MERISTEM

Banking Sector Update: Recapitalization - Then & Now

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Two decades after the 2004 reforms that significantly increased the minimum capital requirement (MCR) for Nigerian banks, the Central Bank of Nigeria (CBN) has announced another review to MCR. This new directive mandates banks across various categories to boost their MCR within a two-year timeframe (April 1, 2024, to March 31, 2026). The focus of the increase lies in Tier 1 capital, specifically share capital and share premium excluding shareholders funds. This emphasis suggests the CBN prioritizes fresh capital injections rather than simply relying on existing reserves. This is aimed at strengthening banks' core equity base, allowing them to cushion the effect of any loss more effectively, and fueling further expansion within the banking sector. This is not the first time Nigerian banks have had to raise their capital base.

MCR History in Nigeria

Year	MCR
1988	10 Million
1991	50 Million
1997	500 Million
2001	1 Billion
2002	2 Billion
2005	25 Billion

N.B:

Following the Global Financial Crisis (GFC), the CBN under the leadership of Lamido Sanusi introduced new guidelines for Deposit Money banks and classified them into three: Regional, National and International. Regional banks must have a minimum paid up capital of NGN10bn, while national must have NGN25bn and international NGN50bn. This came fully on board in 2010.

Type of Bank	Authorization	Old MCR (NGN'bn)	New MCR (NGN'bn)	Growth (%)
Commercial	International	50	**500**	900.00
	National	25	**200**	700.00
	Regional	10	**50**	400.00
Merchant	National	15	**50**	233.33
Non-Interest	National	10	**20**	100.00
	Regional	5	**10**	100.00

Pre-2004 Nigerian Banking: A Sector Ripe for Reform

Nigeria's banking sector before 2004 faced a multitude of challenges. Numerous banks existed, but many suffered from a critically low capital base. This limited their ability to finance large-scale businesses and investment portfolios. The sector was also dominated by various small banks with limited branch networks.

Furthermore, the pre-2004 era witnessed:

- **Poor bank ratings**: Regulatory scrutiny revealed deterioration in overall bank performance based on CAMEL parameters (Capital, Asset quality, Management, Earnings, Liquidity).
- **Weak corporate governance**: This included inaccurate reporting, non-compliance with regulations, and declining ethical standards.
- **Non-performing loans**: A significant portion of loans were classified as non-performing, particularly those connected to insiders.

- **Overdependence on public sector deposits**: Banks relied heavily on deposits from the public sector, leaving them vulnerable to fluctuations.
- **High distress rates**: Deregulation of the banking sector in the 1986-1990 period led to a rise in bank distress.

A Bold Reform Agenda

In response to these issues, the CBN Governor at the time, Charles Soludo, implemented a comprehensive reform program in July 2004. This 13-point plan aimed to consolidate the banking sector and prevent future systemic distress. A cornerstone of the reform was a 12.50x increase in the MCR. Banks needed to raise their unimpaired capital (excluding loan losses) from NGN2bn to NGN25bn (USD190.80mn) by December 31, 2005. Meeting this new standard could only be achieved through mergers, acquisitions, or fresh capital injections. This focus on consolidation was a novel approach, as previous capital increases had not mandated such restructuring, and the Nigerian banking sector had limited experience with mergers and acquisitions.

The 2004 bank recapitalization exercise in Nigeria marked a turning point for the financial sector. The increment of the banks' minimum capital base to NGN25bn in 2006 led to a significant reduction in the number of banks from 89 to the "Super 25" while non-compliant banks had their licenses revoked by the CBN. Following the merger of IBTC-Chartered Bank Plc and Stanbic Bank Ltd in September 2007, the number of consolidated banks in Nigeria stood at twenty-four (24) at the end of 2007.

Benefits of the 2004 Reform

- The consolidation process resulted in the emergence of 24 stronger banking groups, encompassing 75 of the original banks. These consolidated entities held a dominant share, accounting for 93.50% of total deposit liabilities within the banking system. This shift instilled greater confidence among stakeholders and depositors, who previously might have resorted to less secure methods of saving money.

