CHALLENGES & OPPORTUNITIES IN THE CONSOLIDATING NIGERIAN BANKING SECTOR

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Background facts

- Most industries go through a cycle:
    - entry-growth-consolidation-maturity/shakeout
- Consolidation is simply another way of saying survival of the fittest (bigger, more efficient, better capitalized, more skilled etc)
- Consolidation is part of the natural evolution of industries
- Consolidation is primarily driven by:
    - Business motives and/or market forces
    - Regulatory interventions

Background facts

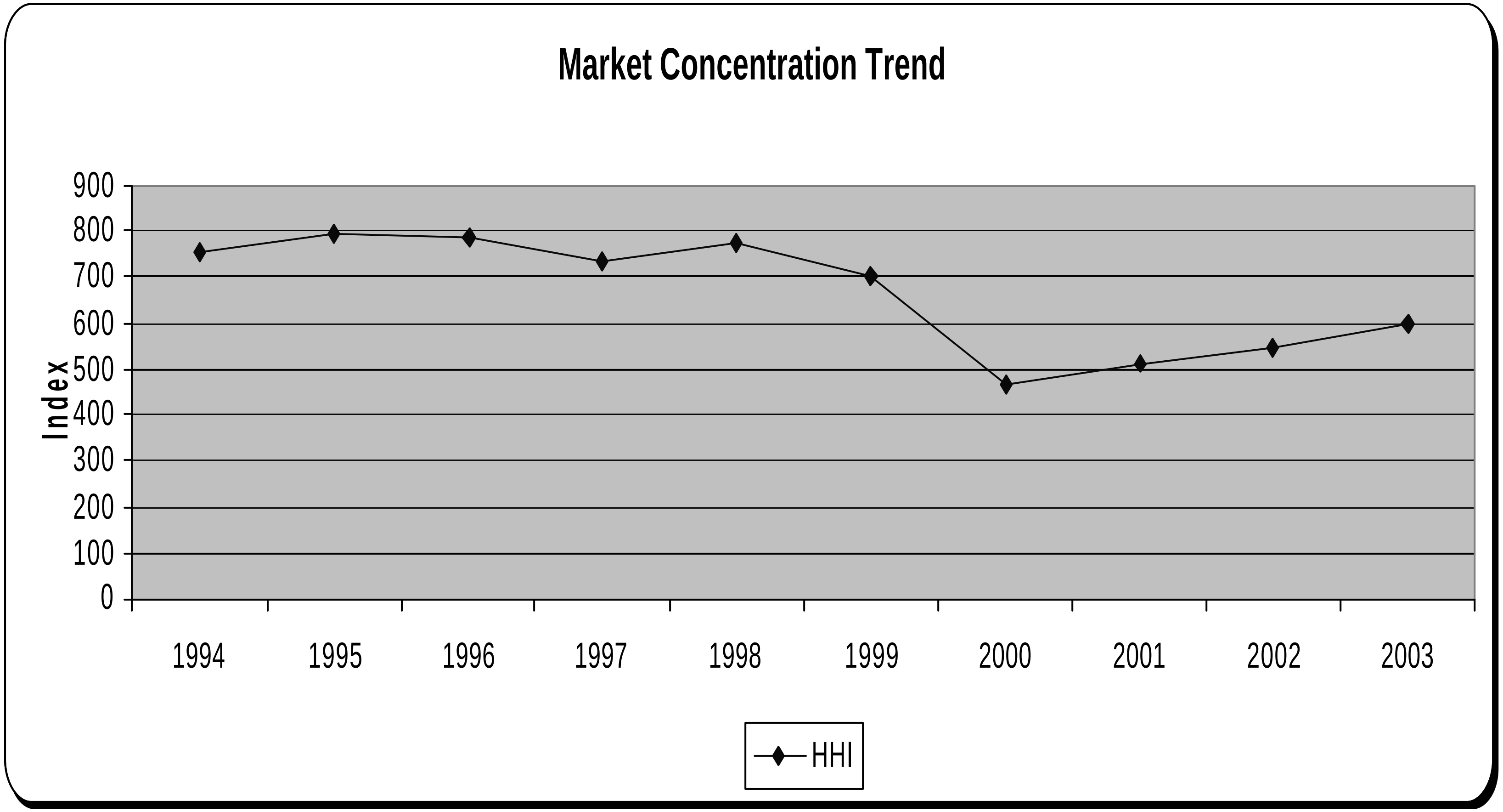
- Regulators drive consolidation by altering industry fundamentals (e.g. entry barriers, capital requirements, operational issues)
- Flights to safety in banking, further entrench the position of dominant players
- Improvements in operational efficiency also result to changes in market share in favour of the efficient players
- The Banking Sector in Nigeria has gradually been consolidating over the years
- Re-alignment of market share over the last 10 years have ended the dominance of the traditional Big 3 (FBN, UBN & UBA)
- There is now a handful of banks that constitute the big league

