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Bank failure in Nigeria: a consequence of capital inadequacy, lack of transparency and non-performing loans?

Abstract

In spite of the 1952 Banking Ordinance, the Nigerian banking sector has experienced a number of bank failures. The period of 1994-2003 also witnessed a wave of systemic distress culminating in another round of bank failures. Notwithstanding the heavy impact this ugly and recurring development has inflicted on this sector, the 2004 Banking Sector Reforms swept away 14 additional banks. The tenacity of bank failure in the country therefore became a matter of grave and utmost concern not only to the entire nation in general but to the practitioners and the academia. The aims of this study are to establish the main factors responsible for bank failure in Nigeria, to assess the extent to which these identified factors are accountable for this failure and to ascertain other factors that may be responsible for it. Consequently, this paper has identified capital inadequacy, lack of transparency and huge non-performing loans as major causes of bank failure in Nigeria. These factors were examined and the extent to which they have been accountable for bank failure in Nigeria were determined. Aside these factors, the author did not pay attention to other factors that may be responsible for bank failure which include ownership structure, weak/ineffective internal control system, poor management among others. Simple percentages were used to describe the data presented and the conclusion drawn was that these three factors have been the main reasons of the incessant bank failure. The paper recommends full disclosure of all financial transactions and the separation of the post of the chairman from that of the managing director for all the banks.

Keywords: capital inadequacy transparency, non-performing loans, central bank, bank failure, internal control, disclosure, management.
JEL Classification: G21, G33.

Introduction

In Nigeria, modern banking started in 1892 when South African had founded the African Banking Corporation (ABC), now First Bank of Nigeria PLC with an office in Lagos. The free banking era ended when the Banking Ordinance of 1952 was promulgated. In spite of the 1952 Banking Ordinance, Nigeria experienced series of bank failures between the period of 1952-1958. Uzoaga (1981) observes that only 4 out of 25 indigenous banks established during this period survived while 21 others went under. The Pre-CBN bank failures were attributed to absence of regulation and control while the post-CBN bank failure was caused by the factors to be discussed here under. With the promulgation of the Central Bank Act of 1958, the banking business came under the regulation and control of the CBN. Symptoms of distress in Nigeria financial system was first officially pointed out by the World Bank team that examined the financial sector shortly before the NDIC (Nigeria Deposit Insurance Corporation) Decree #22 of 1988 took off in February 1989. Ndiulor (2000) thinks that the transfer of parastatals and Government agencies accounts to the CBN, investment mismatches, paper profits, round tripping in foreign exchange and other rent seeking activities are true signals of unfair wind in the industry. The period of 1994-2003 saw another round of bank failure culminating in a good number of banks having their licenses withdrawn by the Central Bank of Nigeria (CBN) and liquidated by the NDIC. The 2004 Banking Sector Reforms swept away 14 additional banks. The tenacity of bank failure in the country therefore became a matter of grave and utmost concern not only to the entire nation in general but to the practitioners and the academia.

Recently, several financial institutions in Nigeria became distressed, thus highlighting the precarious position of the financial sector. Between 1989 and 1996, the financial conditions of many banks and non-bank financial institutions worsened significantly, which compelled the authorities to take decisive steps to restore public confidence in the financial system. During this period, the number of banks classified as distressed increased from 8 to 52. Since then, another round of banking crisis started at the wake of the political instability occasioned by the annulment of the 1993 Presidential Election. Consequently, the CBN revoked the licences of 5 banks (4 in 1994 and 1 in 1995). Also, the CBN took over the management of 17 distressed banks in 1995 and one additional bank in 1996. The bank, in exercising it's powers under Banks and Other Financial Institutions Act, 1991 (as amended), announced the revocation of the banking licenses of 26 banks with effect from January 16, 1998, which was necessitated by their grave financial conditions. This has been the terrible situation of the sector up till July 2004 when the Central Bank governor came up with the N25billion recapitalization policy for banks in Nigeria.

A cursory look at this development would suggest that the banking sector in Nigeria had been operating in an unsafe and unhealthy manner, thus, exposing the fragility of the system and further erosion of public confidence. The belief that the sweeping reforms of 2004-2005 would usher in a new era of banking in Nigeria, especially in the area of enhanced capital base/shareholders funds has turned out to be a mirage. The revelations from the sector in late 2009 have confirmed the fear that this endemic crisis that has been ravaging this sector over the years has not been decisively dealt with. The ugly situation of a huge sum of non-performing loans culminating in the capital erosion of 9 out of the 24 banks in the country portends great danger to the system and requires drastic approach to be embarked upon by the current CBN governor.

1. Statement of the problem

Financial sector distress has been described as a situation in which a sizeable proportion of financial institutions have liabilities exceeding the market value of their assets which may lead to runs and other portfolio shifts and eventual collapse of the financial system. Put differently, distress in the financial system occurs when a fairly reasonable proportion of financial institutions in the system are unable to meet their obligations to their customers, their owners and the economy as a result of weaknesses in their financial, operational and managerial capabilities which render them either illiquid and or insolvent (CBN, 1997). In Nigeria, modern banking started in 1892 when South African based African Banking Corporation (ABC), now First Bank of Nigeria PLC opened an office in Lagos. The free banking era ended when the Banking Ordinance of 1952 was promulgated. The period from 1952 to 1958 saw the first round of bank failures while another round of bank failures occurred between 1994 and 2003. The recapitaliza-tion policy of 2004/2005 ended up with 14 out of the 89 deposit money banks disappearing from the scene as a result of their inability to meet up with the minimum capital base requirement.

