Financial Regulation in Low-Income Countries: Balancing Inclusive Growth with Financial Stability. The Nigeria Case

Olu Ajakaiye and Sheriffdeen Tella

This study investigates the potential trade-off between financial sector regulation and financial stability in Nigeria and implications for financial inclusion and inclusive growth. The effects of the existing regulations on the structure of the banking sector which dominates the Nigerian financial system are regarded as very germane to present and future stability of the financial system which itself is necessary for achieving financial inclusion and inclusive economic growth. Quantitative and qualitative analyses of the financial market activities showed that the *raison d'être* for 2004 consolidation and the 2009 post-consolidation reforms were hinged on instability in the banking sector due to critical gaps in regulatory framework and regulations, inadequate supervision and enforcement of regulations, and, instability caused by capital flows.
Acknowledgements

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# Abbreviations

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<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>AFC</td>
<td>African Finance Corporation</td>
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<tr>
<td>AMCON</td>
<td>Asset Management Company</td>
</tr>
<tr>
<td>ATM</td>
<td>Automated Teller Machine</td>
</tr>
<tr>
<td>BDC</td>
<td>Bureaux-de-change</td>
</tr>
<tr>
<td>BOA</td>
<td>Bank of Agriculture</td>
</tr>
<tr>
<td>BOI</td>
<td>Bank of Industry</td>
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<tr>
<td>BSI</td>
<td>Banking System Indicator</td>
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<tr>
<td>CACS</td>
<td>Commercial Agricultural Credit Scheme</td>
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<td>CBN</td>
<td>Central Bank of Nigeria</td>
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<tr>
<td>CIBN</td>
<td>Chartered Institute of Bankers of Nigeria</td>
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<tr>
<td>CIRN</td>
<td>Chartered Institute of Registrars of Nigeria</td>
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<tr>
<td>DFI</td>
<td>Development finance institution</td>
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<td>DMB</td>
<td>Deposit Money Bank</td>
</tr>
<tr>
<td>FMBN</td>
<td>Federal Mortgage Bank of Nigeria</td>
</tr>
<tr>
<td>FSS</td>
<td>Financial System Strategy</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross domestic product</td>
</tr>
<tr>
<td>GIZ</td>
<td>German International Cooperation</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>M2</td>
<td>Broad money</td>
</tr>
<tr>
<td>MFB</td>
<td>Microfinance bank</td>
</tr>
<tr>
<td>MPI</td>
<td>Macro-Prudential Indicator</td>
</tr>
<tr>
<td>NACS</td>
<td>National Clearing System</td>
</tr>
<tr>
<td>NAICOM</td>
<td>National Insurance Commission</td>
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<tr>
<td>NBFI</td>
<td>Non-bank financial institution</td>
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</table>
NDIC  Nigerian Deposit Insurance Corporation
NEEDS  National Economic Empowerment Development Strategy
NEXIM  Nigeria Export-Import Bank
NIRSAL  Nigerian Incentive-based Risk Sharing System for Agricultural Learning
NV  Nigeria’s Vision
PENCOM  National Pension Commission
POS  Point of Sale
RTGS  Real-Time Gross System
SEC  Securities and Exchange Commission
SME  Small and Medium Scale Enterprises
SMECGS  Small and Medium Scale Enterprises Guarantee Scheme
SMEIS  Small and Medium Enterprises Investment Scheme
SSA  Sub-Saharan Africa
UBDN  Urban Development Bank of Nigeria
USAID  United States Agency for International Development
1 Introduction

The global financial crisis that first came to the open in 2007 caught many countries unprepared and thus had devastating effects on many individual country’s economic and particularly financial systems and the world at large. It sent both policy makers and academics involved in financial matters to the drawing board with the intention to bring about short, medium and long term stability into the banking system and prevent future catastrophe. For the Central Bank of Nigeria (CBN), it was time to undertake immediate review of its consolidation reform programmes, more so when the global crisis had started causing financial instability and attendant effects on the Nigerian economy.

The Nigerian banking system has witnessed substantial policy and regulatory developments in the last five decades. The policy and regulatory development witnessed in the banking sub-sector can be categorized into seven distinct phases of banking reforms.  

At the time of the recent global financial crisis, the banking sector was in its sixth phase which actually commenced in 2004. The phase, which has two sub-phases, is regarded as the era of bank consolidation. The first phase regulations were designed to ensure a diversified, strong and reliable banking sector, which will ensure the safety of depositors money, play active developmental roles in the Nigerian Economy and become competent and competitive players both in the African and global financial systems, while the second phase involved encouraging the emergence of regional and specialized banks (CBN, 2004).

What factors necessitated the need for consolidation policy? How far has the policy tampered with the physical structure, market structure and ensure stability of the Nigerian financial system, as per the global financial crisis? What kind of policy is required for future sustainability of success of the consolidation or for moving the financial system towards desirable path of stability, inclusiveness and growth. These questions are very germane to achieving the core of this study.

This case study, like the others in this book, investigates the potential trade-off between financial sector regulation and financial stability in Nigeria. To this end, the effects of the existing regulations on the structure of the financial system and specifically the banking sector which dominates the system in terms of operations and financial stability are regarded as very germane to the to present and future stability of the financial system which itself is necessary for achieving financial inclusion and economic growth. In the next section we look at the constituent part of the Nigerian financial system as shaped by regulations.

1 Details of the phases can be gleaned from Nwankwo, 1980; Soyibo and Adekanye, 1992 and Ajakaiye, 2013.
2 Structure, Size and Role of the Nigerian Financial Sector

2.1 Structure, Size and Reforms of the Nigerian Financial Sector

A major plank for such financial stability was a review of the regulations and the need to balance such with inclusive growth, particularly for developing economies. As noted by Spratt (2013), the ineffective regulation caused the financial instability that devastated the real sector of some economies and finally metamorphosed, through contagion effects, into the global financial crisis.

Two main channels through which regulations could impact on economic growth and financial stability are firstly, through directly influencing the daily behaviour of financial market actors within the context of demand for and supply of credits. Secondly is through indirect effects based, for example, on the structure of the banking system which influences the pattern of lending by the sector (Spratt, 2013). It is therefore imperative to review the structure of the Nigerian financial system as shaped by regulations under recent reforms.

The structure of the Nigerian financial system has not witnessed dramatic changes in the last two decades or more despite policy changes. The structure can be divided broadly into banking and non-banking financial sectors. The two sectors consist of the operations units and the regulatory authorities. The banking sector has commercial banks, merchant banks, development or specialised banks, community banks and their regulatory authorities (e.g. Central Bank of Nigeria and Nigerian Deposit Insurance Corporation) while in the non-bank financial institutions (NBFIs) are insurance companies, pension fund and the stock exchange with such regulatory institutions as the Security and Exchange Commission (SEC), the National Insurance Commission (NAICOM) and National Pension Commission (PENCOM).