Background facts

Herfindahl-Hirschman (HH) Index is a standard measure of concentration in an industry
HH Index <1000 implies market is unconcentrated

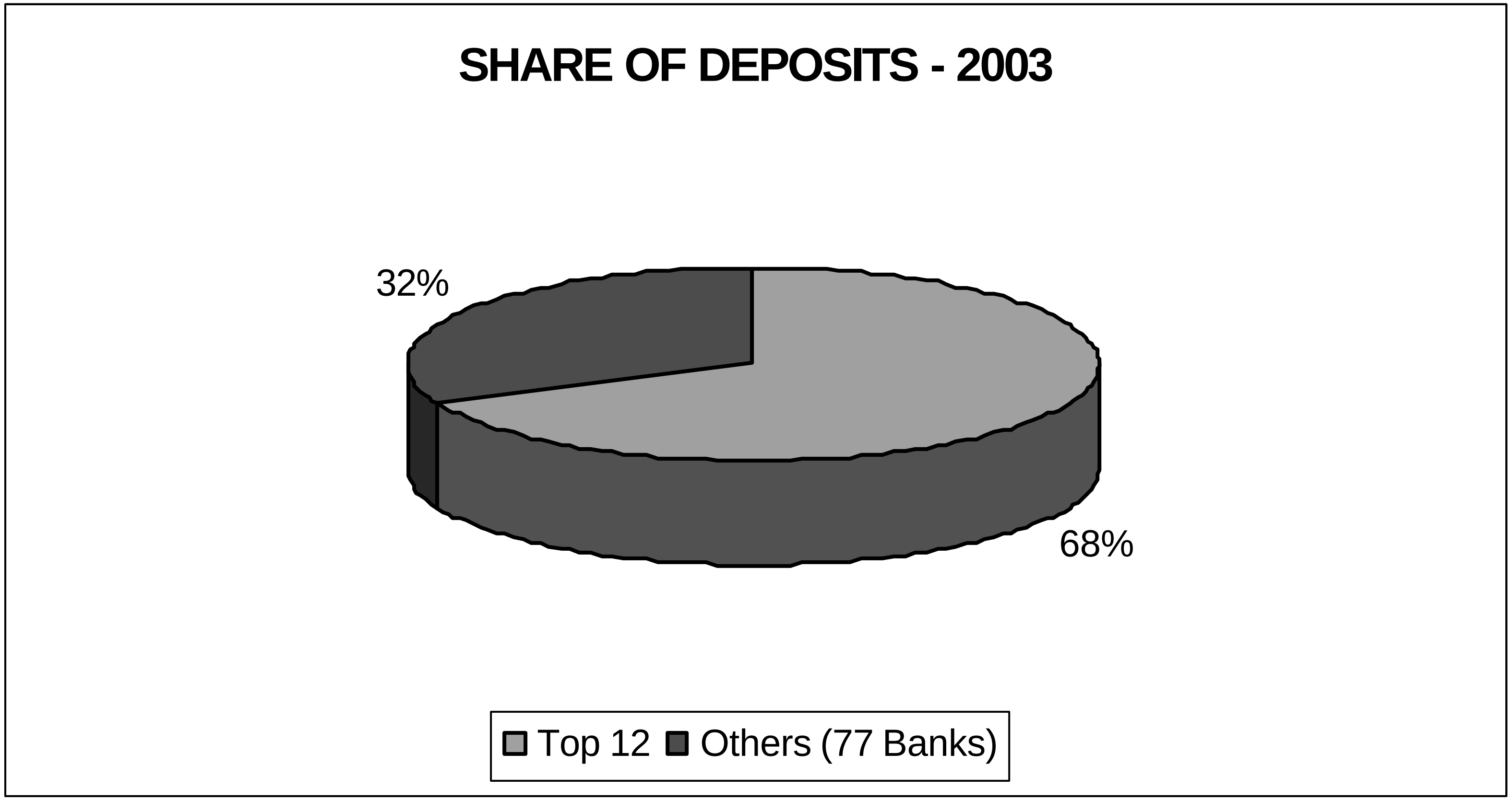
- The HH Index of the sector fluctuated over the last 9 years but has shown a consistent increase in the last 4 years.
- Previous CBN capital increases did not affect consolidation or the HH index materially
- Instead supervisory efforts i.e. bank closures has rather influenced concentration (Bank closures in 1994/5 -5 banks &1997/8 – 26 banks,)
- Recent increase (last 4 years) in concentration has been due to market forces (consistent market share gains by top 12 players)
- July 6 CBN policy is the most significant direct attempt by the CBN to consolidate the sector