Although there appears to be many factors attributed to the incidence of bank failure in Nigeria, a good number of authors have not really established the key ones. While Ogundina (1999) sees ownership structure as a factor accountable for bank failure, Ogubunka (2003) identifies weak/ineffective internal control system, poor management among others as causes of bank distress/failure. However. this work is an attempt to narrow the scope of the causes of bank failure in Nigeria to the key ones such as capital inadequacy, lack of transparency and non-performing loans and sharpen the potency of each of these key causes. The author also attempts to establish whether the other factors may also be accountable for bank failure in Nigeria.

1.1. Research questions. This study indentifies several research question; that are the main objectives of the paper:

1. Can capital adequacy, lack of transparency and non-performing loans be established as the main factors responsible for bank failure in Nigeria?
2. To what extent are these identified factors accountable for bank failure in Nigeria?
3. Are there other factors responsible for bank failure in Nigeria?

1.2. Research hypotheses. In order to answer the research questions and achieve the objectives of the study, the following hypotheses are stipulated.

Hypothesis 1

H_0: Capital inadequacy, lack of transparency and non-performing loans are not the main factors responsible for bank failure in Nigeria.

H_1: Capital inadequacy, lack of transparency and non-performing loans are the main factors responsible for bank failure in Nigeria.

Hypothesis 2

H_0: Other factors may not be responsible for bank failure in Nigeria.

H_1: Other factors may be responsible for bank failure in Nigeria.

2. Conceptual framework and review of literature

According to the Central Bank of Nigeria Annual Report (1995), financial distress is defined as that which occurs in financial institutions which among other things:

- fail to meet capitalization requirements;
- have weak deposit base; and
- are afflicted by mismanagement.

Therefore, there is distress in a situation, in which the bank is having operational, managerial and financial difficulties. The term ‘distressed banks’ entered into the lexicon of banking in Nigeria in the period from 1990 and 1995, though it has been in existence since early 20th century. The term to the general public connotes an unmanageable, unviable and insolvent bank that is tending towards liquidation. In ordinary parlance, distress means ‘being in danger or difficulty and in need of help’.

Umoh (1999) asserts that “a bank is distressed when it is technically insolvent implying that the bank’s liabilities exceed the assets”. The CBN/NDIC (1995: 4) describes a distressed financial institution as “one with severe financial, operational and managerial weaknesses which have rendered it difficult for the institution to meet its obligations to its customers, owners and the economy as and when due. Without necessarily implying the degree or nature of the problem, a bank is said to be distressed when it is either illiquid and/or insolvent to the extent that its ability to discharge its obligations as at when is impaired. In more precise terms, illiquidity is a state of inability to meet payments obligations to customers as at when due, while insolvency is a situation in which the value of the firm's liabilities is in excess of its assets' value, i.e., negative net worth.

The CBN/NDIC (1995: 5) describes banking system distress as "a situation in which a sizeable proportion of financial institutions have liabilities exceeding the market value of their assets which may lead to runs and other portfolio shifts and eventual collapse of some financial firms".

Furthermore, depending on whether public confidence in the system has been eroded or not, financial system distress is classified into two, namely, generalized or systemic. If public confidence has not been adversely affected by the incidence of distress, though widespread among the institutions, it is regarded as a generalized distress otherwise, it is systemic distress. The CBN (2002) provides a working definition of systemic bank distress as "those situations where the solvency and/or liquidity of many or most banks have suffered shocks that have shaken public confidence. Ogubunka (2003) opines that bank distress has become a common lexicon in Nigeria given many bank failures in the period of 1994 through 2003.

Many people erroneously interchange bank distress with bank failure, which are technically distinct. Bank distress is the forerunner of bank failure. Whereas a bank in distress could have chances of regaining health, a failed bank loses every chance of life. Its final destination is the mortuary of Nigeria Deposit Insurance Corporation (NDIC) from where it will proceed to its final destination – liquidation. Imala (2004) posits that financial sector crises have occurred in many countries in recent decades, both in developed as well as emerging market economies. These crises have resulted in substantial macroeconomics and fiscal costs. Bank failures are widely perceived to have greater adverse effects on the economy than the failure of other types of businesses. They are viewed to be more damaging than other failures because of the fear that they may spread in domino fashion throughout the banking system, felling solvent as well as insolvent banks. Thus, the failure of an individual bank introduces the possibility of system wide failure or systematic risk. Bank failures have been and will continue to be a major public policy concern in all countries and that explains the fact that banks are regulated more rigorously than other industries.

This study opines that there are three major factors accountable for bank distress which consequently ends up in bank failure. Each of these factors is reviewed in the following subsections.