However, the physical and operational structure of the banking sub-sector had witnessed structural expansion and contraction in tandem with changing reforms. The reforms, involving regulation, deregulation and re-regulation of the sector were basically carried out to ensure stability, instill confidence in the banking system and improve efficiency. It is imperative at this stage to present the state of the banking sector before the 2004 financial sector reforms. The financial reforms of 2004 were undertaken against the background of:

1. Existence of 89 deposit money banks with weak capital base. The statutory capitalisation requirement was N1 billion and expected to rise to N2 billion by the end of 2005. Thus, the total capitalisation of the banking system at 2004 was N293 million which, according to Soludo (2004) was the capital of the fourth largest bank in South Africa!
2. The aggregate banking credit to the domestic economy was far below 20% of the gross domestic product, such that no Nigerian bank could solely participate in the growing oil and gas industry or provide huge credit to the manufacturing sector. Thus, the contribution of the banking sub-sector to the growth in the real economy was quite low.
3. The sector was not competitive but oligopolistic in nature with high wealth concentration within ten largest banks. Within themselves, they account for over 50 per cent of the industry’s total assets/liabilities;
4. The ratio of banks to population was very low and put at 1:30,432 and the payment system encouraged cash-based transactions;
5. There was high cost of operation arising from infrastructural deficits particularly with respect to inadequate power and the need for the industry to provide such basic but costly item as electricity;
6. Over-dependence on public sector deposits. The banks were merely waiting for deposits from the government and its agencies and engaging in foreign exchange trading.
7. High incidence of non-performing loans. The level of saving in the economy was low while the demand for credit continued to grow. The mismatch resulted in large spread between saving and lending rates. The high lending rates eventually resulted in high incidence of non-performing loans;
8. The sector was also characterised by poor corporate governance with banks engaging in shady contracts and dealings to meet profitability requirements of the shareholders and lots of nefarious boardroom activities that blew open after the introduction of reforms; and,
9. more than one-third of the banks were within marginal and unsound state (Soludo, 2004).

The situation above invariably promoted financial instability and systemic crisis that made banks to frequent the Central Bank for bailout assistance. Such financial environment required that the regulatory authorities strengthened the regulatory framework and supervisory capacity through revolutionary reforms that was introduced in 2004. The reforms were encapsulated in a 13-Point Reform Agenda presented by Professor Charles Soludo within the short time of becoming the Governor of the Central Bank. The Agenda was to develop local content of the Nigerian banks to contribute to development of the real sectors and also become global player.

In this connection, the Vision of the Reform Agenda as presented by Soludo (2004) were to:

1. establish a banking system that will rapidly drive Nigeria’s economic growth and development;
2. integrate the Nigerian banking system into the global financial system;
3. target at least one Nigerian bank in the top 100 banks in the world within the next 10 years;
4. in the long term, make Nigeria Africa’s financial hub, and
5. to create a new Central Bank of Nigeria (CBN) for the 21st century that is best managed and most effective.

The Central Bank therefore, among other policy initiatives,

1. increased minimum capital requirement from N2 billion ($12million) to N25 billion ($148.8million) within a period of 18 months;
2. introduced phased withdrawal of public sector funds from banks;
3. promoted of mergers and acquisition among banks;
4. adopted of risk focused and rule-based regulatory framework;
5. adopted zero tolerance for late reporting and information rendition; and
6. introduced greater transparency and accountability in operations (Soludo, 2004).

The outcome of the reforms, with respect to the structure of commercial and merchant banking sub-sector, can be gleaned from Table 1. The consolidation activities actually changed the structure of the Nigerian financial system and the banking sub-sector in particular. Over 85 commercial and merchant banks merged to just 24 mega banks with capital base of minimum of N25 billion. At the end of the consolidation exercise, the number of foreign banks reduced to four from 11 while the number of indigenous banks also reduced to 21 from 77.

Table 1: Distribution of Number of Banks by Type of Owners 2000-2010

<table>
<thead>
<tr>
<th>Status</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Privately</td>
<td>76</td>
<td>77</td>
<td>78</td>
<td>77</td>
<td>77</td>
<td>77</td>
<td>21</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>Government</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Foreign</td>
<td>10</td>
<td>11</td>
<td>11</td>
<td>11</td>
<td>11</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td>89</td>
<td>89</td>
<td>90</td>
<td>89</td>
<td>89</td>
<td>89</td>
<td>25</td>
<td>24</td>
<td>24</td>
<td>24</td>
<td>24</td>
</tr>
</tbody>
</table>

Source: Data for 2000 to 2006 was sourced from Abel Ezeoha (2007) while the data for the 2007 to 2010 was sourced from the Analysts Data Services and Resources Limited.

Major implications of the exercise on structure and size of the banks are that there were no medium sized banks to service small and medium scale enterprises needs for fund which are relatively smaller than what the mega banks that emerged were ready to offer; no government owned commercial bank; the ratio of foreign banks to local banks which was 1 to 7 reduced to 1 to 6; and more desirably, the universal banking structure which was introduced in 2002 became effective as the distinction between commercial and merchant banks was obliterated by the outcome of the reform.

At the same time, the banks became major players in the international financial market as two of the banks successfully raised funds from the Eurobond market and banks like United Bank for Africa, Zenith Bank, Guarantee Trust Bank and Access Bank moved offshore to open branches in African countries like Ghana, Kenya and Uganda. By the end of 2007, about ten of them have $2 - $4 billion in market capitalization while about six of them have more than $1 billion in Tier-1 capital (Soludo, 2007).

The funding void created by the merger and acquisition of hitherto medium scale banks with the each other or bigger banks was expected to be filled by community and microfinance banks. Also, the gap in long term funding required for development was expected to be filled by the new structure of the banks – universal banking. However, it soon became clear that the microfinance bank could not play the expected role just as the newly capitalized banks were more active in the short end of the financial markets like commercial rather than universal banks. Commercial banks by nature of their philosophy, which is liquidity and profitability, cannot be expected to lend on long term basis. This situation, coupled with other recurring problems in management of the financial sector (as will be
espoused later) led to policy reversal, particularly when the global financial crisis almost destroyed the post-consolidation gains.

Another chapter of the recent banking sector reform began in 2009 with the change in leadership of the CBN and the immediate decision to rescue some banks that were already in distress and prevent crisis of confidence in the system. This led to the suspension of operations of three banks (Bank PHB, Spring Bank, and Equatorial Trust Bank) which were nationalized by the CBN due to their insolvency and the injection of N200 billion into these banks. The Asset Management Company (AMCON), which was a creation of the post-consolidation reforms of 2009, purchased what was referred to as ‘toxic’ assets of the banks in distress.

At the end of 2010, the structure of the financial institutions shows that:

1. commercial banks or deposit money banks (DMBs – as they are now called) which were 89 before 2004 bank consolidation, were 24 but reduced to 20 in 2011 due to merger/acquisition of four banks that were earlier nationalized by the CBN. However, the number of branches increased from 5,799 in 2010 to 5,810 in 2011.
2. there were five Development Finance Institutions (DFIs) namely Bank of Industry (BOI), Federal Mortgage Bank of Nigeria (FMBN), Nigeria Export-Import Bank (NEXIM), the Bank of Agriculture (BOA), and the Urban Development Bank of Nigeria (UDBN).
3. there were five discount houses and 108 finance companies;
4. the number of microfinance banks (MFBs) was 866;
5. 101 primary mortgage institutions existed
6. Bureaux-de-change (BDC) was 1,959 but in 2011 it increased by 92 due to new ones that were granted approval during the year to bring the total number of BDC to 2,051;
7. 690 security brokerage firms were functional
8. the number of Insurance companies was 73, and
9. there were five Pension funds custodians and 13 Pension fund administrators.

