeria Ltd.
15	Co-operative Dev. Bank Plc.	39	Indo-Nig. Merchant Bank Ltd.
16	Commercial Bank Nig Ltd.	40	Industrial Bank Ltd.
17	Devcom Merchant Bank Ltd.	41	Intercity Bank Plc.
18	Diamond Bank Ltd.	42	International Merchant Bank
19	Eco Bank Nigeria Ltd.	43	International Trust Bank Plc.
20	Eko International Bank Nig. Ltd.	44	Investment Banking & Trust Co. Ltd.
21	Equitorial Trust Bank Ltd.	45	Lead Merchant Bank Ltd.
22	Equity Bank of Nigeria Ltd.	46	Liberty Merchant Bank Ltd.
23	FBN (Merch.) Bank Ltd.	47	Lion Bank of Nigeria Plc.

24	Fidelity Union Merchant Bank	48	Magum Trust Bank Ltd.
49	Manufacturer Merchant Bank Plc.	71	Savannah Bank of Nigeria Plc.
50	Marina Inter. Bank Ltd.	72	Societe Bancaire Nigeria Ltd.
51	Merchant Bank of Comm.	73	Societe Generale Bank Ltd.
52	Merchant Banking Corp Ltd.	74	Standard Trust Bank Ltd.
53	Metropolitan Merchant Bank	75	Stanbic Merchant Bank Nig. Ltd.
54	Midas Merchant Bank	76	Trade Bank Nigeria Plc.
55	NAL Merchant Bank	77	Trans. International Bank Plc.
56	Nigbel Bank Ltd. (Merchant)	78	Triumph Merchant Bank Plc.
57	New African Merchant Bank	79	Tropical Commercial Bank
58	New Nigeria Bank Plc.	80	Union Bank of Nigeria Plc.
59	New World Merchant Bank	81	UBN (Merchant Bank) Ltd
60	National Bank of Nigeria Ltd	82	United Bank for Africa Plc
61	Nigeria Assurance Bank Ltd	83	Universal Trust Bank of Nig. Ltd
62	Nigeria-American Merchant Bank	84	Wema Bank Ltd.
63	Nigeria Intercontinental Merchant Bank	85	Zenith International Bank Ltd
64	Nigeria Industrial Dev. Bank	86	Highland Bank of Nigeria Ltd.
65	Oceanic Bank Int'l Ltd.	87	Merchant Bank of Africa Nigeria Ltd.
66	Orient Bank Plc	88	Nationwide Merchant Bank Ltd
67	Owena Bank of Nigeria Plc.	89	Nigerian Merchant Bank Plc.
68	Peak Merchant Bank Ltd.	90	Premier Commercial bank Ltd.
69	Prudent Merchant Bank Ltd.	91	RIMS Merchant Bank Ltd.
70	Pacific Merchant Bank Plc.	92	Peoples Bank of Nigeria Ltd.

Source: Redasal Publications 1998/99 Edition
NDIC Publication 1997/1999 Edition