HH Index

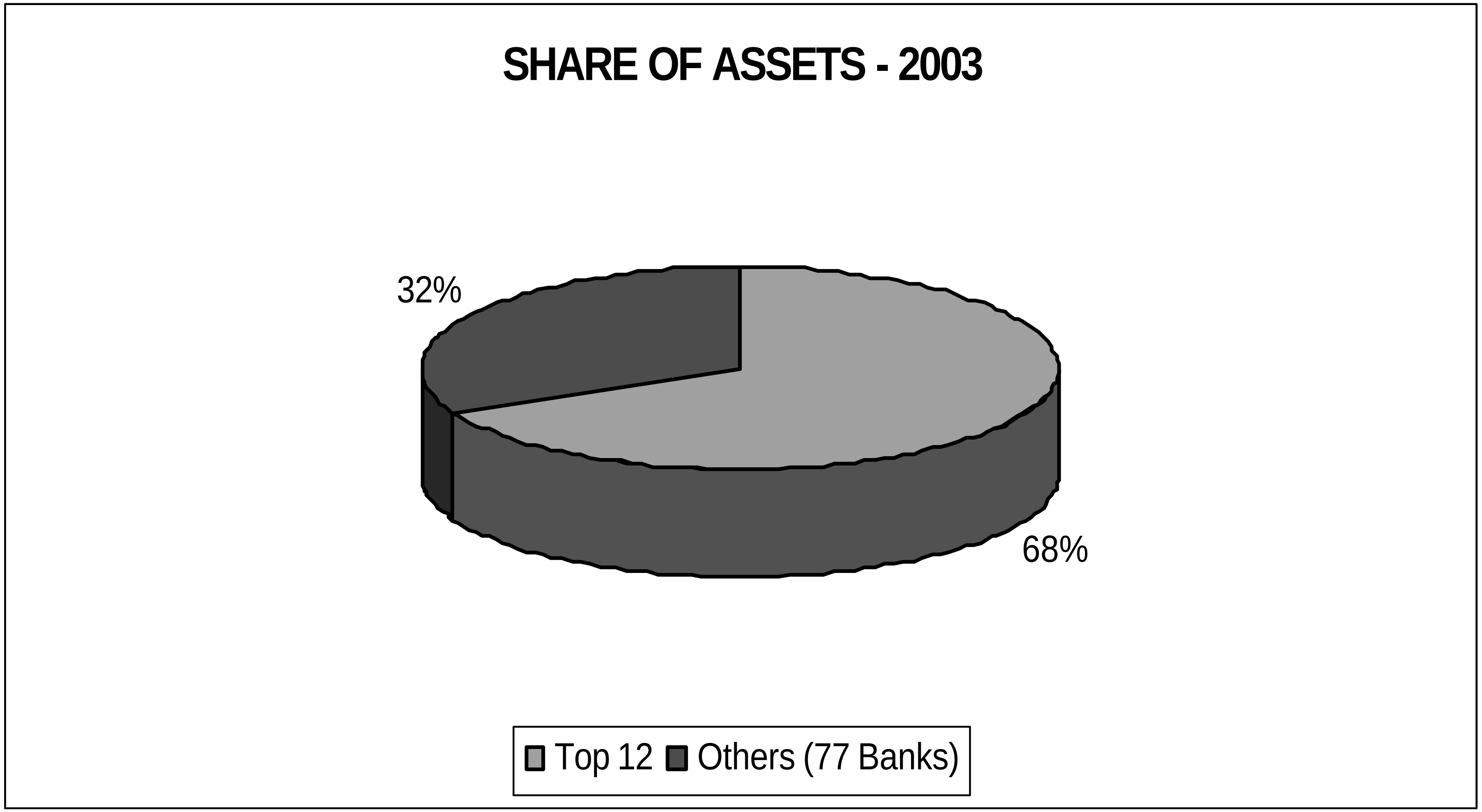


Market Concentration Trend
Index
900
800
700
600
500
400
300
200
100
0
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
HHI

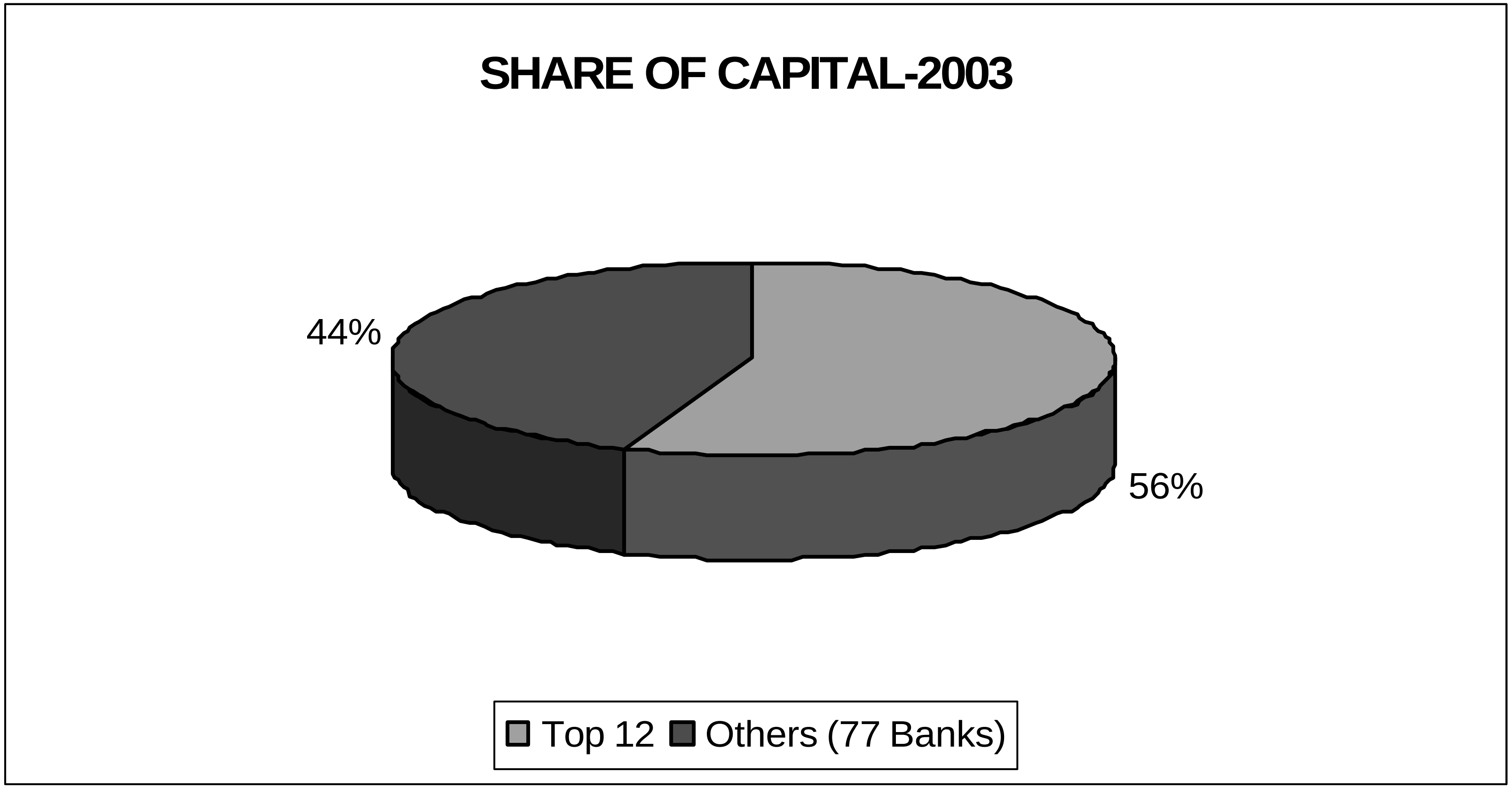
Market Share – Deposits



Market Share – Assets



Market Share – Capital



The Real Issues

- Is the Banking Sector facing any problems/Issues?
- Can consolidation driven by regulatory intervention address the problems/Issues facing the Banking Sector today?