In addition, Nigeria has one of the most active stock exchanges in Africa, the Nigerian Stock Exchange plus an emerging commodity stock exchange; there is one asset management company (AMCON), one commodity and securities exchange. The regulatory bodies were:

- National Insurance Commission (NAICOM),
- National Pension Commission (PENCOM),
- Nigerian Deposit Insurance Corporation (NDIC),
- Securities and Exchange Commission (SEC) and
- CBN.

In terms of clients, number and funds controlled by each component of the financial system, the banking sector dominates, with the commercial and merchant banks dominated by private banks, leading the pack. The funding void created by the merger and acquisition of hitherto medium scale banks with each other or bigger banks was expected to be filled by community and microfinance banks. Also, the gap in long term funding required for development was expected to be filled by the new structure of the banks – universal banking. In general, the the sequence of reforms and regulations in the financial sector over the years have been reactive in response to current or emerging challenges (Okezie, Tella and Akingunola, 2011;
Okezie, 2012) and implementation of policies is often slower than the dynamism in the global financial activities.

2.2 The Financial Sector in Nigeria’s Vision 20:20:20

Nigeria currently runs a development programme tagged Vision 20:2020 or NV 20:2020 which is a long term economic transformation blueprint spanning the period 2009 to 2020 to stimulate the country’s economic growth and launch her into “a path of sustained and rapid socio-economic development”. Before the launching of the NV 20:2020 were two earlier plan documents namely, National Economic Empowerment Development Strategy (NEEDS) which was launched in 2004 and the Seven Point Agenda introduced in 2007. The NV 20:2020 encapsulates these two documents in terms of their key principles and thrusts (Nigeria Vision 20:2020, 2009).

According to the NV 20:2020, it is the intention of “the Federal Republic of Nigeria to become one of the top twenty economies in the world by the year 2020, with an overarching target of no less than $900 billion in GDP and a per capita income of no less than $4000 per annum.” The two broad objectives to achieve these are that the country:

1. optimises her human and natural resource potential to achieve rapid and sustained economic growth; and
2. translate economic growth into equitable social development that guarantees a dignified and meaningful existence for all her citizens.

The Vision’s objectives are to be achieved through well-articulated fiscal and monetary policies. To achieve the monetary policy objectives, the Central Bank developed a vision integrating outstanding issues in the earlier Reform Agenda of 2004 and established a well-articulated strategic plan for the Nigerian financial system that would aid in achieving the new national goals. The Vision was tagged Financial System Strategy 2020 (FSS 2020) with the following broad objectives:

1. to develop a shared vision and an integrated strategy for the nation’s financial system;
2. to develop market and infrastructure strategies that align fully with the strategic intent of the overall system;
3. to develop a partnership of all key stakeholders for the implementation of the strategy with a performance management framework; and
4. to establish a communication and collaboration environment for the development and delivery of the strategy. (CBN, 2007).

The key elements to achieve the objectives include:

1. strengthening domestic financial markets;
2. enhancing integration with external financial market particularly in ECOWAS and Africa generally;
3. building an International Financial Centre such as the African Finance Corporation (AFC);
4. further liberalisation of the foreign exchange market and reforms of the payment system;
5. pursuing macroeconomic stability;
6. promoting convertibility of the domestic currency; and
7. ensuring regulatory capacity and framework to meet the changing and emerging local and global needs.
In his appraisal of the achievement of the 13-Point Agenda and the FSS 2020, Soludo (2008) posited that in the Nigerian banking sector, as at end of 2007:

1. has asset base that grew by approximately 277% between 2003 and 2007;
2. there were 11 out of the 24 banks with over $1 billion in Tier 1 capital;
3. there were 16 branches of Nigerian banks within Africa and 7 outside the continent;
4. share of the banking sector in Nigeria Stock Exchange rose from 30% of the 20 capitalised stocks in 2003 to 65% in 2007; and
5. Fitch rating of Banking System Indicator (BSI) and Macro-Prudential Indicator (MPI) improved significantly.

How these achievements have impacted the growth and development of the real sector of the Nigerian economy with inclusive growth and encourage financial stability are examined next.

2.3 The Nigerian Banking Sector and Economic Performance

Since the publication of the seminal works of McKinnon (1973) and Shaw (1973) on the importance of the financial sector in promotion of economic growth, the results of studies relating to the role of financial deepening on economic growth remain inconclusive as some studies found positive relationships between the development of the financial sector and economic growth while others found negative relationships. The importance of the banking sector in particular is emphasized in the literature (King and Levine, 1993). The argument is that bank-based financial system provides information regarding investment opportunities and direct resources to productive networks or areas thus facilitating economic growth process (Beck et al, 2011). Levine (1997) posited that the financial system can enhance economic growth through five functions that the system performs namely

1. fund mobilisation or intermediation,
2. resource allocation,
3. risk sharing and reduction,
4. facilitation of exchange of goods and services, and
5. exerting corporate controls.

Griffith-Jones and Ewa Karwowski (2013) are of the opinion that financial sectors in Africa can support growth on the continent by helping to ‘mobilise sufficient savings, intermediating savings at low cost and long maturity to investors and consumers and helping companies and individuals manage risks.’ The key words here are sufficiency of saving and long term maturity of credits as absence of these factors will simply imply provision of working capital that keep businesses going rather that building investment.

Since the 2004 reforms, the Nigerian financial system remains one of the fastest growing financial sectors in Africa in terms of structure, competitiveness and outreach or openness. In this context and as already alluded to, foreign banks are not only part of the domestic banking institutions but Nigerian banks have opened branches in many African countries and outside the continent. This has some implications for stability of the financial sector and the economy as noted in a research by the International Monetary Fund (IMF, 2009).

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By the time Charles Soludo was completing his tenure as Governor of the Central Bank, he identified some issues he termed ‘unfinished businesses. Among these unfinished businesses are:

1. The need to manage macro vulnerability and volatility arising from integration of the Nigerian economy to the international financial markets with consequence on real exchange rate and shocks arising from not paying special attention to the flow of hot money or portfolio investment. Foreign capital flows (FDI and portfolio) which was $433 million in 2003 grew to $9.6 billion or by 137% in 2007.
2. Inability to achieve revamping of the payment system with respect to improving Real Time Gross System (RTGS) and overall National Clearing System (NACS) including boosting of electronic banking;
3. Inability to achieve desired financial deepening which was just 31% at as end of 2007;
4. Problems of supervision of international subsidiaries of Nigerian banks and implementation of Basel ll provisions;
5. Mainstreaming microfinance banks to achieve desirable goal of credit delivery to small and medium scale enterprises as well as deepening the capital market; and
6. Inability to make Nigeria an international financial centre.

