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BANKS' CAPITAL REFORM, SIZE AND PERFORMANCE: THE NIGERIAN EXPERIENCE.

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Abstract

Capital reform in the banking industry is a common phenomenon across the globe and the financial environment in Nigeria is not an exception. This study employs financial ratios to measure a sample of commercial banks (14) performance in the period 2007-2011. We found that the performance of the banks fluctuates across the period. The mean performance of profit indicators shows that the net interest margin for all banks ranges between 3.9-6% but only 9 banks made a net interest margin > 5%. In respect of return on capital employed by the banks, mean performance ranges between -24.9-22% and 7 banks made a return on capital employed > 10%. For return on assets the performance range was between -8.02-3.59% and only 8 banks had a returned on total assets > 1%. And for asset growth, the mean growth rate of assets for the period of the study ranges between 4-33% but 10 banks grew their asset at a rate >10%. Finally, we found that size does not matter in the performance of the sample banks.

1.0 Introduction

The performance of a banking institution is largely driven by its ability to increase its customers' patronage, retain them and manage its assets and liabilities to enhance optimal returns. Further, arguments have been made to support the fact that factors that also improve a bank's financial performance include; size of the institution, asset management, operational efficiency and capital adequacy (Medhat, 2006; Sufian and Chong, 2008).

The need to maintain adequate capital funds amongst other reasons is that customers, most often, consider the volume of capital a bank has as a means to guarantee the safety of their deposits. On the other hand, banks use their capital to cushion the effects of their losses. To ensure continuous maintenance of sufficient capital that is adequate for a bank's level of operation, the regulatory body plays a role of ensuring banks compliance because with adequate capital the capacity of a bank absorbing its losses is guaranteed (Barrios and Blanco, 2000; Brash, 2001; Cornett and Tehranian, 2004; Yudistira, 2003).

In 2003, the Central Bank of Nigeria (CBN) conducted a test on how sound the 89 licensed banks were – using the CAMEL parameters. The study reveals that just 11 banks were rated sound, 53 were satisfactory, 14 were marginal and 9 were unsound (CBN, 2003). This tends to suggested that all was not well in the industry. The regulatory body rose up to the challenge and pronounced an increase in banks' minimum share capital to 25 Billion Naira, in the mid 2004 (CBN, 2004).

The regulatory authority anticipated that the capital reform will properly situate the commercial banking institutions in an improved category in terms of capital base when compared to their counterpart in other nations. The authority also expected that the capital reform would be a step to creating mega banks that would be able to serve domestic and international needs with reasonable improvement in their operational performance. The aftermath of this exercise resulted in 25 licensed banks from 89 with a minimum share capital of N25Billion (CBN, 2006).

An increase in the minimum level of capital contributed by bank owners are expected to give protection against insolvency risk and to help ensure that performance and market value of a bank are good enough to allow it to be a going concern (Comett and Tehranian, 2004). Meanwhile, few years after the 2004 capital reform an examination of the health of the banking sector by the CBN reveals that 8 out of the 24 banks operating were facing some problems- like illiquidity, poor corporate governance and capital inadequacy (Sanusi, 2009). This occurrence lends support to Besanko and Kanatas (1996) and Koehn and Santomero (1980) who speculated that under certain circumstances increasing bank capital may be counterproductive because it perversely increases a bank's risk taking. But to mitigate the problem of capital inadequacy, the CBN injected a sum of N620Billion into the 8 ailing banks in order to shore up their capital base (Sanusi, 2010).

It is suffice to say that those banks that made the benchmark of the 2004 capital reform are not of the same size in terms of assets and deposit liabilities. To assess the performance of some of these banks the paper categorized them into three groups based on their deposit liabilities. Bank size has been used in the literature to measure performance (Filbeck et al, 2011). And in some other studies size has been suggested to be closely related to access to capital and relatively large banks with robust deposit base tend to raise capital from the public at a cheaper rate (Short 1979). The significant effect of higher capital on a bank's survival and performance is justified but the effect capital has on bank size differs (Berger and Bouwman, 2012) and to Medhat, (2006) a bank with higher capital, deposits, credits or total assets does not always mean it has better profitability performance.

