# RECAPITALISATION AND BANK PERFORMANCE: EVIDENCE FROM BANKS IN NIGERIA

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**Abstract:**

This study examined the relationship between recapitalization and banks performance in Nigeria. In order achieve the objective of the study, a time series data was generated for 2000 to 2009 periods. The data was analysed using independent t-test and the study found that net interest margin, funding cost, significantly increases in post-recapitalisation period. On the other hand the study found an insignificant decrease in return on assets of banks after recapitalised. Therefore, the study concluded that the policy (recapitalisation) would subject banks (especially the small banks) in the country into severe liquidity crisis. The study recommended among others, that recapitalization policy should be undertaken with pinch of salt because the major obstacle facing Nigerian banks is not peculiar with shortage of capital. Therefore, only banks with acute shortage of capital should be coercing to increase their capital to enable them enjoy economic scale of operation. Similarly an Islamic banks should be established with branches in Muslims dominated areas, this is based on the experiences of the countries practicing such unique banking were not immune to global economic crisis.

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## I-Introduction:

It is widely recognised that the financial system plays a crucial roles in promoting economic development by separating the saving and investment functions. Investment in all economics sectors, particularly the real sector, made possible by the financial resources in the financial system, increases the quantum of goods and services. The financial system includes banking institution are important economic agents in the payment system. Bank facilitate economic transaction between various national and international economic units and by so doing, it encourages trade, commerce and industry (Sani, 2004). It is needless to say that, banking system is able to play the positive role in economic development only if it is functioning efficiently. However, if repressed, inefficient and incapable of providing timely and quality services, the banking system could become a major hindrance to economic growth and development (Cameron, 1972; Mckinnon, 1973).

It is on record that in spite of government's effort to protect the banks failure does occur. Endogenous factors such as bad management, or exogenous ones such as economic recession usually precipitate such failures. Sometimes both factors combine to bring distress to banks, and when that happens, depositors particularly the small ones, are the most affected. The lesson of distress in Nigeria, swept the banking sector and systematic distress gripped the finance house sub-sector. The banking sector failure had serious implication for the financial system and by extension, the economy. This is based on the fact that banks generate financial resources and put these at the disposal of deficit economic unit for increased consumption or output. Surprisingly fifty years after the country's political independence, the banking sector is performing far below expectations. Among the measures implemented to correct the dismal practices in the sector is recapitalisation and consolidation of banks.

The main objective of this study is therefore to examine the performance of banks in Nigeria after recapitalisation. To achieve this objective, the paper is divided into five sections including this introduction. Section two is the review of related literature while section three presents the methodology of the study. Section four is the discussion of the result and the last section concludes the paper.

## II- Literature Review:

Many developing countries implemented financial reforms as a part of market oriented economic reforms since the late 1980s (Ubah, 2005). The importance of the financial sector which comprises bank and non-banks financial intermediaries, the regulatory framework and the ever increasing financial products, in stimulating economic growth is widely recognised in both developed and developing economies. According to Imala (2005) the relationship between real and financial development shows that financial intermediaries, monetisation and capital formation determine the way and pace of economic development. The increase in the capital base of bank in Nigeria would strengthen them and in the process deepen activities within the industry.

Recapitalisation may raise the liquidity in short-run but will not guaranty enabling macro-economic environment required to ensure high quantity and good profitability. Low capitalisation of the bank has made them prone to unethical and unprofessional practices inform of poor loan quality of up to 21% of shareholders funds compare with 1-2% in Europe and America; overtrading abandoning the truth functions of banking to focus on quick profit ventures such as trading in forex and fitting their findings support in favour of import-export trade instead of manufacturing; reliance on unstable sector funds for their deposit base, forcing their female marketing staff in un wholesome conduct to meet unjustifiable targets in deposits mobilisation; and high cost of funds (Soludo, 2004).