At the time Sanusi Lamido Sanusi assumed office as the Governor of the Central Bank in 2009, he noted that that the Nigerian banking system had witnessed dramatic growth post-consolidation but affirmed that “neither the industry nor the regulators were sufficiently prepared to sustain and monitor the sector’s explosive growth” (Sanusi, 2010). Thus, at that time, the banking sector was again in the mood for distress. Sanusi identified and discussed eight main factors that made it possible for the global financial crisis to turn the Nigerian financial system into a fragile entity he received from Charles Soludo. The factors are:

1. Macroeconomic instability caused by large and sudden capital inflow;
2. Major failure in corporate governance at banks;
3. Lack of investor and consumer sophistication;
4. Inadequate disclosure and transparency about financial position of banks;
5. Critical gaps in regulatory framework and regulations;
6. Uneven supervision and enforcement;
7. Unstructured governance and management process at the CBN/Weaknesses within the CBN; and
8. Weaknesses in the business environment (Sanusi, 2010).

In order to correct the precarious situation he met on ground, Sanusi proposed a blueprint built around four pillars for reforming the financial system in the next decade. These are:

1. Enhancing the quality of banks;
2. Establishing financial stability;
3. Enabling healthy financial sector evolution; and
4. Ensuring the financial sector contributes to the real economy.

It is clear from these pillars that the issue of external focus in CBN policy has been halted. There was also immediate reversal of universal banking and introduction of national and regional banks to diminish the status of mega banking. By implication,
the 13-point agenda remained unfulfilled. But what is the status of the financial sector today? Let us consider some statistics.

A cursory look at Table 2 and figure 1 shows that there is no steady pattern of supply of credit to either the public or private sector of the Nigerian economy. The growth rate of credit to the economy fluctuated widely over the period 2004-2013. For most of the period when consolidation reforms started in 2005 and up to 2008 there was steady increase in credit to the private sector but the trend changed from 2009 when government borrowing suddenly increased and this resulted in crowding-out the private sector. The massive borrowing by the government coincided with the time the government revenue fell due to the global crisis that affected oil prices, though temporarily, and it was trying to bail out distressed sectors of the economy such as textile industry, the airlines and recapitalizing development banks to be able to play the roles of assisting in revamping the economy.

Table 2: Selected Financial Indictors of Nigerian Banks, 2004-2013

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<tbody>
<tr>
<td>Net Domestic Credit</td>
<td>12.0</td>
<td>14.5</td>
<td>-69.1</td>
<td>276.4</td>
<td>84.2</td>
<td>59.2</td>
<td>10.0</td>
<td>42.4</td>
<td>-7.2</td>
<td>9.4</td>
</tr>
<tr>
<td>Net Credit to Govt.</td>
<td>-17.9</td>
<td>-37.0</td>
<td>-732.8</td>
<td>-22.3</td>
<td>-31.2</td>
<td>25.9</td>
<td>51.3</td>
<td>52.7</td>
<td>-393.8</td>
<td>4.6</td>
</tr>
<tr>
<td>Net Cr. to Private Sector</td>
<td>26.6</td>
<td>30.8</td>
<td>32.1</td>
<td>94.3</td>
<td>59.2</td>
<td>25.1</td>
<td>-3.8</td>
<td>31.6</td>
<td>6.8</td>
<td>7.1</td>
</tr>
<tr>
<td>Cr. to Private/GDP (%)</td>
<td>12.5</td>
<td>12.6</td>
<td>12.3</td>
<td>17.8</td>
<td>28.5</td>
<td>36.7</td>
<td>18.7</td>
<td>16.9</td>
<td>20.6</td>
<td>19.7</td>
</tr>
<tr>
<td>M2/GDP (%)</td>
<td>18.7</td>
<td>18.1</td>
<td>20.5</td>
<td>24.8</td>
<td>33.0</td>
<td>38.0</td>
<td>20.4</td>
<td>19.2</td>
<td>19.5</td>
<td>18.9</td>
</tr>
<tr>
<td>Saving Rate (%)</td>
<td>4.4</td>
<td>3.3</td>
<td>3.3</td>
<td>3.2</td>
<td>3.6</td>
<td>3.6</td>
<td>1.5</td>
<td>1.4</td>
<td>1.8</td>
<td>2.0</td>
</tr>
<tr>
<td>Prime lending Rate (%)</td>
<td>18.9</td>
<td>17.8</td>
<td>17.3</td>
<td>16.5</td>
<td>16.1</td>
<td>19.0</td>
<td>15.7</td>
<td>16.8</td>
<td>16.9</td>
<td>16.6</td>
</tr>
<tr>
<td>Interest Rates Spread</td>
<td>14.5</td>
<td>14.5</td>
<td>14.0</td>
<td>13.3</td>
<td>12.5</td>
<td>15.4</td>
<td>14.2</td>
<td>15.4</td>
<td>15.1</td>
<td>15.6</td>
</tr>
<tr>
<td>Inflation Rate</td>
<td>10.0</td>
<td>10.0</td>
<td>8.6</td>
<td>6.6</td>
<td>15.1</td>
<td>13.9</td>
<td>13.1</td>
<td>12.3</td>
<td>11.3</td>
<td>10.4</td>
</tr>
</tbody>
</table>


Figure 1: Relationships in the credit market
Figure 2 actually shows that credit to the private sector fell significantly at the peak of the global financial crisis and government was using its might to borrow from the market to meet her financial obligations in the face of dwindling revenue from oil. This ability of the government to borrow without caution contributed in no small way to the financial instability that followed the global crises.

**Figure 2: Net Credit to the private sector, 2004-2013**

![Net Credit to Private Sector](figure2.png)

Actually, the domestic credit growth between 2006 and 2009 was put at 12% to 36% of GDP and in real terms (2002 prices) the domestic borrowing by the private sector grew almost fivefold (Griffith-Jones and Karwowski, 2013). Figure 3 shows the credit growth in real term as presented by the Central Bank.

**Figure 3: Nigerian Private Sector Credit Extension, 2003-2013**

![Private sector credit (real in 2002 prices)](figure3.png)


The ratio of private sector credit to GDP and the ratio of broad money (M2) to GDP depict financial depth (Table 2). The improvement in credits to the private sector promoted financial deepening as percentage of financial depth steadily rose to peak
at 36.7 per cent in 2009 but a steady decline to 16.9% in 2011 before marginal increase in 2012. The same trend is noticed in the M2/GDP ratio. Both ratios represent shallowness of the Nigerian financial market. Table 2 also presents savings interest rates, prime lending rates and interest rates spread (also see Fig. 4). The interest rates spread can be used to measure the level of efficiency in the market and as such, its high values indicated gross inefficiency of the financial system. Using the relationship between the interest rates on saving and the inflationary rates, it is clear, , that the real interest rates on saving have been negative and so cannot encourage saving while the positive real interest on loans could discourage investors. If we then look at the total picture in terms of growing credits to the economy, particularly to the private sector before 2009, which mirrors the demand for credit, it can be deduced that the credit so required cannot be for investment in the real sector but largely for working capital requirements of the surviving firms.