Many studies in Nigeria have assessed how some variables impact on bank performance. For example, Okoye and Eze (2013) assessed the effect of lending rate on bank performance. Kolapo et al (2012) was on credit risk and bank performance. Oke (2012) examined the effect of marketing strategies on performance of consolidated banks. Others, who have conducted similar but not identical studies- see: Ajayi and Atanda (2012), Gunu and Olabisi (2011), Newman (2012).

Our approach is a significant departure from studies reviewed on Nigeria, which typically does not differentiate bank size in assessment of bank performance after the 2004 capital reform. In view of this, the paper clarifies whether categorization of Nigerian banks, using their deposit liabilities to define size, has implication on their profitability performance in the post capital reform period (2007-2011). The study is organized as follows: the next section reviews the literature. The third section is on the Nigerian commercial banking sector capital reform experience, section four is on methodology section five is on results while section six concludes the paper.

2.0 Literature Review- Theory and Evidence.
The literature is replete on the issue of indicators of bank performance and comprehending whether higher capital has significant effect on bank performance. This effect has been proven in literature to differ depending on bank size and some other factors like efficiency, asset management, etc. (see: Adegbaju and Olokoyo, 2008; Medhat, 2006). Asedionlen (2004) (as cited by Adegbaju and Olokoyo 2008) suggested that recapitalization may raise liquidity in the

short run and a non-guaranteed conducive macroeconomic environment may not ensure high asset quality and good profitability in the long run. Irrespective of this, the roles banks play in economic development are important issues for regulators who consider the level of capital requirement in order to achieve improved performance of the sector (Soludo, 2004).

The theoretical exposition, which asserts that holding banks' assets and liabilities portfolios constant while there is higher capital would mechanically imply a higher likelihood of performance, is the incentive-based theory. This theory has been supported by Holmstrom and Tirole (1997) and Mehran and Thakor (2011). They discovered that capital either enhances a bank's incentive to monitor its relationship borrowers, reduce the probability of default, attenuate asset-substitution, moral hazard or lessen the attractiveness of innovative but risky products. However, others (like: Koehn and Santomero, 1980; Besanko and Kanatas, 1996) with a contrast opinion suggest that under certain circumstances increasing bank capital may be counterproductive because it perversely increases a bank's risk taking (Berger and Bouwman, 2013).

The first theory is buttressed by the empirical evidence in studies done by Calomiris and Meson (2003) and Calomoris and Wilson (2004). They found that capital enhances a bank's competitive position in terms of asset and liability market which also improve performance and survival. Some studies (see: Calomiris and Powell, 2001; Kim, Kristiansen and Vale, 2005)) also suggests that higher-capital banks are able to compete more effectively for deposits and loans (Berger and Bouwman, 2013).

Nevertheless, the incentive-based theory does not distinguish between banks of different sizes. The size distribution of banks is important to policy makers because size determines a bank's risk taking (Demsetz and Strahan, 1997); credit availability (Stein, 2002); and it may be a source of economic strength just like capital. Beltratti and Stulz (2012) consider size in their study by using a global sample of large publicly quoted banks of all sizes. They opine that capital is one of the factors that explain bank performance.

Kunt and Huizinga (2012) examine how a bank's risk and return on assets, activity mix and funding strategy, and the extent to which the bank faces market discipline depend on size. The study uses two measures of size: absolute and systemic size. They found that a bank's rate of return on assets increase with its absolute size, but decline with its systemic size. On the contrary: Medhat (2006), who classified and assessed the financial performance of commercial

banks in Oman, found that a bank with higher predictors of total assets, credits, deposits, or shareholder equity does not mean that it has better profitability. That is higher size of a bank does guarantee higher profitability.

Studies conducted on bank performance have used econometric techniques (see: Kunt and Huizinga, 2012); some have used financial ratios as indicators of bank performance (see: Arby, 2003; Kosmidou and Zipounidis, 2008; Kumbirai and Webb, 2010; Said and Tumin, 2011)); while other studies used other analytical methods like: the CAMEL model which has been used in measuring commercial banks performance in India by Sangmi and Nasir (2010). They found that the banks comprised in the study are sound and satisfactory based on their capital adequacy, asset quality, management capability and liquidity.