- At the end of the consolidation exercise, the total capitalization of the 25 successful banks came to NGN755bn as against NGN324bn before the commencement of the 2004 banking sector reforms. This led to increased capacity of banks to finance large-scale projects and support major initiatives in sectors like manufacturing and telecommunications. A prime example is the USD150mn (NGN19bn) consortium loan provided by 13 domestic banks in 2008 for the purpose of expanding the second phase of the largest cement plant in sub-Saharan Africa, located in Obajana, Kogi State, and to kick start the cement plants in Ibese and Senegal. Another crucial aspect of the 2004 reform was the implementation of the Wholesale Dutch Auction System (WDAS). This system aimed to unify the official and parallel foreign exchange rates within Nigeria. By liberalizing foreign exchange transactions, the reform sought to reduce distortions and mitigate inflationary pressures in the economy.
- The reforms led to a more stable and transparent banking sector with renewed investor confidence and higher foreign investment. This influx of capital provided additional resources for banks to expand their lending activities and support economic growth. Nigerian banks raised NGN406.40bn from the capital market, out of which NGN360.00bn was verified and accepted by the CBN as at end-December 2005. As a result, aggregate capital base of the sector rose from about USD3.00bn to USD5.90bn. The programme also attracted NGN350.20bn (c. USD3.00bn) in new investments and USD500.00mn from foreign direct investment (FDI) inflow.
- The reform also increased public awareness and the deepening of the capital market, as the aggregate capitalization of banks as a share of the stock market capitalization rose from 24% to 41.80% in December 2006.
- The banking sector experienced major financial deepening between 2004 and 2008. A broad measure of financial depth is the ratio of broad money stock (M2 – currency plus demand and interest-bearing liabilities of banks and other financial intermediaries) to GDP, which increased from 18% in 2005 to 20.30% in 2006 and rose further to 38% post-recapitalization. Additionally, the recapitalization saw an increase in credit to the private sector from 13.20% to 33.50%.

Table 1: The 2004 Merger & Acquisition of Nigerian Banks in Nigeria

S/N	Bank Name	Members of the Group
1	Access Bank Plc	Marina Bank, Capital Bank International, Access Bank
2	Afribank Plc	Afribank Plc, Afrimerchant Bank
3	Bank PHB Plc.	Plantinum Bank Limited and Habib Nig. Bank Limited.
4	Diamond Bank Plc	Diamond Bank and Lion Bank
5	Fidelity Bank Plc	Fidelity Bank, FSB Intl. Bank, Manny Bank.
6	First Bank of Nig. Plc	First Bank Plc, MBC, Intl Bank And FSB (Merchant bank)
7	Equitorial Trust Bank PLC	Equitorial Trust Bank Ltd and Devcom Bank ltd.
8	First City Monument Bank Plc	First City Monument Bank, Coop Dev. Bank, Nigeria-American Bank and Midas Bank
9	FirstInland Bank Plc	First Atlantic Bank, Inland Bank, Nigeria Plc, IMB Intl. Bank Plc And NUB Intl. Bank.
10	IBTC Chartered bank plc	IBTC, Chartered Bank Plc and Regent Bank Plc.
11	Intercontinental Bank plc	Citizen international bank, ACB international bank, Guidance Express bank, Omega Bank
12	Oceanic Bank Intl. plc	Oceanic Bank Intl. Plc and International Trust Bank.
13	Skye Bank plc	Prudent Bank Plc, Bond Bank Ltd, Reliance Bank Ltd, Cooperative Bank Plc and ETB Intl. Bank ltd.
14	Spring Bank Plc	Guardian Express Bank, Citizens Bank, Fountain Trust Bank, Omega Bank, Trans International Bank, ACB
15	Sterling Bank Plc	Magnum Trust Bank, NBM Bank, NAL Bank, INMB, Trust Bank of Africa
16	UBA Plc	United Bank for Africa Plc, Standard Trust Bank Plc, and Continental Bank
17	Union Bank of Nigeria Plc	Union Bank of Nigeria Plc, Union Merchant Bank Ltd Broad bank of Nigeria Ltd and Universal Trust bank Nigeria Plc.
18	Unity Bank Plc	New Africa Bank, Tropical Commercial Bank, Centre -Point Bank, Bank of the North, NNB, First Interstate Bank, Intercity Bank, Societe Bancaire, Pacific Bank
19	Wema Bank PLC	Wema Bank PLC and National Bank of Nigeria LTD
20	Ecobank Nigeria Plc	Ecobank Nigeria Plc
21	Stanbic Plc	Stanbic Plc
22	Standard Chartered Bank	Standard Chartered Bank
23	Nigeria International Bank	Nigeria International Bank
24	Guaranty Trust Bank	Guaranty Trust Bank

Source: ***Meristem Research***

In line with President Tinubu's vision of a USD1trn economy in 2030, the new recapitalization directive is a strategic move to drive economic activities, fostering job creation and maximizing production. This reform directly addresses key areas crucial for economic growth: deepening of the financial sector, maximizing production, and propelling business expansion through increased lending capacity. Furthermore, a stronger banking system fosters global integration, attracting foreign investment and facilitating international trade. This aligns Nigeria with regional and international best practices, creating a competitive environment that fuels the nation's economic goals. The urgency for this reform is underscored by the fact that Nigerian banking sector currently has one of the lowest assets-to-GDP ratios compared to global average (16.03% vs. a 74.68% 10-year average).