2.1. Inadequacy of capital. CBN (1995) claims that banks are expected to maintain adequate capital to meet their financial obligations, operate profitably and contribute to promoting a sound financial system. It is for these reasons that the CBN prescribes minimum capital requirements. This minimum ratio of capital adequacy has been increased from 6 per cent in 1992 to 8 per cent in 1996. It is further stipulated that at least 50 per cent of the component of a bank's capital shall comprise paid-up capital and reserves, while every bank shall maintain a ratio of not less than one to ten (1:10) between its adjusted capital funds and its total credit. When a bank's capital falls below the prescribed ratio, it is an indication that the bank may be heading for distress. Bank examination reports showed that a good number of banks operating in Nigeria were grossly undercapitalized. This situation has been attributed to the low level of initial capital, the effect of inflation, the adverse operating results mainly due to their inability to make appreciable recoveries from their non-performing assets and the large portfolio of non-performing loans maintained by some banks. These factors have combined to erode the capital base of many banks. With the introduction of Prudential Guidelines, banks were required to suspend interest due, but unpaid, on classified assets and to make provisions for non-performing credit facilities, a good proportion of which was subject to losses. Inability to meet stipulated higher minimum capital requirements was one of the criteria used for classifying banks into either "healthy" or "unhealthy" and the latter category was barred from the foreign exchange market.

In describing capital inadequacy, Ogundina (1999) argues that capital in any business whether bank or company serves as a mean by which losses may be absorbed. It provides a cushion to withstand abnormal losses not covered by current earnings pattern. Unfortunately, a good number of banks are grossly undercapitalized. This situation could partly be attributed to the fact that many of the banks were established with very little capital. This problem of inadequate capital has been further worsened by the huge amount of non-performing loans which have eroded the capital base of some of these banks. Available statistics on banks' capitalization reveal that as at the end of 1992, 120 operating banks in the country required the aggregate additional capital to the tune of N5.6 billion to meet the statutory minimum capital funds set by bank regulators for 1992.

Ogubunka (2003) contends that when a bank is undercapitalized, it ought not to continue with its magnitude of operations prior to the depletion of capital. If it does without the introduction of increased capital, distress could ensue. Many banks that became distressed were affected by inadequacy of capital. Consequently, they could not sustain their operations, first, as a result of overtrading and second, due to their inability to absorb losses arising from costs of operations. A function of capital in a bank is to serve as a mean by which losses can be absolved. Capital provides a cushion to withstand abnormal losses not covered by current earnings, enabling banks to regain equilibrium and to re-establish a normal earnings pattern. The need for adequate capital largely informed the decision of the regulatory authorities to raise the minimum equity share capital of banks over the years. As at 2002, the minimum paid-up equity share capital is 2 billion for a new bank to be licensed and the existing universal banks had the deadline of December 31, 2002 to beef up their paid-up equity share capital to 1 billion. This problem of inadequate capital has been further accentuated by the huge amount of non-performing loans which has eroded some banks' capital base. It has even been discovered that many of the closed banks in Nigeria started with fictitious capital through the use of commercial paper. Such debt instruments were paid back soon after commencement of business with deposits. Many of such so-called bank owners contributed nothing to own a bank, yet they use the means to amass wealth and ruin the bank at the end of the day.

Imala (2004) opines that banks are expected to maintain adequate capital to absorb operational shocks or unexpected losses, support their level of operation, operate profitably and consequently contribute towards promoting a sound financial system. It is for these reasons that the CBN periodically prescribes minimum capital requirements in the form of minimum paid-up and the capital to risk-weighted asset ratio. The minimum capital adequacy ratio requirement has remained at the international standard of 8% and this was expected to become 10% from January 2004. Inability to meet the minimum capital requirement was one of the criteria used for classifying banks as unhealthy one.

2.2. Disclosure and transparency. Sanusi (2002) posits that disclosure and transparency are key pillars of a corporate governance framework, because they provide all the stakeholders with the information necessary to judge whether or not their interest are being served. He sees transparency and disclosure as an important adjunct to the supervisory process as they facilitate banking sector market discipline. For transparency to be meaningful, information should be accessible, timely, relevant and qualitative. According to Anameje (2007), transparency and disclosure of information are key attributes of good corporate governance which banks must cultivate with new zeal so as to provide stakeholders with the necessary information to judge whether their interest are being taken care of. Sanusi (2003) opines that lack of transparency undermines the ethics of good corporate governance and the prospect for effective contingency plan for managing systemic distress.

Anya (2003) observes that lack of transparency has obscured the way many financial and economic activities are conducted and has contributed to the alarming proportion of economic/financial crimes in the financial industry. 'Trust' and the fiduciary principle, which was the cornerstone of banking, has been completely jettisoned as banks now engage in all forms of sharp practices. Some of these sharp practices involve the deliberate manipulation or distortion of records to conceal the correct and true state of affairs. These records which form the bedrock of supervisory oversight by the regulatory authorities in monitoring the soundness of the system has thus been undermined. Such distortions therefore, would necessarily result in wrong information being sent to the regulatory authorities, which should have been in a position to take adequate measures to prevent further deterioration of the bank's position. The regulatory authorities are thus handicapped by such concealment until the bank hit the irreversible point of total collapse. Thus lack of transparency has been identified as one of the most catastrophic modern societal problems plaguing banks today.