3.0 The Commercial Banking Environment- Statutes and Capital Reform Efforts So Far.
Nigerian economy started to experience commercial banking services from 1892 by the grace of our colonial administration who established them primarily to facilitate financial services needed by them between the domestic and their nation's economy (Nwankwo, 1980). These banks facilitated payments system for trading activities, served as a safe keeping receptor of their sales and a means of financing their business.

At start, commercial banking business was mainly controlled by foreign banks until 1933 when license was granted to (National Banking of Nigeria) an indigenous bank to operate side by side with the foreign banks. Although some indigenous banks were been set up before National Bank came on but they all folded up due to under capitalization (Adekanye, 1983).

Banking business was not regulated in Nigeria in the period 1892-1953 but the enactment of 1952 Banking Ordinance brought the sector under regulation. Subsequent statutes like Banking Act 1958 and the successor statute – Banks and other Financial Institutions Act (BOFIA), Decree of 1991 delimit the activities of commercial and merchant banks in the country and in response to this statutory provision, majority of merchant banks turned commercial banks through CBN approval.

The indigenization of business by the Federal government around early 70s (indigenization decree of 1973) witnessed the transformation of commercial banking ownership structure (including other businesses fully owned by foreigners) from a foreign based type to joint ownership that is comprised of Nigerians and foreigners. The banking sector was funded by government in the ratio of 60% for Nigeria and 40% to foreigners. This experience lasted for

about one and a half decade because about 5years after the Structural Adjustment Program (SAP) of 1986 government started to divest its ownership in many of the commercial banks due to declining performance and high political influence of some board members in the management of the bank's financial resources.

By the late 90s most of the government owned banks hasfully divested its shares and such shares acquired by individual persons and firms through the stock market. While the government divests its share holdings of these banks,new firms were granted license to operate as a commercial bank.

Within the period 1973-2004, the number of commercial banks rose at a high rate. Operating commercial banks licensed in 1973 was 16 it doubled within 10 years and by the end of 1995 it had risen to 64. Between 1996 and 2000 it dropped to 54 and rose again to 89 by the end of 2004. The increase in the number of banks is not without some challengesin particular in the period 1996-2000. While regulatory authority (CBN) granted license for new banks to join the banking market some banks' licenses were also withdrawn due to lack of performance resulting from mismanagement and or illiquidity to mention a few (CBN, 2004).

Capital reform by the regulatory authority started with the enactment of the law that regulates banking business in Nigeria. After 1952, minimum share capital for commercial banks was raised by 100% to 400,000.00 Pounds Sterling. In subsequent periods, changes in the minimum share capital of commercial banks have been recurring. It rose sharply from N1.5Million and N0.6Million for foreign and domestic banks in 1969 to a uniform minimum capital base of N5million for both foreign and local banks in 1988. Before the end of the same year the regulatory bank increased it by 100% such that by 1990 the minimum share capital requirement for commercial banks has reached N50million. 1997 experienced another sharp increase in the minimum requirements for bank capital and it was this year that the CBN enjoined a convergence in the minimum share capital for banks (commercial or merchant) from N50Million and N40Million for commercial and merchant banks to N500Million. While some banks were able to meet the minimum capital requirement others who failed had their licenses withdrawn by the CBN (CBN Annual Reports).

To further sanitize the commercial banking market and emplace a sound and more resilient system that could make positive returns to shareholders and enhance sufficient funding for improved performance of commercial banks government introduced a capital reform in 2004

(minimum of 25Billion Naira) and allowed for over a year moratorium to meet the conditions or be wounded up. The number of licensed commercial banks dropped sharply from 89 to 25 by December 2005 being the end of the grace period granted by the CBN.

In 2009, some few years after the start of the N25Billion minimum capital base an examination of the health of the banking sector by the CBN reveals that 8 out of the 24 banks operating were facing some problems- like illiquidity, poor corporate governance and capital inadequacy (Sanusi, 2009). To mitigate the problem of capital inadequacy and low liquidity, the CBN injected a sum of N620B into the 8 banks found to be in need of bailout funds so as to shore up their capital base (Sanusi, 2010).