**Figure 4: Relationships among price variables – interest rates and inflation, 2004 -2013**

Although the Table 2 shows that there was a shift in credit from private sector to public sector from 2009, it is imperative to note that the growth in credit to the private sector for the period it lasted must of necessity have long term effects on the economy. This implies that if the credits were truly provided for real sector investments, the multiplier effects would lead to financial empowerment and inclusion as well as employment generation in the medium to long term. As it were, the credit to the private sector was basically short-term (Table 3) and it can be inferred that, coming at the time of massive capitalisation and consolidation, the banks were in the business to possibly make short term profits rather than investments in real sector to expand production capacity. The consequence was the attendant financial instability and distress.
Table 3: Maturity of DMBs Credits/Sectorial Shares, 2007-2011

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term (%)</td>
<td>75.8</td>
<td>75.4</td>
<td>70.3</td>
<td>65.3</td>
<td>60.0</td>
</tr>
<tr>
<td>Medium-term (1-3 years) %</td>
<td>13.5</td>
<td>14.5</td>
<td>14.3</td>
<td>14.6</td>
<td>15.2</td>
</tr>
<tr>
<td>Long-term (3 years above) %</td>
<td>10.7</td>
<td>10.1</td>
<td>15.3</td>
<td>20.1</td>
<td>24.8</td>
</tr>
</tbody>
</table>

Credit to:

<table>
<thead>
<tr>
<th>Priority Sector (%)</th>
<th>25.9</th>
<th>26.2</th>
<th>25.2</th>
<th>30.4</th>
<th>36.1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less Preferred Sector (%)</td>
<td>41.2</td>
<td>42.0</td>
<td>46.9</td>
<td>47.8</td>
<td>45.8</td>
</tr>
<tr>
<td>Unclassified (%)</td>
<td>32.9</td>
<td>31.8</td>
<td>27.9</td>
<td>21.8</td>
<td>18.1</td>
</tr>
</tbody>
</table>


Based on experience exhibited in other continents, Griffith-Jones and Karwowski (2013) opined that fast credit growth could exacerbate vulnerabilities and enhance the risk of financial crises. This became a reality in the case of Nigeria because when Sanusi Lamido Sanusi came on board as the Governor of the Central Bank in 2009, a new issue of distress in the banking sector was exposed and operation of four banks had to be suspended before further action and to prevent systemic failure of the banking system. Non-performing loans as percentage of gross loans rose sharply from 9.5% in 2007 to almost 30% in 2009. The nine financial institutions that were close to collapse had to be rescued at the cost of US$4 billion. The cost of cleaning up the balance sheets and recapitalising the banks concerned is estimated at about 2.4 trillion Naira, equivalent to almost 8 per cent of GDP (IMF, 2011).

The Nigerian recurring financial crisis shows there is no reason for complacency about the need for rigorous financial regulation in African economies especially in the face of rapid credit expansion in many SSA markets (Griffith-Jones and Karwowski, 2013). More importantly, the issue of financial stability remains a recurring decimal in the management of the Nigerian financial system, probably not because there are no regulations to check the unwholesome activities that lead to the recurrence but the inconsistent and unsustainable manner of enforcing the regulations. This is part of what Ojo (2010) called maladapted financial system. To provide empirical support to test the stability of the Nigerian financial system, quantitative and qualitative analysis were carried out and the outcomes are subject matter of the next sections.
3 Quantitative and Qualitative Analyses on Nigerian Banks

3.1 Quantitative Analysis of Nigerian Banks

For the quantitative analyses of banking stability, we considered the atheoretical properties of the input and output variables and also the efficient ratios of Nigerian banks. For these statistical properties, the areas of focus relates to the standard deviation, the skewness, Jarque-Bera tests, Kurtosis and mean values. The standard deviation normally identifies the dispersion around the mean values, which itself gives the average of the values around the maximum and minimum values. The skewness shows the direction of dispersion while the Jarque-bera statistics indicates the patterns of distribution which could be normally and asymptotically distributed or otherwise the series is skewed (see Bhardwarj, 2005). Finally, the kurtosis relates to the degree of ‘peakedness’ that the distribution could pattern. Given the normal skewness, Jarque-Bera tests, Kurtosis and mean values, we employed the Banking Stability Index (BSI) which is based on the conditional expectation of default probability measure developed by Huang (1992) to carry out this aspect of the study. The BSI reflects the expected number of banks becoming distressed given that at least one bank has become distressed (see. Carey and Stulz, 2007; Segoniavo and Goodhart, 2009).

Using the data sources of ten surrogate banks from among the 24 banks that were in existence as at 2010¹ we presented statistical analysis of stability of banks in Nigeria. Table 4 shows that the input and output variables in the banking sector are negatively skewed, suggesting high level of instability. That is, the dispersion of the variables from their normal values appears detrimental to the stability of the Nigeria banking sector. The estimates of the kurtosis also show platykurtic (flat head) distribution of these variables as the values for these variables are less than the normal distribution values of 3.0.

¹ The banks are Access, Diamond, First City Monument Bank (FCMB), First Bank of Nigeria (FBN), Guarantee Trust Bank (GTB), Fidelity, Skye, Stanbic IBTC, United Bank for Africa (UBA) and Zenith Bank.
### Table 4: Descriptive Analyses of Banking Stability

<table>
<thead>
<tr>
<th>Measure</th>
<th>EFFIC_RATIO 1</th>
<th>NET_INT_INC 2</th>
<th>NON_INT_EXP 3</th>
<th>NON_INT_INC 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>0.310474</td>
<td>71599.00</td>
<td>75650.00</td>
<td>175692.2</td>
</tr>
<tr>
<td>Median</td>
<td>0.318647</td>
<td>85443.00</td>
<td>87562.00</td>
<td>212750.0</td>
</tr>
<tr>
<td>Maximum</td>
<td>0.327666</td>
<td>109588.0</td>
<td>113288.0</td>
<td>266888.0</td>
</tr>
<tr>
<td>Minimum</td>
<td>0.283846</td>
<td>26832.00</td>
<td>31298.00</td>
<td>68686.00</td>
</tr>
<tr>
<td>Std. Dev.</td>
<td>0.016161</td>
<td>31188.99</td>
<td>31171.30</td>
<td>75711.09</td>
</tr>
<tr>
<td>Skewness</td>
<td>-0.628035</td>
<td>-0.299074</td>
<td>-0.284504</td>
<td>-0.300471</td>
</tr>
<tr>
<td>Kurtosis</td>
<td>1.882262</td>
<td>1.502367</td>
<td>1.476235</td>
<td>1.453454</td>
</tr>
<tr>
<td>Jarque-Bera</td>
<td>5.889681</td>
<td>5.418092</td>
<td>5.511727</td>
<td>5.735284</td>
</tr>
<tr>
<td>Probability</td>
<td>0.052610</td>
<td>0.066600</td>
<td>0.063554</td>
<td>0.056833</td>
</tr>
<tr>
<td>Sum</td>
<td>15.52372</td>
<td>3579950.</td>
<td>3782500.</td>
<td>8784610.</td>
</tr>
<tr>
<td>Sum Sq. Dev.</td>
<td>0.012798</td>
<td>4.77E+10</td>
<td>4.76E+10</td>
<td>2.81E+11</td>
</tr>
<tr>
<td>Observations</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
</tr>
</tbody>
</table>

**Notes:** Column 1 is Efficiency ratio, Column 2 is Net interest income, Column 3 is Non-interest expenses, Column 4 is Non-interest income.