Imala (2004) contends that the issue of transparency has to be taken seriously in the new dispensation. Transparency has been a recurring problem in the financial industry in Nigeria, and, unless improved upon, has the potential of making nonsense of the efforts of the supervisors in implementing the New Accord. It is hoped that the Bankers Committee's efforts, through its ethics and professionalism subcommittee and the new code of corporate governance, would greatly assist in laying a solid foundation for transparency in the industry, being one of the pillars of the New Capital Accord. The evolutionary nature of the New Accord increasingly cedes more responsibilities in the measurement of capital adequacy to the operations. Consequently, a bank has to convince the supervisor of improvement techniques in order to rise to a higher level in the evolutionary ladder. With the present situation in the banking industry, many banks may remain at the lowest rung of the ladder of sophistication in the capital measurement approach.

2.3. Huge non-performing loans. A major revelation showed that many owners and directors abused or misused their privileged positions or breached their fiduciary duties by engaging in self-serving activities. The abuses included granting of unsecured credit facilities to owners, directors and related companies which in some cases were in excess of their banks' statutory lending limits, in violation of the provisions of the law (Oluyemi, 2005). A critical review of the nation's banking system over the years has shown that one of the problems confronting the sector had been that of poor corporate governance. From the closing reports of banks liquidated between 1994 and 2002, there were evidences that clearly established that poor corporate governance led to their failures.

Ogundina (1999) observes that the Nigerian financial system over the years has been under severe stress as a result of large amounts of non-performing loans. The classified loans and advances of the whole banking industry in 1990 amounted to N11.9 billion, representing 44.1 percent of the total loans and advances. The problem of bad debts is usually exacerbated by the negligence on the part of the lending officers. Some of these loans were not granted without regard to the basic tenets of lending, nor do they comply with any rational lending criteria. This makes it extremely difficult or impossible to recover a substantial part of the loans.

Also, the devaluation of the naira in the wake of Structural Adjustment Programme has its toll on the ability of borrowers to repay. A devaluation by more than 600 percent since the introduction of SAP shore up foreign manufacturing input prices, leading to greater domestic capacity underutilization and reduced inability of business borrowers to repay their bank loans and advances. According to CBN (1997), several of the distressed banks suffer from poor asset and liability management. The portfolios of assets of the majority of these banks were concentrated on loans and advances that became non-performing. Other assets such as treasury securities, investments and cash accounted for a small proportion of their asset portfolio. Furthermore, merchant banks that were expected to source medium to long-term funds relied mainly on short-term deposits whose tenor ranged between call/overnight funds to 3 months. These funds were obtained at excessively high rates of interest. In some cases, some banks and finance houses borrowed short and lent long, resulting in mismatch of assets and liabilities. The deterioration in asset quality was not provided for through adequate loan-loss provisions. This situation increased the vulnerability of the banks to external shocks. The profile of poor asset and liability management exposed the banks to liquidity risk which weakened the confidence that the public had in the banking sector.

3. Methodology

For the purpose of this study, the researcher has identified the problem, formulated the research questions and hypothesis. Survey research design through the use of structured questionnaire is adopted. The study population covers all the banks in Nigeria and the elements are the entire workforce within the sector. Nigeria has six geopolitical zones and one of them, the South West, with Lagos as its main city, serves as the headquarters of almost all the banks. Nigeria also operates a branch banking system and more than 25% of the branches are concentrated in Lagos and its environs while the rest are scattered all over the country. Since all the branches of these banks are scattered over a large geographical area, it is not possible within the time frame to reach this population of the study. Any attempt to cover this group of interest will result in considerable expenditure of time, money and effort. Besides it is rather unnecessary and generally impracticable to use the entire group of interest. All individuals with whom the study is concerned cannot be included, hence, a small proportion of the population through a process of sampling is selected. This small representative group from the population is the sampled elements for the study.

The sampling methods employed are stratified sampling and simple random sampling. The banks are devided into 2 and they are healthy banks and troubled banks. From a total number of 24 banks, 15 are healthy while 9 are troubled going by the classification of the CBN in August/September 2009. The banks were selected at random and the 5 banks are Fidelity Bank Plc, Skye Bank Plc, Eco Bank Plc representing the 15 healthy banks and accounting for 20% of the banks in this category. The other two are Equatorial Trust Bank Plc and Union Bank of Nigeria Plc representing the 9 troubled banks and accounting for approximately 20% as well. A total of 100 questionnaires were distributed to each of the 20 staff selected in each of the 5 banks. The 20 officials from each of 5 selected banks (4 top management staff, 8 middle management staff and, 8 junior staff) were selected randomly from the head office and 3 randomly selected branches for each of the 5 banks.

To ensure the validity and the reliability of the questionnaire used for the study, two experts were consulted to examine its contents in relation to its ability to achieve the stated objectives of the research, the level of coverage, how logical and how suitable they are for the prospective respondents. A total of 82 questionnaires were returned by the respondents. The data collected from the questionnaire were analysed, summarized and interpreted according to the aid of descriptive statistical techniques such as total scores and simple percentages. Chi-square was used to measure the discrepancies existing between the observed and the expected frequencies and to also prove the level of significance in testing the stated hypotheses.