Umar and Olatunde (2011) based on non- financial measures (primary data) assessed the performance of banks, after 2005 consolidation, using the issue of managerial capability, Oyewole et al (2013) conducted a study on E-banking and bank performance and Abosede et al (2011) on managerial skill found that managers ability has a positive significant effect on bank performance.

Studies on capital reform and bank performance include Somoye (2008) who based his study on aggregate data of 20 out of 25 banks that made the Billion Naira minimum capital requirement and compared changes in some performance indicators of the commercial banks' two years after capital reform with 2004 as the base year. Adegbaju and Olokoyo (2008) on a sample of three banks based on three years before and three years after recapitalization of 2005 assessed performance based on some accounting ratios.

4.0 Data and Methodology
4.1 Sample and Data

The data set for this study includes 14 commercial banks (also referred to as deposit money banks) out of 22 that are presently operating after the CBN capital reform that took effect in January 2005. Data from the financial statements of commercial banks for the period 2007-2011 are used. The sample banks are classified into three sizes. Size A are banks whose mean total deposit liabilities in the five year period is above N1Trillion. Size B is comprised of banks whose mean total deposit liabilities is above N500Billion but below N1Trillion and class C is made of banks whose total deposits liabilities are below N500Billion (see tables 1&2 in the appendix).

4.2 Methodology
Following the study by Revell (1980) who uses interest margin as a performance measure for United States commercial banks, this study also employs a descriptive analysis of some financial ratios computed to measure commercial bank performance in Nigeria. In addition we employ some profitability measurement indicators to measure bank performance- Return on Capital Employed (ROCE), Return on Total Assets (ROA) following the work of Noulas (1999). The benefit of ROA is that it captures the efficiency of bank's management use of assets (white et al, 1997). We also estimated changes in asset acquisition in the period of the study to determine relative improvement in total assets after the mandatory increase of banks equity to a minimum of N25Billion by the regulatory authority.

5.0 Results
5.1 Total Asset Performance
The total asset performance is concerned with the assessment of the increase or reduction in assets of the banks after capital reform. We found that in the period of the study, in absolute terms the value of their assets appears to be experiencing increase in nominal terms. But considering the relative change from 2007 all the banks experienced reasonable increase in total assets from 2007 to 2008 but total assets dropped significantly across all banks in 2009.

In 2010, total asset performance improved; 8banks improved total asset value while 5 banks experienced a reduction in total assets. The position improved slightly in 2011 as 9 banks improved their assets and 2 experienced a drop, others had incomplete information (see table 7 in the appendix).

The performance indicator evidences that size of the bank does not matter as a bank in category C doubled its total assets in 2008 while some others in the same category experienced increase in assets for as high as 93% but banks in size A experienced increased assets ranging between 52-90% in the same year. Other banks in the sample, irrespective of the size, experienced fluctuating changes in total assets in the period of the study.

The mean performance of asset growth shows that all the banks experienced positive growth rate irrespective of their size throughout the period of study. This ranges between 4-33% while 10 banks on average grew at a rate that is above 10%, 4banks had an average growth rate that is

below 10%. It is pertinent to note that some banks in group C had a higher average growth rate than some of those in size A and or B (see table 8 in the appendix).

5.2 Profitability Performance

A common measure of bank performance is profitability indicator like ROA and ROCE. The ROCE ratio was highest in 2007 for majority of the banks but only 5 banks improved on their profit performance in 2008. In 2009 11 banks could not improve on their 2008 records but the position improved significantly in 2010 as all the banks improved on their profit performance. The position dropped in 2011 except for some very few banks that improved on the immediate year position (see table4 in the appendix).

ROA ratio trend is not generally different from the ROCE, 2010 was the year in which all banks except one made a positive return on assets. But the situation in 2011 dropped for some banks when compared with 2010.

The mean performance of these two ratios indicate that ROA and ROCE range between -8.02-3.59 and -24.9-22% respectively. One bank had a negative ROA while 3 banks had a negative ROCE and all the others had a positive profit performance on total assets and capital employed.

7 banks were able to generate above 10% profit on capital employed and the rest generated a mean ROCE of below 10%. 8 banks generated above 1% profit on total assets while 6 banks generated below 1% (see table 8 in the appendix).