The current structure of the banking system has promoted tendencies towards sticky behaviour of deposit rate, particularly at the retail level, such that while banks lending rate remain high and positive in real terms. Most deposit rates especially those on savings are low and negative. In addition saving mobilisation of the grass-root level has been discouraged by the unrealistic requirement by many banks for the opening account within them (Imala, 2005). The Nigerian banking system has undergone remarkable changes over the years in terms of the number of institutions, ownership structure as well as depth and breadth of operations. Those changes had been influenced large, challenges forced by deregulation of the financial sector, globalisation, operations, technological innovations and adoptions of supervisory and prudently requirements that conform to international standards. The Nigerian banking system today is fragile and marginal. The system faces enormous challenges which if not addressed urgently, could snowball into crisis in the near future (Soludo, 2004).

The objective of banking system is to ensure price stability and facilitate rapid development. Regrettably these objectives have remained largely unattained in Nigeria as a result of some deficiencies in the banking system. These includes low capital base as average capital base of Nigerian banks was $10 million which is very low, large number of small banks with relatively few branches, the dominance of few banks, poor rating of a number of banks, week corporate government among others (CBN, 2005). The reform are designed to enable the banking system develop the required flexibility to support the economic development of the nation by efficiently performing it function as a reform of financial intermediation (Lemo, 2005). Thus the reform were to ensure a diversified, strong and reliable banking industry where there is safely of depositors money and position the banks to play active developmental roles in Nigerian economy.

## III- Methodology:

This study employed secondary data for various performance indicator covering 2000 to 2009 obtained from Nigeria Deposit Insurance Corporation (NDIC) annual reports of various issues. The periods were purposely selected to enable us compare five year pre with five year post recapitalisation periods. This study employed both descriptive and inferential statistics in analysing the data. Descriptive statistics is an event or outcome of events that are described without drawing conclusion(s). It is primarily concerned with the collection, organisation, summarising, analysis and presentation of an array of qualitative and quantitative data (Monga, 2009).

On the other hand, in order to draw inference on comparison between pre and post recapitalisation performance of the Nigerians banks, independent t-test was used. The method enables us to examine the whether for each measures of performance, the average values to recapitalisation differed significantly from pre-recapitalisation to the post-recapitalisation periods. T-test is applicable if the sample size is less than thirty and the data must come from normally distributed population. The formula for t-statistic is given below:

$$t = \frac{\bar{X}_1 - \bar{X}_2}{\delta\bar{X}_1 - \bar{X}_2}$$

Where $\bar{X}_1$ is the mean value of pre-recapitalisation data for 2000 to 2004 periods and $\bar{X}_2$ is the mean value of post-recapitalisation data for 2005 to 209. While $\delta\bar{X}_1 - \bar{X}_2$ is the standard error of the difference between means. The formula for computing standard error is given below:

$$\delta\bar{X}_1 - \bar{X}_2 \sqrt{\frac{\delta^2}{n_1} + \frac{\delta^2}{n_2}}$$

$$where:$$

$$\delta^2 = \frac{n_1 - 1\ s_1^2 + n_1 - 1\ s_2^2}{n_1 + n_2 - 2}$$

Degree of freedom is used in checking the t-table value which is given as $df = n_1 + n_2 - 2$. In testing the hypothesis decision rule is involved which is if the computed value i.e. test statistics is less than or equal to the critical value (the table value), null hypothesis $H_0$ will be accepted. On the contrary, if the computed value is greater than the table we reject the null hypothesis and accept the alternative $H_1$. Two errors are commonly committed when making the decision i.e. type I error and type II error. Type I error is committed when null hypothesis is accepted when it is false and type II is committed when null hypothesis is rejected when is true.