**Source:** Authors Computation

This is further reinforced by the Jarque-Bera statistics which has probability values greater than 0.05; implying an abnormal distribution which is significant at the 5 per cent level. That is, there is a wide swing between the maximum and minimum values of these variables. In essence, the input and output variables of the Nigeria banking sector is highly volatile over the period of 2006 and 2010.

The BIS index is originally expected to be lower for stability in the banking sector such that the closer to zero the higher the level of stability. The figures in Table 5 show that stability has started setting in from 2010. These suggest that the banking sector has hitherto been unstable until around 2010. This conclusion conforms with the results obtained for the descriptive statistics of Table 4.
Table 5: BIS Indices of Banking Stability, 2006-2011

<table>
<thead>
<tr>
<th>Measure</th>
<th>NET_INT_INC</th>
<th>NON_INT_EXP</th>
<th>NON_INT_INC</th>
<th>Deposit_Fund</th>
<th>Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>0.63</td>
<td>0.63</td>
<td>0.63</td>
<td>0.63</td>
<td>0.63</td>
</tr>
<tr>
<td>2007</td>
<td>0.73</td>
<td>0.79</td>
<td>0.55</td>
<td>0.34</td>
<td>0.64</td>
</tr>
<tr>
<td>2008</td>
<td>0.63</td>
<td>0.65</td>
<td>0.71</td>
<td>0.63</td>
<td>0.63</td>
</tr>
<tr>
<td>2009</td>
<td>0.88</td>
<td>0.49</td>
<td>0.79</td>
<td>0.51</td>
<td>0.43</td>
</tr>
<tr>
<td>2010</td>
<td>0.45</td>
<td>0.51</td>
<td>0.28</td>
<td>0.34</td>
<td>0.44</td>
</tr>
<tr>
<td>2011</td>
<td>0.16</td>
<td>0.11</td>
<td>0.27</td>
<td>0.20</td>
<td>0.12</td>
</tr>
</tbody>
</table>

Source: Authors Computation

3.2 Qualitative Analysis of People's Perception of Regulations of Nigerian Banks

The primary data for qualitative analysis were obtained through the administration of well-structured questionnaires. The essence is to solicit for the opinions of the stakeholders about the effectiveness of the Central Bank regulations in shaping some activities of the banks under its jurisdiction. The questionnaires were administered and interviews were conducted with the staff of regulatory and supervisory bodies namely the Central Bank of Nigeria (CBN), the Securities and Exchanges Commission (SEC), the Nigerian Deposit Insurance Corporations (NDIC) and also professional bodies and associations like the Chartered Institute of Bankers of Nigeria (CIBN), Chartered Institute of Registrars of Nigeria (CIRN) among others. In addition, other stakeholders i.e. the bank customers, bankers, investors (prospective and existing) were interviewed and given questionnaires to obtain some essential information bordering on regulations and supervisions of the financial institutions in Nigeria.

We distributed 115 questionnaires among bank stakeholders in Lagos area which serves as the commercial centre of the country and head offices of most of the banks. The information contained in the exercise was gathered from various stakeholders of commercial banking operations in Nigeria which include the bank staff, employees of bank regulators such as the Central Bank of Nigeria (CBN) and Nigerian Deposit Insurance Corporation (NDIC).

Before the commencement of the analysis, tests of measurement tool (Questionnaire) were performed to validate it as the proper data collection tool. Questionnaire tests, as used in this research findings, are to evaluate inquiry of items within; verbally, and to obtain the validity and reliability level. The questionnaire validity test is through the Product Moment Correlation (Pearson) method which is 0.64 and is larger than its critical value counterpart (from Pearson table) at 5 per cent significant level, hence, the questionnaire is considered valid. On the other hand, Cronbach-alpha (Cr) method is used to test for reliability. The Cr value is 0.98 which is larger than the benchmark value of 0.75, hence, the questionnaires were also considered reliable.

Of the 115 questionnaires was distributed, 112 were returned, out of which 104 were usable (completed), yielding a response rate of 90.4 per cent (Table 6). This
response rate considered large enough and sufficient for statistical reliability and
generality (Tabachnick and Fidell, 1996; Stevens, 2002; Pallant, 2002). The
questionnaire has three parts. The first part contains information about
demographic characteristics of the respondents; the second part revolves around the
research questions while the third as well as the final part hinges on the research
hypotheses for its acceptance or rejection at a given level of significance.

**Table 6: Distribution of respondents by sex**

<table>
<thead>
<tr>
<th>SEX</th>
<th>Bank Regulators (CBN/NDIC)</th>
<th>Bank Staff &amp; Employees</th>
<th>Depositors/Other Stakeholders</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Frequency</td>
<td>Percentage</td>
<td>Frequency</td>
</tr>
<tr>
<td>Male</td>
<td>9</td>
<td>81.8%</td>
<td>13</td>
</tr>
<tr>
<td>Female</td>
<td>2</td>
<td>18.2%</td>
<td>18</td>
</tr>
<tr>
<td>TOTAL</td>
<td>11</td>
<td>10.6%</td>
<td>31</td>
</tr>
</tbody>
</table>

*Source: Field Survey, 2014.*

Table 7 which is concerned with issues on corporate governance, moral hazards and
bank stability, shows that overwhelming majority of the respondents agree that the
regulatory efforts of the CBN guaranteed good corporate governance, curbed moral
hazard, reduced the risk of bank failure and secured consumer protection. However, relatively few (35.5%) of the respondents agree that CBN regulatory
efforts promoted transparency in Nigerian banking sector. This is because, people
are concerned about the banks’ declaration of profits when the rest of the economy
are in distress and particularly when people failed to see the contributions of the
banks to the real sector of the economy.

**Table 7: Percentage distribution of respondents by efficacy of CBN regulations in promoting efficiency and stability**

<table>
<thead>
<tr>
<th></th>
<th>Strongly Agree</th>
<th>Agree</th>
<th>Indifferent</th>
<th>Disagree</th>
<th>Strongly Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>CBN Regulations guaranteed good Corporate Governance in Banks</td>
<td>27.3%</td>
<td>72.7%</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>CBN Regulations Reduced moral hazard and bank failure</td>
<td>45.5%</td>
<td>54.5%</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>CBN Regulations Bank secured consumer protection</td>
<td>27.3%</td>
<td>72.7%</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>CBN Regulations improves Transparency in Nigerian Banks</td>
<td>27.3%</td>
<td>18.2%</td>
<td>9.0%</td>
<td>45.5%</td>
<td>-</td>
</tr>
</tbody>
</table>

*Source: Field Study, 2014*
4 Issues in Financial Inclusion

In a recent study conducted by Ajakaiye, Jerome, Olaniyan, Mahrt and Alaba (2014) it was established that Nigeria’s widespread poverty would require making growth inclusive to sustain its alleviation. Such poverty alleviation programme cannot be achieved with the nature of current credit provision that not only tend towards short end of the financial market but are directed towards non-preferred sector of the economy.