In addition to the survey research design approach employed by this study, secondary sources were utilised. Academic journals, textbooks, research papers and other materials that are secondary in nature and are considered useful for the study were also consulted. Simple percentages were used for the analysis of the secondary data collected.

4. Data presentation and analysis

Table 1. Sex

	Frequency	Percentage	Cumulative percentage
Male	54	65.85	65.85
Female	28	34.15	100.0
Total	82	100.0	

Source: Field Survey 2010.

Table 1 shows that 54 or 65.85% of the respondents are male while 28 or 34.15% of respondents are female. Thus, the survey reveals that more of the respondents were male who are considered to be more objective.

Table 2. Work status

	Frequency	Percentage	Cumulative percentage
Top management	16	19.51	19.51
Middle management	34	41.46	60.97
Junior staff	32	39.03	100
Total	82	100.0	

Source: Field Survey 2010.

Table 2 shows that 16 or 19.51% of respondents are top management staff, 34 or 41.46.% of the respondents are middle management staff, 32 or 39.03% of the respondents are junior staff. Thus, the survey reveals that most of the respondents are from the middle level and junior cadre.

Table 3. Work experience

	Frequency	Percentage	Cumulative percentage
Below 10 years	32	39.03	39.03
10-20 years	40	48.78	87.81
Above 20 years	10	12.19	100.0
Total	82	100.0	

Source: Field Survey 2010.

Table 3 shows that 32 or 39.03% of respondents had experience of less than 10 years, 40 or 48.78% had between 10 and 20 years, 10 or 12.19% had over 20 years experience. Thus, the survey reveals that most of the respondents do not have more than 20 years experience.

Table 4. Capital inadequacy, lack of transparency and non-performing loans are the main factors responsible for bank failure in Nigeria

	Frequency	Percentage	Cumulative percentage
Yes	46	56.09	56.09
No	28	34.15	90.24
Undecided	8	9.76	100
Total	82	100.0	

Source: Field Survey 2010.

Table 4. shows that 46 or 56.09% of the respondents believe that capital inadequacy, lack of transparency and non-performing loans are the main factors responsible for bank failure in Nigeria. 28 or 34.15% of the respondents do not agree at all while 8 or 9.76% of the respondents are undecided.

Table 5. The capital bases of Nigerian banks are grossly inadequate

	Frequency	Percentage	Cummulative percentage
Strongly agree	60	73.17	63.41
Agree	8	9.76	82.93
Undecided	6	7.31	90.24
Disagree	8	9.76	100.0
Total	82	100.0	

Source: Field Survey 2010.

Table 5 shows that 60 or 73.17% of the respondents agree that Nigerian banks are grossly undercapitalized, 8 or 9.76% are also of a similar opinion. Significantly, majority of the respondents believe that Nigerian banks are grossly undercapitalized.

Table 6. Nigerian banks are not transparent enough in their operations and disclosures

	Frequency	Percentage	Cummulative percentage
Strongly agree	50	60.98	60.98
Agree	15	18.29	79.27
Undecided	10	12.19	91.46
Disagree	7	8.54	100.0
Total	82	100.0	

Source: Field Survey 2010.

Table 6 shows that 50 or 60.98% of the respondents strongly agree that Nigerian banks are not transparent enough in their operations and disclosures 15 or 18.29% are also of a similar opinion. Significantly, majority of the respondents believe that Nigerian banks lack adequate transparency in their operations and disclosures.

Table 7. Nigerian banks are saddled with huge non-performing loans

	Frequency	Percentage	Cummulative percentage
Strongly agree	52	63.41	63.41
Agree	16	19.51	82.92
Undecided	8	9.76	92.68
Disagree	6	7.32	100.0
Total	82	100.0	

Source: Field Survey 2010.

Table 7 shows that 52 or 63.41% of the respondents agree that Nigerian banks are saddled with huge non-performing loans, 16 or 19,51% are also of the same opinion. Significantly, majority of the respondents believe that Nigerian banks carry so much of non-performing loans.

Table 8. Other factors may be responsible for bank failure in Nigeria

	Frequency	Percentage	Cummulative percentage
Strongly agree	46	56.09	56.09
Agree	20	24.39	80.48
Undecided	10	12.20	92.68
Disagree	6	7.32	100.0
Total	82	100.0	

Source: Field Survey 2010.

Table 8 shows that 46 or 56.09% of the respondents agree that other factors may also be responsible for bank failure in Nigeria, 20 or 24.39% are also of the same opinion. Significantly, majority of the respondents believe that other factors may be responsible for bank failure in Nigeria.

4.1. Testing of hypotheses. This research work is limited to the use of chi-square (X^2) statistical tool for testing its hypotheses in respect of the primary data collected. It involves calculating the probability that an observed value randomly picked from the population equals a normal curve frequency of the hypothetical population. The observed and the expected frequencies will be compared and arranged in single table.

