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Building Resilience: Recapitalizing Nigerian Banks in the face of Severe Naira Devaluation

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Introduction

Recapitalization of banks refers to the process of increasing a bank's capital base by raising additional funds from shareholders, investors, or through internal means. This is usually done to strengthen a bank's financial position and to ensure that it has adequate capital to support its operations and absorb potential losses. Recapitalization is often implemented in response to regulatory requirements or as a proactive measure to improve a bank's ability to withstand financial shocks and risks.

In the context of the Nigerian banking sector, a pivotal transformation is underway. On 24th November 2023, the Governor of the Central Bank of Nigeria, Mr. Olayemi Cardoso, during his keynote address at the 58th Annual Banker's Dinner and Grand Finale of the 60th Anniversary of the Chartered Institute of Bankers of Nigeria (CIBN)[1], underscored the need to evaluate and assess the capacity of the Nigerian banking industry to meet the demands of a larger economy, considering Nigeria's projected economic expansion. To pave the way for this ambitious economic vision, the CBN Governor announced a strategic move – the directive for banks to increase their capital base.

President Bola Ahmed Tinubu's administration's economic agenda, as outlined in the Policy Advisory Council report on the national economy published in May 2023, sets a goal of achieving a Gross Domestic Product (GDP) of $1 trillion over the next 8 years. This economic expansion makes it vital for the CBN, as the apex regulator, to bolster the banking industry, ensuring Nigerian banks have adequate capital relative to the needs of the financial system to service a $1 trillion economy.

The last recapitalization of Nigerian banks, conducted by the CBN, was nearly two decades ago in July 2004 under the administration of former CBN Governor, Professor Charles Soludo. During this recapitalisation initiative, the CBN mandated banks to increase their minimum capital base from ₦2 billion to ₦25 billion, effective from December 31, 2005. This strategy led to a notable reduction in the number of commercial banks in Nigeria from 89 banks[2] to 25 banks.

The current initiative by the CBN is a welcome development, as the current capital base of Nigerian banks has significantly diminished, over the years, due to the loss of value occasioned by the depreciation of the Naira and inflationary pressures. Hence, it is imperative that the minimum capital requirement of Nigerian banks is reviewed to strengthen the financial system and ensure that banks can maintain financial stability and resilience in the face of economic challenges.
The urgency of this recapitalization becomes glaring when we examine the staggering decline in the real value of Nigerian banks' capital base. In 2004, the ₦25 billion capital requirement stood at approximately $186.5 million. Currently, in December 2023, the equivalent capital

[1] https://www.cbn.gov.ng/Out/2023/CCD/Governor_Address_CIBN_AnnualDinner_24Nov_Ver2%20Lagos%202.pdf
[2] The 89 Legacy Banks before Banking Consolidation in Nigeria

stands at a mere $26.3 million. The CBN foreign exchange rate in 2004 was around ₦134 to $1, while the exchange rate today is around ₦950 to $1.

Furthermore, there has been a considerable hike in inflation over the years. According to the National Bureau of Statistics (NBS)[3], the inflation rate in Nigeria rose to 27.33% in October 2023 from 26.72% in September 2023. This is a significant change from 2004 when the inflation rate was only 15%[4], according to a report on inflation by the World Bank.

The devaluation of the Naira and the upward trend in inflation rate make it essential for Nigerian banks to increase their capital base to ensure they can withstand any economic challenges and cater to the financial needs of the economy in anticipation of the projected $1 trillion economy by 2030. This strategy would also protect banks from financial distress and is commendable.

The strategy to recapitalize Nigerian banks is not just a safeguard against economic uncertainties; it is a proactive step to empower Nigerian banks to compete effectively in the global economy. Although Nigerian banks have experienced growth in terms of the volume of depositors' funds and bank assets over the last two decades, it is crucial to review their minimum capital requirements to align with current economic realities in Nigeria and globally.

Recapitalization directly affects the capital adequacy ratio, which measures a bank's capital relative to its risk-weighted assets. By increasing the bank's capital base, recapitalization improves the capital adequacy ratio, indicating a stronger financial position and a greater ability to absorb potential losses in terms of credit risk exposure and enhance risk mitigation. Recapitalisation would also boost the banks' lending capacity and facilitate access of capital to the strategic sectors of the economy including manufacturing, agriculture, and small-sized businesses.

Moreover, the recapitalization of the banking sector has great potential to strengthen the Nigerian economy by promoting Foreign Direct Investments (FDIs) into the banking sector. This will help stabilise the value of the Naira by attracting investment in foreign currency and providing opportunities for inflow of foreign exchange into Nigeria, ultimately contributing to economic stability.

The significance of this recapitalization drive was underscored by the Presidency in a goodwill message at the 40th anniversary of The Guardian Newspapers on November 28, 2023. A subsequent analysis in The Punch Newspapers revealed a positive market response, with certain financial institutions gaining over ₦101.18 billion in market capitalization following the CBN Governor's announcement.

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[3] https://nigerianstat.gov.ng/download/1241407

[4] https://data.worldbank.org/indicator/FP.CPI.TOTL.ZG?end=2022&locations=NG&start=2004

For the 24 commercial banks affected by this policy, proactive measures are imperative. Tier-1 national banks may weather the storm, but tier-2 institutions face uncertainty. Mergers and acquisitions, initial public offers, rights issues, and foreign investments emerge as viable strategies for the latter to meet the revised capital requirements, anticipated to range between ₦150 billion and ₦250 billion.

The significance of Nigerian banks in driving economic growth cannot be overstated. By recapitalizing, they will be better positioned to support infrastructural development, small and medium-sized enterprises (SMEs), and overall economic growth. The enhancement of their financial capabilities will also ensure greater confidence from both domestic and international investors.

The ability of banks to absorb shocks and risks is crucial for safeguarding depositor funds, preserving financial integrity, and sustaining the flow of credit in the economy. In this way, recapitalization serves as a proactive measure to strengthen the foundations of the banking system and enhance its capacity to support sustainable economic growth. This increased resilience enables banks to continue providing essential financial services, maintain confidence in the financial system, and support economic stability.

However, it is important for the CBN to consider the potential impact of the recapitalization policy on the tier-2 banks and ensure that appropriate support mechanisms are in place to aid their transition. Additionally, the regulatory framework should support a level playing field and promote healthy competition within the banking sector.

In conclusion, the CBN's commendable recapitalization policy is a strategic move to fortify Nigerian banks and position them as stalwarts in the evolving economic landscape. As the banking sector braces for the imminent changes in minimum capital requirements, proactive measures are paramount for sustainability and continued operational success. This initiative is not just a regulatory mandate; it is a critical step to ensure that Nigerian banks remain the backbone of the economy, steadfastly supporting the nation's economic expansion.

This article is authored by Mr. Ugochukwu Obi, a Partner, and Ms. Victoria Oresanwo, an Intermediate Associate, of the Banking and Finance Department of Perchstone & Graeys LP.

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