## IV- Results and Discussions:

The result is divided into descriptive and inferential results. The Tables below shows the descriptive results of various performance indicators:

**Table 1: Net Interest Margin (NIM)**

| | Pre-recapitalisation | Post-recapitalisation |
|---|---|---|
| N | 5 | 5 |
| Minimum | 7.71 | 215.33 |
| Maximum | 11.55 | 656.81 |
| Mean | 9.81 | 66.1.62 |

| | | |
|---|---|---|
| Standard deviation | 1.46 | 846.87 |

Source : Data analysis, 2011

It could be discerned from the above Table that the net interest margin has minimum value of 7.71 before recapitalisation and then rises to 215.33 after recapitalisation. The maximum value of the variable during pre-recapitalisation period is 11.55 while in post-recapitalisation is 656.81 with the standard deviation of 1.46 and 846.87 for pre-recapitalisation and post-recapitalisation periods respectively.

**Table 2: Yield on Earning Assets (YEA)**

| | Pre-recapitalisation | Post-recapitalisation |
|---|---|---|
| N | 5 | 5 |
| Minimum | 4.62 | 3.47 |
| Maximum | 27.55 | 22.87 |
| Mean | 15.50 | 10.47 |
| Standard deviation | 9.82 | 8.79 |

Source : Data analysis, 2011

From the Table, it clear that minimum value of yield on earning assets is 4.62 and 3.47 in pre- and post-recapitalisation period respectively. The maximum value of the variable is 27.55 (pre-recapitalisation period) and 22.87 (post-recapitalisation period). The mean value is 15.50 in pre-recapitalisation period which fall to 10.47 in post-recapitalisation period. Moreover, the standard deviation of the variable is 9.82 and 8.79 in pre-recapitalisation period and post-recapitalisation period respectively.

**Table 3: Funding Cost (FC)**

| | **Pre-recapitalisation** | **Post-recapitalisation** |
|---|---|---|
| N | 5 | 5 |
| Minimum | 9.47 | 395.56 |
| Maximum | 13.50 | 3047.75 |

| | | |
|---|---|---|
| Mean | 9.59 | 521.41 |
| Standard deviation | 2.44 | 407.74 |

Source : Data analysis, 2011

The minimum value of funding cost is 9.47 and 395.56 in pre-recapitalisation and post-recapitalisation period. The maximum value is 13.50 in pre-recapitalisation period which rose to 3047.75 in post-recapitalisation, while the mean value is 9.59 (pre-recapitalisation) and 521.41 (post-recapitalisation). The standard deviation is 2.44 and 407.74 in pre-recapitalisation and post-recapitalisation periods respectively.

**Table 4: Return on Equity (ROE)**

| | Pre-recapitalisation | Post-recapitalisation |
|---|---|---|
| N | 5 | 5 |
| Minimum | 29.11 | 4.12 |
| Maximum | 114.29 | 23.07 |
| Mean | 68.34 | 8.97 |
| Standard deviation | 16.52 | 13.65 |

Source : Data analysis, 2011

It could be observed from the above Table that minimum value of return on equity is 29.11 and 4.12 during pre-recapitalisation and post-recapitalisation period respectively. The maximum value of the variable is 114.29 (pre-recapitalisation period) and 23.07(post-recapitalisation period) with the mean value of 68.34 and 8.97 for pre-recapitalisation and post-recapitalisation period respectively. The standard deviation of return on equity in pre-recapitalisation period is 16.52 and 13.65 in post-recapitalisation period.

**Table 5: Return on Assets (ROA)**

| | Pre-recapitalisation | Post-recapitalisation |
|---|---|---|
| N | 5 | 5 |
| Minimum | 2 | 0.49 |

| | | |
|---|---|---|
| Maximum | 4.82 | 3.94 |
| Mean | 3.20 | 5.76 |
| Standard deviation | 0.52 | 33.95 |

Source : Data analysis, 2011

It is clear from the above Table that the minimum value of return on assets is 2 in pre-recapitalisation period and 0.49 in post-recapitalisation period while the maximum value of the variable is 4.82 (pre-recapitalisation period) and 3.94 (post-recapitalisation period). The mean value of the variable is 3.20 and 5.76 in pre-recapitalisation and post-recapitalisation period respectively. Furthermore, the standard deviation of the variable is 0.52 in pre-recapitalisation period and 33.95 in post-recapitalisation period.