The formula for calculating the chi-square (X^2) is as stated below:

$$X^2 = \frac{\sum (O-E)^2}{E}, \tag{1}$$

where O is observed frequency, E is expected frequency.

Hypothesis 1

H_0: Capital inadequacy, lack of transparency and non-performing loans are not the main factors responsible for bank failure in Nigeria.

H_1: Capital inadequacy, lack of transparency and non-performing loans are the main factors responsible for bank failure in Nigeria.

Table 9. Test of hypothesis 1

	Observed O	Expected E	Residual $(O-E)$	$(O-E)^2$	$\frac{(O-E)^2}{E}$
Yes	46	27.33	18.67	348.57	12.7541
No	28	27.33	0.67	0.45	0.0165
Undecided	8	27.33	-19 33	373.65	13.6717
Total	82	82.0			26.44

Decision Rule: Reject H_0 where X^2 calculated is greater than X^2 tabulated, otherwise accept H_1

$$\text{Calculated } X^2 = \frac{\sum (O-E)^2}{E} = 26.44.$$

Degree of freedom (d.o.f.) = $n - 1$,

where n is a number of rows.

Therefore d.o.f. = 3 – 1 = 2

Tabulated X^2 at 0.05% level of significance for 2 degrees of freedom is 5.991.

Decision: Since the calculated X^2 is greater than the tabulated, the null hypothesis (H_0) is rejected and the alternative hypothesis (H_1) is accepted.

This indicates that capital inadequacy, lack of transparency and non-performing loans are the main factors responsible for bank failure in Nigeria.

Hypothesis 2

H_0: Other factors may not be responsible for bank failure in Nigeria.

H_1: Other factors may be responsible for bank failure in Nigeria.

Table 10. Test of hypothesis 2

	Observed O	Expected E	Residual $(O-E)$	$(O-E)^2$	$\frac{(O-E)^2}{E}$
Strongly agree	46	20.5	25.5	650.25	31.72
Agree	20	20.5	-0.5	0.25	0.0122
Undecided	10	20.5	-10.5	110.25	5.38
Disagree	6	20.5	-14.5	210.25	10.26
Total	82	82			47.37

Decision Rule: Reject H_0 where X^2 calculated is greater than X^2 tabulated, otherwise accept H_1

$$\text{Calculated } X^2 = \frac{\sum (O-E)^2}{E} = 47.37.$$

Degree of freedom (d.o.f.) = $n - 1$,

where n is a number of rows.

Therefore d.o.f. = 4 – 1 = 3.

Tabulated X^2 at 0.05% level of significance for 3 degrees of freedom is 7.815.

Decision: Since the calculated X^2 is greater than the tabulated, the null hypothesis (H_0) is rejected and the alternative hypothesis (H_1) is accepted.

This indicates that other factors may also be responsible for bank failure in Nigeria.

4.2. Empirical findings. Based on the primary data analyzed in this work, the findings include the following among others:

1. More than 56% of the respondents were of the view that capital inadequacy, lack of transparency and non-performing loans are the main factors responsible for bank failure in Nigeria.
2. Majority of the respondents (73.17%) strongly agreed that the capital bases of Nigerian banks are grossly inadequate.
3. Quite a large number (60.98%) of the respondents strongly agreed that Nigerian banks lack adequate transparency in their operations and disclosures.
4. A sizeable proportion of the respondents (63.41%) strongly agreed that Nigerian banks carry so much of non-performing loans.
5. Over 50% of the respondents strongly agreed that other factors may be responsible for bank failure in Nigeria.

Further observations, findings and comments

The study revealed that capital inadequacy is a very strong factor in bank failure in Nigeria. From Table 5, it can be observed that a good number of the respondents agreed vehemently that Nigerian banks had inadequate capital. The banks were operating with a minimum paid up capital of N2 billion as in July 2004 and a good number of them were declared terminally distressed and ultimately liquidated. According to the CBN governor, this ultimate regulatory intervention has become necessary in the face of the grave financial conditions of the affected banks. The capital bases of the banks have been totally eroded and they are both illiquid and insolvent. Consequently, they continue to default in meeting their obligations to depositors and creditors. Furthermore, the various actions taken by the regulatory authorities to halt deterioration in the financial conditions of the banks including holding action and call for recapitalization, did not yield the desired results. The banks have failed for all practical purpose and are terminally distressed (Ogwuma, 1995). In spite of the fact that the capital base of the banks was raised to N25 billion in December 2005, events emerging from the sector showed that the capital base of 9 out of the 24 banks in the country were completely eroded hence the sudden sack of the managing/executive directors of these banks.

It was further found out that there were serious cases of lack of transparency in the sector. The directors and management of these banks who were supposed to act as agents to the stockholders were pursuing interest different from those of the stakeholders and were not transparent in their dealings. Bulk of the loans and advances were given to the directors and were not backed up with the required collaterals. Most of these loans went bad and the shareholders funds of the banks were completely wiped off thus making the banks to be operating with negative capital bases. Table 11 below shows the position of the risk assets of the banks as at the time of their winding up.

