

## BANKING SECTOR CONSOLIDATION AND STOCK MARKET PERFORMANCE

ADU, CECILIA ADURAYEMI

Dept.of Accounting & Finance, Crawford University, IGBESA, Gun State

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### ABSTRACT

*In this paper, an attempt has been made to address the impact of banking sector consolidation on the stock market performance in Nigeria between 2001 and 2012. The introduction to the banking system in Nigeria was discussed, some literatures were reviewed, past challenges in the capital market, consolidation exercise between 2004 and 2009 were looked into. The secondary source of data was used to analyze if there was any significant relationship between the banking sector consolidation and stock market performance before, during and after the consolidation exercise. It was concluded that banking consolidation policy on its own could not increase stock market returns but there must be adequate mix with other monetary and fiscal policy instruments to produce desired result.*

*Key Words: Consolidation, Stock Market and Banks.*

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### INTRODUCTION:

The banking system plays a fundamental role in the growth and development of any economy. In fact, the health of the banking system of a nation determines the well-being of the economy (Osaze, 2000). The Nigerian banking sector has undergone remarkable changes since 1892, when the African Banking Corporation (ABC) was set up to today's era of consolidation. The financial system has also gone through eras such as Free-Banking Era (1882-1952), emergence of Banking Regulation or Pre-Central Banking (1952-1958), Era of Consolidation Growth following establishment of the Central Bank of Nigeria or Era of Banking Legislation (1959-70), Era of indigenization (1970-1976), Post - Okigbo Era (1977-1986), Era of Deregulation (1986-2005) and Era of Bank Consolidation (2005-till date) (Nwankwo, 1990).

Since inception, the changes in the banking industry have been influenced by the need for sounder banking industry, globalization of operations, technological innovation and adoption of supervisory and prudential requirements that conform to the international standards and the need to make Nigerian banks Basel I and II compliant. The reasons which prompted the reform program in the banking sector were due to the weak capital base of the banks, weak corporate

governance, gross insider abuse, sharp practices, over independence on public sector deposits, insolvency and internally focused competition.

The consolidation in the banking industry by the Central Bank of Nigeria(CBN) through the recapitalization to N25 billion is monumental. It created a remarkable transformation not only in ensuring more diversified , strong and reliable banks but also enhancing banks' liquidity position and their ability to assume risks. Moreover, it recreated the Nigerian capital market by stimulating activities in both the primary and secondary market through increase in aggregate market capitalization, new issues of banks stocks and increased inflow of Foreign Direct Investment (FDI) into the market ( Ebi, 2006; Salako, 2006) . It is no doubt that the banking system is the engine of growth and financial lubricant in any economy, given its financial intermediation role. Through this role, banks facilitate capital formation, lubricate the production of any nation and promote economic growth. However, economic growth and development of any nation depend on the health, soundness and stability of the banking system. The banking sector happens to be one of the sectors in the economy and it is one of the most regulated sectors in the economy.

In order to have a strong and reliable banking sector, Prof. Charles Soludo outlined the first phase of reforms thus:

The primary objective of the reforms is to guarantee an efficient and sound financial system. The reforms are designed to enable the banking system develop the required resilience to support the economic development of the nation by efficiently performing its functions as the fulcrum of financial intermediation (Lemo,2005). The reforms was to ensure safekeeping of depositors' funds, make banks to play active roles in the Nigerian economy, and become major players in global financial markets.

The key elements of the 13-point reform programme were:

- i. minimum capital base of N25 billion with deadline of 31<sup>st</sup> December,2005;
- ii. consolidation of banking institutions through mergers and acquisitions;