5.3 Net interest Margin Performance

The net interest margin of each bank is measured from the product of interest income less interest expense divided by total assets. We found that all the banks in the sample had a positive net interest margin which ranges between 3.9-6% in the period of the study. This implies that all the sample banks are performing well in the management of their inflow and outflow of interest. The best performing bank had an NIM of 6.08% and the least had 3.90%. It was also found that size does not matter in the management of the net interest margin because a medium size bank performed better than a big bank and a small bank performed better than a medium size bank (see table 8 in the appendix).

6.0 Conclusion

This paper measures the performance of deposit money banks in a micro sense for the period 2007-2011. Evidence from our study tends to suggest that sample banks are experiencing fluctuating performance in the period of study. While the profitability indicator supports that 2010 was the best performing year, asset growth indicate a variable growth rate in which some small banks grow at a rate that is higher than medium or big banks. Lastly, we conclude that size of commercial banks in Nigeria based on deposit classification does not imply higher profitability performance.

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Appendix

Table 1

Total Deposit Liabilities of Listed Commercial Banks (7).

Year	One N Billion	Two N Billion	Three N Billion	Four N Billion	Five N Billion	Six N Billion	Seven N Billion
2007	205.2	211.6	84.0	78.6	581.8	188.0	290.8
2008	351.8	403.7	229.9	176.7	661.6	251.6	357.0
2009	405.7	449.0	310.7	379.7	1244.0	272.6	662.3
2010	440.5	378.7	243.8	288.8	1330.8	334.9	713.0
2011	522.6	544.2	215.4	327.3	1783.8	410.6	964.1
total	1925.8	1987.2	1076.8	1251.1	5602.0	1457.7	2987.2
mean	385.16	397.44	215.36	250.22	1120.4	291.54	597.44

Source: Annual Reports of the Commercial Banks 2007-2011

Table 2
Total Deposit Liabilities of Listed Commercial Banks (7).

Year	Eight N Billion	Nine N Billion	Ten N Billion	Eleven N Billion	Twelve N Billion	Thirteen N Billion	Fourteen N Billion
2007	72.4	75.0	269.3	897.6	417.4	125.4	568.0
2008	98.9	106.9	501.6	1258.0	649.3	136.1	1161.5
2009	170.4	184.7	452.9	1151.1	782.0	94.8	1111.3
2010	187.6	160.5	471.0	1119.1	598.9	121.5	1289.6
2011	295.9	199.3	642.6	1216.4	399.2	147.4	1576.0

total	825.2	726.4	2337.4	5642.2	2846.8	625.2	5706.4
mean	165.04	145.28	467.48	1128.44	569.36	125.04	1141.28

Source: Annual Reports of the Commercial Banks 2007-2011

Table 3

Categorization by Deposit Liabilities Based on the Mean of 5years

Name of Bank	Group A - BIG Above 1 Trilion Naira	Group B -- MEDIUM Between 1trillion And N500Billion	Group C- SMALL Below N500Billion
One			*
Two			*
Three			*
Four			*
Five	***		
Six			*
Seven		**	
Eight			*
Nine			*
Ten			*
Eleven	***		
Twelve		**	
Thirteen			*
Fourteen	***		

Source: Computed by the Authors

Table 4: Return on Share Capital in %

	2007	2008	2009	2010	2011
One	5.0116	11.0709	0.0241	9.6812	8.6187
Two	16.3156	12.8729	-8.2058	8.1005	-16.6558
Three	28.9937	-2.8267	-8.0833	13.0763	19.0102
Four	14.7978	11.6263	3.5313	6.1922	N/A
Five	28.5672	11.1874	13.1347	9.8425	9.7300
Six	-5.1160	-3.5702	0.5657	5.6188	-11.8732
Seven	32.3618	16.8880	14.3041	22.1648	26.3145
Eight	12.1461	13.7597	9.4742	13.1345	8.0678
Nine	2.2585	20.1627	-40.9760	14.0129	N/A
Ten	25.7721	21.7628	2.4400	10.6214	0.8985
Eleven	17.3613	29.0383	7.3126	4.6050	-0.2593
Twelve	15.8543	26.7329	-112.3904	9.1233	-64.0393
Thirteen	7.4603	N/A	N/A	87.3753	-111.9439
Fourteen	20.6400	14.4642	9.6695	9.5130	10.2921