The issue of financial inclusion has been in front burner of the activities of the CBN for long but this has not been successful. In the 1970s, the CBN introduced rural banking with the hope of integrating the rural dwellers into the formal banking system but the project failed largely because the banks complained that the costs of running the rural branches were high and they were unprofitable. In 1990s, the CBN introduced People’s Bank and Community Banks, with the former addressing funding of informal sector technical/artisan associations organised into cooperative groups. It was a government-funded bank and it collapsed eventually due to lack of transparency and accountability in operation. Many of the community banks, which were community based, collapsed and the surviving ones were transformed in microfinance banks. In addition, government encouraged the banks to contribute 2% of their profits to the Small and Medium Enterprises Investment Scheme (SMEIS) with imperceptible impact and, hence, was discontinued.

So, in realising the need to directly promote financial inclusion and inclusive growth, the CBN had to step up its developmental functions. The realisation of the inability of the banking system to promote inclusive growth over the years can be gleaned from CBN Report (2010:122):

The real sector plays strategic roles in an economy...The sector has, however, grossly underperformed as a result of various constraints. The major constraints were poor access to credit, the high cost of credit, inadequate power supply and other infrastructural challenges. The constraint of credit has been further exacerbated by the impact of the global financial crisis on the economy, as the pool of loanable funds shrunk significantly. Against this background, the CBN and the federal government initiated measures to boost credit to the real sector.

In this regard, the following represent the initiatives which were introduced in 2009 and 2010 by the five specialised or development banks in partnership with commercial banks or even the CBN:

1. N200 billion Commercial Agricultural Credit Scheme (CACS): In order to promote commercial agriculture in Nigeria, the Central Bank, in collaboration with the Ministry of Agriculture and Rural Development, established the CACS in 2009. The Federal Government issued a bond worth N200 Billion ($1.25 billion) for funding the scheme. By June-2013, N199.37
billion had been disbursed to 273 projects under this scheme and N8.72 billion was repaid by banks for 16 projects financed earlier.

2. **N200 billion Small and Medium Scale Enterprises Guarantee Scheme (SMECGS):** The SMECGS was established in 2010 with the main objectives of fast-tracking the development of the small and medium scale and manufacturing sector of the Nigerian economy; set the pace for the industrialization of the economy; and, increase access to credit by promoters of the SMEs and manufacturers. The *modus operandi* of the scheme is to guarantee 80 per cent of loans extended by participating banks to the recipients and thus cover risks that have prevented the banks to give credits to the real sector. A total of 52 projects worth N2.2 billion were guaranteed between the inception in 2010 and mid-year 2013.

3. **N200 billion SME Restructuring/Refinancing Fund:** To improve the financial positions of the Deposit Money Banks (DMBs) and thereby enhance access of manufacturers to credits, the CBN established the SME Restructuring/Refinancing Fund. The fund serves to re-structure banks’ existing loan portfolios to the SMEs and manufacturing sectors. The sources of funding the project came from N500 billion ($3.13bn) debenture stock issued by the Bank of Industry (BOI). As at end-December, 2010, the CBN had released N199.67 billion ($1.25bn) to BOI which had disbursed N197.59 to participating banks for restructuring/refinancing loans to 539 eligible projects.

4. **N300 billion Power and Aviation Intervention Fund:** This Fund was established to refinance existing loans and leases and provide working capital for the power and aviation sector. It is to stimulate credit to the domestic power and troubled airline industries. At the mid-June 2013, forty-one projects worth N221.0 billion have been funded.

5. **The Nigerian Incentive-based Risk Sharing System for Agricultural Lending (NIRSAL)** was initiated by the CBN but in collaboration with various stakeholders to solve value-chain lending problems in agricultural sector. It is a demand-driven credit facility. Banks are free to choose which part of the value chain to patronize. Many international agencies embraced the programme over time. For example, by June 2013, the German International Cooperation (GIZ) had given grants worth N176 million for four crop projects viz tomato, rice, cocoa an cotton production, and, NIRSAL signed MoU with the United States Agency for International Development (USAID) and the Federal Ministry of Agriculture and Rural Development for technical partnership with $100 million fund.

On the issue of financial literacy, the CBN claimed that it has been able to sustain its efforts at achieving the broad objective of raising financial inclusion to 80.0 per cent by 2020. The activities undertaken included the developments of the Financial Literacy Framework to enable people acquire basic skills on finance-related issues and sensitization of students in five (5) Universities (Gombe State University, Lead City University, Ibadan, University of Nigeria, Nsukka, University of Maiduguri and Adekunle Ajasin University) was undertaken on the Child and Youth Finance Initiative. Financial literacy is very important for financial inclusion in Nigeria given the low level of patronage and trust in the banking system and the low literacy rate among the populace.

As part of promoting financial inclusion, the CBN continues to promote e-banking, involving the use of Automated Teller Machine (ATM), Point of Sale machine (POS) as well as internet banking. These are becoming increasingly popular, even in the rural areas. These and other initiatives are relatively nascent such that an
assessment of their impact on inclusive growth may be too early. Nevertheless, recent pronouncements by Government and the new CBN Governor indicate clearly that they are likely to be sustained and, indeed, stepped up allaying the fears of possible policy reversals on account of changes in leadership of key institutions like the CBN.
5 Issues in Capital Flow and Financial Stability

The IMF, in its Global Financial Stability Report (IMF, 2012b) noted the importance of the link between the structure of the financial sector and growth and affirms that preliminary results of the relationship indicate that cross border connections through foreign banks could be beneficial in normal times but be a source of instability during crisis. Tella (2009) found that the financial crises in the United States during the recent global financial had contagion effects on the Nigerian capital market and placed this on the openness of the market, including the capital account liberalisation that encouraged huge capital inflow through the capital market. The huge capital inflow, largely denominated in dollars, into the Nigerian stock market before the global crisis and the subsequent withdrawal of same at the onset of the crisis created instability in the Nigerian stock market (Table 8 and Fig. 4) and by extension on the banking sub-sector.

Table 8: Nigerian Stock Exchange All Share Index, 2005-2012

<table>
<thead>
<tr>
<th>Year</th>
<th>All Share Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>24,085.8</td>
</tr>
<tr>
<td>2006</td>
<td>33,189.3</td>
</tr>
<tr>
<td>2007</td>
<td>57,990.2</td>
</tr>
<tr>
<td>2008</td>
<td>31,450.8</td>
</tr>
<tr>
<td>2009</td>
<td>20,827.2</td>
</tr>
<tr>
<td>2010</td>
<td>24,770.5</td>
</tr>
<tr>
<td>2011</td>
<td>20,730.6</td>
</tr>
<tr>
<td>2012</td>
<td>28,078.8</td>
</tr>
</tbody>
</table>
Since 1986 when the Nigerian foreign exchange market was liberalised, the capital account was liberalised along, even though there were some times of restrictions. The CBN’s policy of internationalisation of the financial system under 2004 Consolidation reforms further deepen the financial liberalisation policy and propelled openness of the economy. Thus, the openness of the economy aided easy inflow and outflow of capital. Table 9 shows average foreign direct investment flows to Nigeria between 2000 and 2011. The content of the Table shows that the period 2005 to 2009 witnessed huge inflow and outflow of capital. The period can be linked with the consolidation reform era, as well as, the global financial crisis. We can infer that the consolidation reforms package encourage initial capital inflow while the financial crisis encourage eventual capital outflow.