- iii. phased withdrawal of public sector funds from banks beginning from July, 2004;
- iv. adoption of a risk-focused and rule-based regulatory framework;
- v. zero tolerance for weak corporate governance, misconduct and lack of transparency;
- vi. accelerated completion of the Electronic Financial Analysis Surveillance System(e-FASS);
- vii. the establishment of an Asset Management Company;
- viii. promotion of the enforcement of dormant laws;
- ix. closer collaboration with EFCC and the establishment of the Financial Intelligence Unit;
- x. establishment of a hotline, confidential internet address ([Governor@cenbank.org](mailto:Governor@cenbank.org)) for all Nigerians wishing to share any confidential information with the Governor of the Central Bank on the operations of any bank or the financial system. Only the Governor should have access to this line.
- xi. strict enforcement of the contingency planning framework for systemic banking distress;
- xii. revision and updating of relevant laws and drafting new ones relating to effective operations of the banking system;
- xiii. rehabilitation and effective management of the mint to meet the security printing needs of Nigeria. (Adeyemi, 2005)

In order to strengthen the competitiveness and operational capabilities of banks in Nigeria with a view to enhancing global and public confidence in Nigeria banking system and the economy in general , the Central Bank of Nigeria commenced a banking sector reform in July 2004. A key element of the reform was a prescribed minimum capital base of N25 billion for each bank .The monetary authority also encouraged strategic merger and acquisition among the then existing 89 banks, which ultimately resulted in 25 consolidated banks with the list capitalized banks at prescribed minimum capital base. The number of banks further dropped to 24 as a result of self

induced merger between two of the most dynamic and competitive banks in the country .This in particular, improved the performance of their shares on the Nigeria Stock Exchange(NSE).

Prior to consolidation, the industry was highly skewed, then with many banks having very small and undiversified capital. With a higher capital base, Nigerian banks are expected to play important roles in the economic development including increased financial intermediation support to the private sector.

Post-consolidation period for Nigerian banks, however, came with its own challenges. There were issues of corporate governance, shallow risk assessment capacity and deterioration of assets quality, among others. Consequently, the monetary authorities conducted a special examination in July 2009, which was jointly undertaken by the Central Bank of Nigeria and the Nigeria Deposit Insurance Corporation to ascertain the state of affairs of the Nigerian banks. The examination was intended to review, evaluate and determine the quality of all banks portfolio. The examination focused attention on the banks' assets quality, liquidity and corporate governance. Following the outcome of the two batches of the exercises, 10 banks out of 24 banks were indicted. Then 2 out of the 10 banks were directed to be recapitalized, while the chief executive officers (CEOs) and directors of the remaining banks were removed by Central Bank of Nigeria based on mismanagement and corporate governance issues.

Given the concerns over the shares of the affected banks on the Nigerian Stock Exchange, a tripartite agreement between the Central Bank Of Nigeria, Securities and Exchange Commission and the Nigerian Stock Exchange was taken with a view to protecting investors and preventing unprecedented dumping of shares of the 7 affected banks that were listed on the Exchange as follows : Afribank Nigeria Plc, Oceanic Bank Int. Plc, Fin Bank Plc, Intercontinental Bank Plc, Union Bank of Nigeria Plc, Bank PHB and Spring Bank.

#### STATEMENT OF THE PROBLEM:

Banks made consolidation (merger and acquisition) as an alternative means of recapitalizing. The latest reform compelled all commercial banks (deposit- taking institutions) to raise their capital base from N2 billion to N25 billion on or before 31<sup>st</sup> December, 2005 which sent some

of the banks on their toes considering consolidation (merger and acquisition) as the best option. From the Nigerian Stock Fact Book during the years before consolidation, there were no improvement in all-share index, volume, values of shares traded and banking sector capitalization compared to the consolidation period and thereafter. Has this improvement being brought about by the consolidation exercise of 2005? What was the sole factor that was responsible for this sudden improvement?

What effect did banking sector consolidation have on the Stock market performance in terms of improving the performance indices of the stock market? What has been the trend of all-share index before and after banking sector consolidation? To what extent has consolidation exercise of 2005 impacted the stock trading activities in the stock market? Looking at the Fact Books of NSE before, during and after consolidation, had the banking sector consolidation brought boom or doom to the capital market in Nigeria?