Source: Computed by the Authors

Table 5 : Return on Total Assets in %

	2007	2008	2009	2010	2011
One	1.8003	1.8454	0.0064	2.4305	1.6932
Two	2.8159	2.4960	-1.4993	1.7265	-2.1315
three	3.2423	-0.2076	-1.6712	1.6149	1.6165
Four	2.0279	2.9629	0.9062	1.7416	N/A
Five	2.8965	3.2622	2.7653	1.7135	1.2539
Six	-0.6029	-1.0140	0.1575	1.4271	-2.3490
Seven	3.2089	3.7881	2.6433	4.2629	4.0707
Eight	2.8886	3.0489	2.1574	2.7339	1.1053
Nine	0.4146	2.5780	-4.4120	1.4209	N/A
Ten	1.6854	2.6023	0.3452	1.6979	0.8985
Eleven	2.5958	3.5943	0.8824	0.6034	-0.0266
Twelve	2.4718	3.2793	-30.9771	-1.2389	-13.6281
Thirteen	1.1380	N/A	N/A	6.3817	-3.3855
Fourteen	2.6347	2.9142	2.0184	1.8629	1.7237

Source: Computed by the Authors

Table 6: Net Interest Margin in %

	2007	2008	2009	2010	2011
One	2.6730	2.5146	5.1135	5.4817	5.1087
Two	5.0939	3.7680	4.0947	8.9652	7.3404
Three	4.2575	4.2527	6.5391	4.5359	3.3993
Four	4.0619	4.1362	6.5950	5.5188	N/A
Five	5.1944	4.9360	5.2212	5.7696	6.1602
Six	3.6121	4.4450	3.1519	3.5850	4.7413
Seven	3.8197	4.8364	7.2055	7.1074	6.2637
Eight	3.1195	6.3483	7.2755	6.9230	5.3211
Nine	4.4282	4.9558	6.0556	5.5740	N/A
Ten	N/A	N/A	7.6480	5.9247	4.6949
Eleven	3.8140	4.6917	7.6336	4.3924	3.7405
Twelve	5.4958	5.3253	N/A	4.3187	2.6039
Thirteen	7.4752		N/A	2.7912	5.2756

		N/A			
Fourteen	4.8967	5.2291	6.5588	4.6924	5.4745

Source: Computed by the Authors.

Table 7: Relative Change in Total Assets in %

	2007	2008	2009	2010	2011
One		130.9597	-37.2409	12.2589	30.1263
Two		93.2192	0.1118	-9.2050	31.8313
Three		38.8799	-97.9174	16.2143	63.6941
Four		145.5154	-5.4320	-5.1858	N/A
Five		52.7710	43.0697	17.3823	46.1314
Six		77.0169	-1.1027	15.2131	11.9229
Seven		50.0932	42.0490	4.5937	42.9569
Eight		13.5335	-4.2608	12.5716	45.5326
Nine		62.0164	-13.0494	26.2296	N/A
Ten		75.9366	- 20.7311	8.3419	32.4586
Eleven		37.8959	1.8544	-7.4695	15.5541
Twelve		46.3495	1.5606	8.6255	-15.6820
Thirteen		N/A	N/A	N/A	9.3992
Fourteen		90.0923	-6.3742	13.7467	20.4115

Source: Computed by the Authors.

Table 8: Mean Performance of Commercial Banks % (2007-2011)

	Growth Rate of Assets	Return on Assets	Return on Capital	Net Interest Margin
One	27.22	1.56	6.88	4.19
Two	23.19	0.68	2.49	5.85
Three	4.17	0.92	10.03	4.60
Four	33.72	1.91	9.04	5.08
Five	31.87	2.34	14.49	5.46
Six	20.61	0.48	2.88	3.91
Seven	27.94	3.59	22.41	5.85
Eight	13.48	2.34	11.32	5.80
Nine	18.80	0.0003	-1.14	5.25
Ten	19.20	1.45	12.30	6.09
Eleven	9.57	1.53	11.61	4.85
Twelve	8.17	-8.0186	-24.94	4.44
Thirteen	4.70	0.8268	-3.42	5.18
Fourteen	23.58	2.23	12.92	5.37

Source: Computed by the Authors