Problems/Issues of the Banking Sector

- Financial & Business Perspectives
  - Significant asset quality problems
  - Undercapitalization of a number of industry players
  - Thinning spreads
  - A number of industry players operating at scale levels that cannot deliver competitive return on equity
  - Significant corporate governance issues
  - Need for enhanced risk management practices
- Customers' Perspective
  - Need for better service and diversified delivery channels
  - Need to access banking services at lower costs (only possible if industry costs are lowered)
- Learning & Growth perspective
  - Thin spread of experienced manpower
- Other Issues/Problems
  - Regulation needs to become fully abreast with actual operating practices
  - Desire for higher contribution to economic growth

Challenges & Opportunities of Consolidation

- Can the opportunities provided by consolidation address sectoral issues/problems or would the challenges just compound them?

Opportunities of Consolidation

- Injection of fresh capital into the industry
  - Addresses cases of weak capitalization directly or indirectly
  - Provides investment capital for service delivery systems and risk management capabilities
  - Improves ability to upscale
- Mergers/Acquisitions
  - Enables the industry to use increased volume to dilute the impact of inevitable margin reductions
  - Where successful, reaps the benefits of scale/scope economics
  - Reversal of thinned out experienced industry manpower
  - Likely dilution of “over bearing” share holders/board members
  - Provides a better platform for more effective banking regulation and policy realizations
  - Reality is that small-scale commercial banking without a high level of efficiency/niche strength in not economically viable

Opportunities of Consolidation

- International integration
  - Post consolidation banks will be come more internationally competitive especially in West Africa
  - Increased opportunities to access more significant offshore lines of credit to boost financing of local projects/companies
  - Increased ability to access certain up-market opportunities that are currently significantly not locally banked e.g. upstream oil & gas, Telecoms
- PFA competition is round the corner

Challenges of Consolidation

- Benefits are not automatic!!
  - Technology & process integration
  - Human resources upgrade
  - Culture clashes
  - Bigger is not automatically more efficient etc
- Return on Investment & management challenges
    - Increased capitalization will lower ROI in the short-term. Managers must resist the temptation of taking non-banking risks to boost returns
    - Banks must also manage the possibility of over-capitalization
  - Management Challenges
    - Are there requisite experience/skills to carry this through successfully within a short time frame?
    - Managers may be thrust into the deep end of managing large businesses they did not grow!
    - Managing a large commercial banking business is about managing risks, serving customers and controlling costs

Challenges of Consolidation

- Post Consolidation Banks Will Have To Lend
  - Credit underwriting and management skills become very critical
  - Meaningful economic contribution comes from channeling financial capital to efficient users, capital, particularly in sub-Saharan Africa is a scarce resource

Challenges of Consolidation

- Corporate Governance/Regulatory Oversight Must Work
  - Promised regulatory incentives must materialize
  - Key economic policies must complement banking reforms
  - A 25bn+ banking failure will be a disaster
  - A 25bn+ banking rescue will be too expensive

The real challenge

- Can we in this room use this consolidation process to ensure that our banking system embraces the structural changes to place us at the frontier:
  - Ability to support deeper financial markets, with dependability to settle trillions of =N= of transactions
  - Custodian of financial assets for large institutions
  - Ability to support the local economy with loans from locally and internationally sourced funding
  - Ability to better integrate us with the global financial system
  - Creating (at least) a leading African competitive financial system in terms of efficiency and cost

In closing

- The Business of Banking Has Not Changed, Time tested issues are:
  - Asset quality
  - Solvency and capital adequacy
  - Liquidity
  - Positive conservatism & Risk averseness
  - Strong risk management practices
  - Customer focus
  - Cost control

THANK YOU