Table 9: Five-year Average FDI Flows to Nigeria, 1995-2011

<table>
<thead>
<tr>
<th>Periods</th>
<th>FDI Inflow (N'M)</th>
<th>FDI Outflow (N'M)</th>
<th>FDI Net-flow (N'M)</th>
<th>% Change in Net-flows</th>
<th>FDI as % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000-2004</td>
<td>12,794.94</td>
<td>3,215.82</td>
<td>9,579.12</td>
<td>42.31</td>
<td>0.133</td>
</tr>
<tr>
<td>2005-2009</td>
<td>531,384.38</td>
<td>78,158.86</td>
<td>453,225.52</td>
<td>4,631.39</td>
<td>2.356</td>
</tr>
<tr>
<td>2010-2011</td>
<td>1,126,050</td>
<td>131,025</td>
<td>995,025</td>
<td>119.54</td>
<td>3.077</td>
</tr>
</tbody>
</table>

Source: Authors’ Computations with data sourced from the Central Bank of Nigeria Statistical Bulletin (Various Issues)

However, Table 8 presents a disaggregated data that allows bird’s eye view of the component of the international financial investment positions of the country. It is obvious from the Table that large proportion of investment was ‘hot money’ i.e. portfolio investment which is considered more dangerous for financial stability since it can be withdrawn at short notice. Such withdrawal happened causing significant fall in the Stock Exchange All Share Index from 2008 (Table 8). Portfolio investments simply imply that the transmission mechanism of fund into the economy was through the banking sector as the first intermediary and
ultimately the security markets. The rapid growth in capital flow noted by Soludo (2008) was largely for portfolio investments and when the global crisis occurred, it was the source of financial crisis for the Nigerian economy as there was reversal of funds from the system at the height of the crisis in 2008.

Table 10: International Investment Positions of Nigeria, 2005-2011

<table>
<thead>
<tr>
<th>Investment</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Foreign Assets</td>
<td>41,417.85</td>
<td>60,475.21</td>
<td>77,498.53</td>
<td>88,463.64</td>
<td>83,928.45</td>
<td>83,668.5</td>
</tr>
<tr>
<td>Portfolio Investment</td>
<td>2,823.17 (6.82%)</td>
<td>4,349.21 (7.19%)</td>
<td>6,208.32 (8.01%)</td>
<td>10,967.09 (12.4%)</td>
<td>11,797.86 (14.06%)</td>
<td>12,739.73 (15.23%)</td>
</tr>
<tr>
<td>Direct Investment</td>
<td>302.00 (0.73%)</td>
<td>624.48 (1.03%)</td>
<td>1,506.42 (1.94%)</td>
<td>2,564.69 (2.90%)</td>
<td>4,118.29 (4.91%)</td>
<td>5,041.17 (6.03%)</td>
</tr>
</tbody>
</table>

Source: Central Bank of Nigeria (2012). Note; Figures in parentheses are percentages of Total Foreign Assets.

Figure 6: Trend in Portfolio and Direct Investment in Nigeria 2006-2010

The issue of macroeconomic instability caused by large and sudden capital inflow was the major emphasis in Sanusi’s evaluation of what went wrong with the Nigerian banking sector when he assumed office. Since banks were the first recipients of capital inflow and Nigerian banks have often been accused of trading mainly in the foreign exchange market, it is obvious that this was a major channel through which the global financial crisis directly affected the money and capital markets, and hence, the economy at large in 2008/2009. Other important, albeit indirect, channels include temporary fall in oil prices which adversely affected government fiscal posture resulting in deficit financing, rising interest rates and crowding out the private sector mentioned earlier.
6 Summary and Conclusion

This study sets out to identify national risks to financial stability in Nigeria and obstacles or gaps in policy measures that support financial stability towards achieving inclusive growth in Nigeria, taking cognisance of the management of the resources of the country; and identify issues relating to management of capital accounts, in recent times to support financial stability.

The study focused on the banking sub-sector within the financial system given the fact that the sub-sector dominates the financial system in terms of number and types of institutions, the volume of funds it controls and volume of transactions in terms of popularity and patronage among the citizens and business enterprises. The study notes the existence of foreign banks but also noted the insignificant share of their fund in total assets and liabilities of banks. By the same token, Nigerian banks are now engaged in offshore banking.

The study investigates the trends in development of the banking sub-sector within the context of physical or structural growth, nature and structure of credits, the consequences of the financial intermediation activities going on within the sub-sector and more importantly the regulations and compliance with these regulations.

A review of the financial market situation and financial intermediation activities showed that the 2004 consolidation reform and the 2009 post-consolidation reforms were hinged on instability in the banking sector (supported by quantitative analysis) arising from, among other factors, critical gaps in regulatory framework and regulations, inadequate supervision and enforcement of regulations, and, instability caused by capital flows (Soludo, 2004; Sanusi, 2010). Summarily, the following become obvious with respect to the Nigerian financial industry:

1. It is very susceptible to instability because of the nature of uses of fund on short term basis to meet the philosophy of liquidity and profitability, as well as the continuous flow of short term funds through the banks in form portfolio investment or “hot money”. This constitutes a risk to financial stability.

2. Another risk is the continuous policy reversal and inability to see a reform through. This is partly because of rapid change in leadership of the bank by government and with each leader introducing his ideas as new reforms. For example, within the last ten years, the Central Bank has had three governors with different ways of pursing the same problems financial instability, inefficiency in the financial system and poor corporate governance in the banking sector.

3. A third risk is that the government has undue influence on the activities in the financial system as it finances its budget deficits from the banking system resulting in fiscal dominance, rising interest rates and crowding out the private sector. (Table 2).
4. There is considerable disregard for regulation such that the banks often prefer to be punished for disobeying laws particularly with respected to lending to the preferred sectors of the economy. This is supported by peoples’ perception that the CBN’s regulations do not enforce transparency and accountability in banking activities.

5. The liberalisation of the capital account since 1987 and the CBN policy of internationalisation of the banking activities under the 2004 consolidation reforms have combined to create *laissez faire* environment in the foreign exchange market with increasing movement of short term funds that have destabilising effects.

6. The CBN and the financial sector generally need additional high quality manpower to supervise and operate the financial system efficiently, just as the need for constant training for those on ground.

These concluding remarks lead to the following recommendations on the kind of banking sector environment and activities required to promote financial stability and inclusive growth in Nigeria:

1. Policy consistency and sustainability is imperative. In order to insulate the system from the consequences of changes in leadership, policies and programmes should be institutionalized and depersonalized quickly and effectively.

2. There should be effective enforcement of regulation by the regulatory authorities in the financial sector to ensure sound and dynamic financial system and good corporate governance. This calls for strengthening the cooperation and coordination among the regulators in view of the intensifying links among the various components of the Nigerian financial market and between it and the global financial markets.

3. The sustenance of CBN policy of balanced growth of the economy based on nine sustainability principle by the new leadership is encouraging as this signals the much desired depersonalization and institutionalization of initiatives; and

4. Manpower development should be accorded priority in the industry in order to meet the emerging challenges posed the dynamics of domestic and global financial systems which require proactive and pre-emptive rather than reactive policy initiatives.
References


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