Table 11. Highlight of facilities granted to owners and directors of some selected banks in liquidation

Period	Bank (in-liquidation)	Ratio of Insider loans to total loans
1	ABC Merchant Bank Ltd	50.66
2	Alpha Merchant Bank Plc	55.00
3	Commerce Bank Plc	52.00
4	Commercial Trust Bank Ltd	55.90
5	Credite Bank Nig Ltd	76.00
6	Financial Merchant Bank Ltd	66.89
7	Group Merchant Bank Ltd	77.60
8	Kapital Merchant Bank Ltd	50.00
9	Nigeria Merchant Bank Ltd	99.90
10	Prime Merchant Bank Ltd	80.70
11	Republic Bank Ltd	64,90
12	Royal Merchant Bank Ltd	69.00
13	United Commercial Bank Ltd	81.00

Source: Closing Reports, Receivership and Liquidation Dept, NDIC.

The banks were classified as unsound and unhealthy and were terminally distressed. The distress syndrome in the banking sector therefore culminated in the revocation of licenses of about 36 banks during the period of 1994-2003. In 1994, Financial Merchant Bank, Kapital Merchant Bank and United Commercial Bank all failed and their affairs wound up. In 1995, it was only Republic Bank that was so unlucky. With the persistence of distress trend in Nigeria, the year of 1998 marked the exit of 26 banks, en masse from the banking sector. According to the then CBN governor, Dr. Paul Ogwuma, the Central Bank of Nigeria in exercise of its powers under the provision of BOFIA #25 of 1991 (as amended) announced the revocation of the banking licenses and the commencement of the winding up of the affairs of the 26 banks as shown in the following tables below with effect from January 16, 1998.

Table 12. Commercial banks

S/#	Name of bank
1	Allied Bank of Nig. Plc
2	Amicable Bank of Nig. Plc
3	Commerce Bank Ltd
4	Commercial Trust Bank Ltd
5	Co-operative and Commerce Bank Ltd
6	Credite Bank Ltd
7	Highland Bank of Nigeria Plc
8	Lobi Bank of Nigeria Ltd
9	Mercantile Bank of Nig. Plc
10	North South Bank (Nig.) Plc
11	Pan African Bank Ltd
12	Pinnacle Commercial Bank Ltd
13	Progress Bank of Nigeria Plc

Source: CBN (1998).

Table 13. Merchant banks

S/#	Name of bank
1	Abacus Merchant Bank Ltd
2	ABC Merchant Bank Ltd
3	Century Merchant Bank Ltd
4	Continental Merchant Bank Plc
5	Crown Merchant Bank Ltd
6	Great Merchant Bank Ltd
7	Group Merchant Bank Ltd
8	Icon Ltd (Merchant Bankers)
9	Merchant Bank of Africa Ltd
10	Nigeria Merchant Bank Plc
11	Prime Merchant Bank Lid
12	Royal Merchant Bank Ltd
13	Victory Merchant Bank Ltd

Source: CBN (1998).

Nevertheless, the trend continued and in September of the same year (1998), Alpha Merchant Bank that had been distressed for quite some time was also liquidated. It was the turn of Ivory Merchant Bank, Premier Commercial Bank and Rims Merchant Bank in the year 2000. Savannah Bank and Peak Merchant Bank also went under in 2002 and 2003 respectively.

Aside the three identified factors, the secondary sources revealed that there are other numerous factors that could also be responsible for bank distress which may end up in bank failure. These are:

Ownership structure. Ownership structure is another critical factor that can cause financial distress in banks. Unwarranted intervention (especially in government owned banks) in the internal management of the banks very often contributed to the banks financial distress. Besides, most of the government owned banks are treated as political banks. Some of these banks are characterized by inept management whose tenures of office are occasionally very unstable, while appointment to the board and key management position are usually based on criteria other than merit. The result is shoddy and inconsistent policies with loans and advances to owner governments and their agencies becoming doubtful of recovery (Ogundina, 1999).

Ogubunka (2003) identifies the following factors contributing to bank distress:

Boardroom squabbles arising from ownership structure. Unlike bedfellows promoted and owned some banks. Lacking corporate discipline, these owners/directors engaged in incessant squabbles and quarrels at the detriment of the banks. Thus, the banks remained directionless and uncontrolled.

Frauds and forgeries. Experience shows that in many distressed banks high incidences of frauds and forgeries abound. These were manifested in different forms-outright theft and account manipulation in distinct operational areas of the banks such as credits, clearing, treasury, administration, etc.

Weak/ineffective internal control systems. These often contributed to distress in banks. As a result of weak/ineffective internal control, frauds and other misdemeanors were prevalent. There was really lack of quality control in all aspect of distressed banks' operations and this resulted in serious leakages in the system.

Lack of adherence to CBN Prudential Guidelines. Some banks did not comply with CBN regulations and this made them susceptible to distress. For example, failure to comply with cash and liquidity requirements exposed them to liquidity problems.

Poor management. Most distressed banks were poorly managed. Evidences of poor management include inefficiencies in operations, which result in losses, poor asset quality, illiquidity, assets/liabilities mismatch, etc.