**Table 6: Independent t-test results**

| **Variable** | **t-value** | **Probability** |
|---|---|---|
| NIM | -1.72 | 0.0124* |
| YEA | 0.86 | 0.4170 |
| FC | -2.81 | 0.0023*** |
| ROE | 3.37 | 0.0010*** |
| ROA | 0.59 | 0.5720 |

* ** *** Indicate significance at 10 & 1 percent level of significance

Source : Data analysis, 2011

It could be discerned from the Table above that the t-value of Net Interest Margin (NIM) is -1.72 with the probability of 0.0124. This indicates that the variable is significant at 10% level of significance. Meaning that, there is significant difference in the value of NIM after recapitalising banks. This finding supported the finding documented in previous researches (see for instance Lemo, 2005). Similarly, the coefficient of Yield on Earning Assets has t-value of 0.855 with 0.4170 as the probability level. This variable is not significant at even 10% level. This means that there is an insignificant decrease in yield on earning assets in Nigerian banks which refuted the apriori expectation. This finding tends to disputes macroeconomics theory which postulates that increase in capital is directly proportional with the increase in earning.

Funding cost is another indicator of performance improvement of bank after recapitalisation. To this end, we examined the variable in Nigerian case. The results in the Table above shows that t-value of the variable is -2.81 with probability of 0.0023 value. This indicates that the variable is significant at 1% level of significance. This finding is not odd with finding of Lemo (2005). Recapitalisation tends expose banks to costly experience of attracting new shareholders through marketing, establishing new branches and promos. This brought an unprecedented increase in funding cost of Nigerian banks. Evidence has shown that some banks (Intercontinental Bank, Union Bank, Afri Bank among others) are facing liquidity problem after being recapitalised.

Moreover, the t-value of return on equity is 3.37 with the level of probability of 0.0010 which indicates that the variable is significant at 1% probability level. Surprisingly, this study unveil that there is significant decrease in return on equity of the recapitalised banks. Nigeria is among the countries that were hit by the global economic crisis that severely affected the country's capital market. As results of this banks based on their exposure to the capital market experienced a shrink in their equity. Finally, return on assets has t-value of 0.39 with 0.5720 as probability level. It appears that the variable is not significant, meaning that the study found an insignificant decrease in return on assets after recapitalisation policy persuaded by CBN.

## V- Conclusion:

Recapitalisation tends to decrease net interest margin and funding cost of Nigerian banks on the one hand. It could therefore be concluded that this policy (recapitalisation) would subject banks (especially the small banks) in the country into severe liquidity crisis. Evidence has shown that some banks experience financial crisis since implementation of the policy. On the other hand, recapitalisation decreases the return on earning and return on assets in the country. This implies that problems of Nigerian banks is not much associated with shortage but poor financial literacy, low banking culture, interest rate among others. Therefore, unless ways are found to redress the severity of this factors banks in the country would continue to found difficulties in their tripartite roles.

**Policy Implications**

i- Recapitalization policy should be undertaken with pinch of salt because the major obstacle facing Nigerian banks is not peculiar with shortage of capital. Therefore, only banks with acute shortage of capital should be coercing to increase their capital to enable them enjoy economic scale of operation.

ii- An Islamic banks should be established with branches in Muslims dominated areas, this is based on the experiences of the countries practicing such unique banking were not immune to global economic crisis. Therefore, we recommend Malaysian system of Islamic banking in order to enhance banks performance. To this end conversion of existing commercial banks could be pursued in short run while establishment of new Islamic banks could be done in long run.

iii- Financial literacy should be promoted order to improve banking culture in the country. This would enhance people patronage of banks which in turn would boost their profitability and enhances the efficacy of financial system as money that were hitherto kept out the banks were now brought in to banks (Aliero and Ibrahim).

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