Before bank capitalization precisely in 2005, deposit money banks could not compete effectively with the banks in Europe, United State of America, Asia etc. Literature has it that before capitalization the whole of the banks in Nigeria put together was not up to the size of one bank in South Africa in terms of assets, volume, deposits etc (Vanguard,2011) . One would imagine how much loan from deposit could be given out as loan to the real sector to stimulate growth of the economy. If this be case, the banking sector may not have been able to affect the stock market and one of the reasons for the slow growth in Nigeria is attributed to the All-Share index which gives an indication of the performance of the economy. Post consolidation of Nigeria deposit taking banks has improved their capital base and they are now able to compete favorably with others in the world. It is in this light that this study attempts to investigate if there is any significant difference in the market capitalization of NSE before , during and after consolidation; if the all-share index is affected by the banking sector consolidation.

#### RESEARCH QUESTIONS:

1. What has been the significant difference in the market capitalization of NSE before, during and after consolidation?

2. To what extent has consolidation in the banking sector significantly improved all – share index of the NSE?
3. How has the consolidation exercise of 2005 had impact on the stock trading activities in the capital market?
4. In what ways has bank consolidation improved the performance indices of the stock exchange?

#### OBJECTIVES OF THE RESEARCH:

1. To examine if there is any significant difference in the market capitalization of NSE before during and after consolidation
2. To determine if consolidation in the banking sector has significantly improved all-share index of NSE
3. To examine the impacts of bank consolidation exercise of 2005 on the stock trading activities in the capital market
4. To examine the improvement being made by bank consolidation on performance indices of the stock exchange

#### HYPOTHESES:

1. There is significant difference in the market capitalization of NSE before, during and after consolidation
2. Consolidation in the banking sector has improved all- share index of NSE
3. Bank Consolidation exercise of 2005 has impact on the stock trading activities in the capital market
4. Bank consolidation has improved the performance indices of the exchange

**METHODOLOGY:**

The source of data was secondary, market capitalization and the all- share index of the Nigerian Stock for 2001 to 2012 were collected from the NSE Fact Book .

The hypotheses were tested using the Regression Analysis to find out if there was significant difference before, during and after the banking consolidation and the stock market returns.

**Econometric Analysis-**

Table 4.2 Regression Result

Dependent Variable: MKTR

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LBSMC	-0.094346	0.005917	-15.94476	0.0399
LTEL(-1)	4.341905	0.550939	7.880925	0.0804
LTNI	0.003006	0.009761	0.307952	0.8098
LVAST(-1)	-0.055780	0.006560	-8.503175	0.0745
LVST	0.136495	0.030901	4.417092	0.1417
BCONS	-0.142655	0.020091	-7.100401	0.0891
C	-10.29314	1.052720	-9.777661	0.0649
R-squared	0.997793	Mean dependent var		0.007191
Adjusted R-squared	0.984551	S.D. dependent var		0.133279
S.E. of regression	0.016566	Akaike info criterion		-5.692381
Sum squared resid	0.000274	Schwarz criterion		-5.622870
Log likelihood	29.76952	Hannan-Quinn criter.		-6.161207
F-statistic	75.34975	Durbin-Watson stat		2.406008
Prob(F-statistic)	0.087956			



## DISCUSSION OF RESULTS:

The above model captures the relationship between bank consolidation and stock market performance proxy by stock market return. The empirical evidence from the analysis shows that the included variables bank sector market capitalization (BSMC), total equities listed (TEL), total new issues (TNI), value of stock listed (VAST), volume of stock (VST) and the policy dummy for bank consolidation (BCONS) jointly accounted for 99.7 percent of the total variation in stock market return (MKTR) while the adjusted R-squared captures this 98.4 percent. The result of the F-statistic 75.349 with the probability value of 0.08 shows the model statistical significance and fitness at 10 percent level of significance. The Durbin Watson statistic suggests no serious evidence of auto correlation considering the variables used in the model.

Specifically, the estimated result of the analysis shows that the influence of total equity listed and value of stock traded does not consist the current period alone but take into cognizance influence of the previous period. A closer observation of the empirical result shows an inverse relationship between stock market returns, bank sector consolidation, value of listed securities and bank consolidation policy. This implies that bank sector market capitalization, value of traded security and bank consolidation policy have retardation effect on stock market returns. The result further reveals a direct relationship between total equities listed, total new issues and volume of stock. This shows that increases in total equities listed, total new issues and volume of stock traded brings about a proportionate increase in stock market returns. A critical analysis of the result shows that all the exogenous factors with the exception of total new issues and volume of stock traded exhibits a significant relationship with stock market returns.