According to CBN (1997), the following factors are also accountable for bank distress:

Weak management. An important factor that has caused distress in the Nigerian financial system is weak management. Over the years, the number of professionals available in the financial system, particularly in the banking sector, has been thinning with the rapid expansion that followed liberalization. This resulted in relatively inexperienced staff being saddled with management of some banks. This was reflected in poor credit qualities, inadequate internal controls, and high rate of labor turnover.

Macroeconomic instability. An unstable macroeconomic system can cause distress in the financial system. For example, when there is economic recession and output slows down or actually declines over a period of time, some borrowers may find it difficult to repay their loans as a result of low sales. Similarly, inflationary conditions could adversely affect deposit mobilization by banks as households spend greater proportion of their income on durable items of consumption. Both events could pose liquidity problems to a bank. Since the early 1980s, Nigeria has had many economic problems, including high inflation, depreciating value of the naira, large fiscal deficits, external debt overhang and slow growth. For instance, inflation rose steadily from 5.7 per cent in 1991 to 54.2 per cent in 1993 and peaked at 72.8 per cent in 1995. During the same period, manufacturing capacity utilization fell from 39.4 and 37.0 per cent in 1991 and 1993, respectively, to 27.2 per cent in 1995, mainly as a result of high cost of imported inputs (as depreciation of the naira persisted), high product prices and reduced sales as a result of declining purchasing power. Interest rates were also unstable, with inter-bank rates fluctuating between 19.5 and 92 per cent from 1991 to 1993 until 1994 when ceilings were imposed. Given these developments, many borrowers, that is, corporate organizations, individuals and governments and their agencies, were unable to service their loans, putting many financial institutions under severe liquidity pressure and contributing to conditions of distress.

Fraudulent and corrupt practices. The problem of weak management has been compounded by unprofessional behavior of some bank owners and managers. Revelations from the proceedings of the Failed Banks (Recovery of Debt) and Financial Malpractices Tribunal show that they obtained loans from their banks without proper documentation and comparable collaterals. Most of those who obtained loans in that way had no intention of repaying.

The causative distress factors in the Nigerian financial institutions as evident in some prevailing literature (Adewunmi, 1993; Afolabi, 1994; CBN/NDIC, 1995; Ebhodaghe, 2001; Imala, 2001 include the following economic factors:

- High and rising inflation rate.
- Monetary policy changes.
- Inconsistent/unstable economic policies.
- Unguided economic reform programmes, e.g., deregulation.

Political factors. These are politically induced issues, which turn out to have adverse consequences on the effective management of banks. For instance, political instability and indeed uncertainty associated with the annulled June 12, 1993 Presidential Elections, engendered fear in the populace. That led to unanticipated massive withdrawal of funds from banks. Another example is political interference on the management of banks. In this instance, most government owned banks were politically influenced to grant loans and overdraft which soon after became hard core and remained unpaid.

Regulatory and supervisory factor. It is the responsibility of regulatory/supervisory agencies to husband the financial services sector to ensure its safety, soundness and stability. Some of the actions and inactions of these agencies encouraged distress in the system. For instance, the use of stabilization securities on both liquid and less liquid banks, for the purpose of excess liquidity control, exacerbated the problems of less liquid banks. Again, the withdrawal of government deposits from conventional banks to control banking system liquidity, created deep holes in the deposit profile of some banks and thus led to high loan/deposit ratios, indicating overtrading.

Conclusion and recommendation

The study was carried out with a view to assessing the extent to which inadequate capital, lack of transparency and huge non-performing loans are accountable for bank failure in Nigeria. It was observed that these three variables combined dealt a serious blow to the banking sector in Nigeria thus leading to the demise of some of these banks. It was also observed that aside from these factors, there are other factors that may be accountable for bank distress and bank failure in Nigeria. Survey research design through the use of structured questionnaire was adopted and chi-square was used to test the hypotheses formulated for the study. Simple percentages were also used to determine the ratio of non-performing loans and advances especially the ones granted to the owners and directors to total loans.

To arrest the issue of capital inadequacy, banks must ensure they maintain reasonable and acceptable shareholders' fund unimpaired by losses at all times and avoid capital erosion. They must endeavour to develop maturity profile that can accommodate the matching of their assets and liabilities. Every loan granted by each of the banks has to be adequately collateralized and the incidence of insider related credits must be deemphasized to avoid loan losses or huge non-performing loans. The regulatory authorities on the other hand should engage themselves in capacity building to enable them perform their supervisory and regulatory functions as effectively as possible. The CBN must continue to emphasize and enforce the prudential regulation. They must ensure strict compliance of banks with not only the monetary measures but also the provisions of the Banks and Other Financial Institutions Act 1991 (as amended) and the CBN Act 1991 (as amended).

In the final analysis, this study is therefore recommending enduring corporate governance that will bring about total separation of the post of the chairman from that of the managing director and full disclosure of all financial information to the stakeholders in the sector. The regulatory authorities must continue to beam their searchlight on this sector with a view to dealing decisively with the erring banks to avoid any contagion arising from the systemic distress which is always rearing its ugly head in the sector.

The author wishes to suggest that further research should be carried out in the realm of the consequences of bank failure in Nigeria and the preventive measures. A comparative analysis of bank failure in Nigeria or any other developing country with that of any advanced country could also be attempted.

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