While Nigerian banks might boast nominal growth in capital base measured in Naira, the devaluation of Naira paints a different picture when measured in dollar terms. The 2024 recapitalization plan recognizes this disparity. Targeting a NGN3.57trn injection (USD2.79bn) dwarfs the USD190.80mn infused in 2005. We believe the recapitalization will go a long way in addressing the true capital needs of the banking sector in today's economic climate.

To meet these new capital requirements, the CBN has offered several options.

- They can raise fresh capital through various methods like private placements or public offerings.
- Alternatively, they can explore mergers and acquisitions which offer economies of scale and a quicker path to compliance, though there is the consideration of potential job losses
- Lastly, upgrade or downgrade of licenses which allows banks to adjust their operational structure based on their capital position and target market.

Table 2: Estimated Funding Gap of Nigerian Banks

Banks	License	Share Capital + Share Premium (NGN'bn)	Minimum Capital Requirement (NGN'bn)	Capital Raise Target (NGN'bn)	Capital Adequacy Ratio (CAR)
ACCESSCORP*	International	251.81	500.00	248.19	19.01%
FBNH*	International	251.34	500.00	248.66	16.00%
FCMB*	International	125.29	500.00	374.71	15.30%
Fidelity Bank*	International	129.71	500.00	370.30	16.10%
GTCO**	International	138.19	500.00	361.81	24.70%
UBA**	International	115.82	500.00	384.19	36.00%
Zenith Bank**	International	270.75	500.00	229.26	22.00%
Citibank***	National	14.44	200.00	185.56	N/A
Ecobank Nigeria***	National	193.04	200.00	6.97	13.70%
Keystone Bank***	National	296.90	200.00	0.00	N/A
Polaris Bank***	National	50.43	200.00	149.57	N/A
Stanbic IBTC*	National	109.26	200.00	90.74	17.90%
Standard Chartered***	National	45.42	200.00	154.58	N/A
Sterling Bank*	National	57.15	200.00	142.85	14.70%
Titan Trust****	National	29.20	200.00	170.80	N/A
Unity Bank**	National	16.33	200.00	183.67	N/A
Wema Bank*	National	15.13	200.00	184.87	13.31%
Globus Bank***	Regional	25.06	50.00	24.94	N/A
Providus Bank***	Regional	31.87	50.00	18.13	N/A
Suntrust Bank***	Regional	11.84	50.00	38.16	N/A
Jaiz Bank*	Non-Interest National	18.62	20.00	1.38	N/A
Lotus Bank***	Non-Interest Regional	13.03	10.00	0.00	N/A
Taj Bank***	Non-Interest Regional	14.06	10.00	0.00	N/A

Source: ***Meristem Research, CBN***

* = 2023FY Unaudited; ** = 9M:2023; *** = 2022FY Audited; **** = 2021FY Audited

In total, Nigerian banks are expected to raise NGN3.57trn in fresh capital within the specified timeframe. As it stands, notable players including **FBNH, FIDELITY, WEMABANK,** and **ACCESSCORP** have signaled their intentions to raise capital through rights issues and private placements. In response to the CBN's policy, we anticipate a surge in capital market activities. **Going forward, more banks are likely to join the fray, seeking to bolster their capital reserves through private placements, rights issues, and public offerings. We expect most banks to explore right issues and other capital raise activities. Furthermore, there's a growing anticipation of potential bank consolidations, particularly targeted at banks unable to meet the regulatory requirements.**

Strategic Challenges and Potential Impacts:

The onus is on the banks to develop effective capital raising strategies within the stipulated timeframe. The capital injection is likely to have a dual impact.

Positives

- Higher capital buffers will strengthen the banking system's resilience and stability.
- Given the relative low valuation of Nigerian banks compared to their regional peers, we expect increased foreign investments and capital flow from international investors which is positive for the external reserves.
- Increased activities and participation in the Nigerian capital market.
- Increased earnings for capital market operators.
- Moderation in exchange rate.

Negatives

- Return on Equity (ROE) will decrease due to the dilution of existing shareholder ownership by the influx of new capital.
- Long-term increase in money supply.

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