The analysis of the result shows there is an indirect relationship between bank sector market capitalization and stock market return significant at 5 percent. This shows that bank sector market capitalization on the average have not contributed meaningfully to stock market return considering the scope covered by this study. A percentage increase in bank sector market capitalization significantly retards stock market performance by 0.09 percent holding other variables effects at constant.



Total equity listed shows a significant positive relationship with stock market return though at 10 percent level of significance. This therefore suggests that by increasing the total number of equity listed by the Nigerian Stock Exchange, there could be a significant improvement in stock market performance. The empirical support of the result indicates that a percentage increase in total equity listed leads to a resultant increase of 4.34 percent. This further implies that increases in equity securities listed could be used as a significant yard stick for measuring stock market performance in Nigeria. This result also supports the evidence that this impact can be considered as a result of the cumulative effect of previous period of equity listed.

The result emanating from the estimated result of total new issues reveals a positive elasticity coefficient of 0.003 percent showing that a percentage increase in total new issues has the possibility of improving stock market return though not significant enough compared with level of statistical significance utilized by the study. This estimated result however implies that there could be a significant result with the advent of time considering the estimated positive coefficient at the current time.

The previous period of traded stock value shows a significant inverse relation with stock market return at 10 percent significance level. This shows that increases in value of stock traded does not lead to a corresponding increase in stock market return. It could be observed that a percentage increase in value of stock indicate a decreasing effect of 0.05 percent on market performance. This could be related to the adverse effect of the financial crisis that has affected stock value of quoted firms in the Nigerian Stock Exchange despite the banking sector consolidation exercise though not significant at the current time. The empirical result however indicated that a percent increase in volume of traded stock could increase stock market return by 0.13 percent all things being equal.

The policy of bank sector consolidation reveals a significant negative elasticity coefficient in relation with stock market return at 10 percent level of significance. This shows that the bank consolidation policy on its own could not increase stock market return but there must be adequate mix with other monetary and fiscal policy instruments to produce its desired result.

Conversely the result showed that bank consolidation when considered alone could bring a decreasing effect of 0.14 percent on stock market performance proxy by stock market returns

There is a positive relationship between volume of stock traded and market performance but not significant enough. This shows that increases in volume of stock traded is capable of bringing a resultant increase in stock market return

#### SUMMARY AND CONCLUSION:

One of the greatest things to happen to the Nigerian banking industry over its 120 years of existence could be its consolidation in 2005, which has not only opened up the trading opportunities in the Nigerian capital market to individuals and corporate investors, but also increased public awareness about the operations and activities of the Nigerian Stock Exchange.

It has also become a veritable source for banks to raise funds even in the post –consolidation era for various purposes. Bank consolidation has brought immense transformation to the banking sector and it has helped to reposition Nigerian banks in the global financial market.

Moreover, following the banking consolidation, the Nigerian Stock Exchange experienced significant increase in the market capitalization and all-share index performance indices.

Similarly, there were significant impacts of the consolidation in terms of increased stock trading activities in the frequency of trading, number of deals etc particularly in the banking sector. Nevertheless, there is yet to be remarkable improvement in the number of companies listed on the Nigerian Stock Exchange.

#### RECOMMENDATIONS:

The regulatory authorities of the capital market in Nigeria such as SEC and NSE must continue to make concerted effort towards cushioning the effects of the global financial meltdown on the Nigerian Stock Exchange which has significantly affected its performance. This will help to restore investors' confidence and revival in the market.

Also, while the current reform by the CBN to sanitize the banking industry is welcome; it has to be carefully implemented to ensure banks are better positioned to perform their strategic roles in the Nigerian capital market and the economy.

Banks must also channel the funds raised from the stock market into profitable investment ventures that will maximize the shareholders capital and increase the value of the banks.

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