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Market Alert for July 2010:

The CBN and Economic Growth – Consistent Inconsistency



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"The key to delivering on a sound economic growth lies in the ability to bridge the disconnect between fiscal and monetary policies – avoiding over promising and under delivering.....just as avoiding creating an over-regulated environment which might act as an impediment to growth." – Executive Breakfast briefing Notes by FDC - 2009

Discussions on the Nigerian economy have largely been dominated by the focus on the banking sector for far too long. News reports, commentaries by money and capital market analysts, political leaders and law enforcement officers have tended to focus on this industry more than other sectors for the past decade and more. Less and much more focus has been placed on the non-quoted firms as well as other sectors listed on the bourse of the Nigerian Stock Exchange. The often used mantra, especially during the previous years was that the economy will go the way the banking sector goes – Nigeria, like London would become the financial hub of Africa.

Those who make these arguments advance the claim that stringent application of regulatory oversight and the all-in approach of an apex regulator (*as now adopted by the UK government*) from the monetary side can advance the development of the Nigerian economy.

The position is plausible if we had an integrated financial service blueprint that was linked to fiscal execution imperatives. But then, Nigeria has never been able to deliver this save for a brief period during the **Dr. Okonjo Nwela** and **Prof. Chukwumah Soludo** stint in office – before it all fell apart. The success of the debt relief, economic growth and clarity achieved then could be attributed to a measured use of regulation supported by a linkage between monetary and fiscal policy decisions.

Evidence available today however appears to indicate that we have gone further southwards in achieving this linkage with an over concentration on regulation – not just as a tool of management but as a means of re-ordering societal values and emphasis.

The latter will be a matter for a post-script at some later date in the future. Of immediate importance at this time must be the former – the role of CBN in managing the banking sector changes we all agree to (the diagnosis is correct by the CBN Governor) and the overall impact of the sector on the economy.

It appears quite clear that the CBN and indeed, most players in the administration of the country's affairs desire to advance a climate that promotes an enabling environment for firms to grow their contribution and expanded linkage to the economy - albeit; in a virtuous way. This is where the contradiction apparent in new developmental economics throws a nation a curve ball.

Rather than be a veritable source of growth, it is appearing clear that over-regulation is acting as an impediment to growth.

A cursory review of the growth trends of the banking sector compared with the telecoms sector, breweries and the conglomerates (either singularly or as a block) reveals that while the banking sector growth is declining, the others are ascending – and that is despite the fact that these industries equally enjoy some form of regulation as well.

Whereas the banking sector had some many of its players are seriously considering approaching the market to raise money (*equity and bond*), NB plc and Guinness Nigeria plc have not and do not intend to. Why is this so?

It is the intention of this paper to present a birds' eye commentary on the aggressive yet inconsistent application of regulation as a driver of growth. When one considers the examples of the south East Asian countries and compare this to other nations where aggressive regulation has been deployed consistently, the conclusions are stark.

To start of the discussion, we begin with a review of developments in the banking sector vis-à-vis the regulatory interventions that have taken place – steps which have been adequately documents in our reports – The Bull in the China Shop and 100 Days After – actions which delivered another major inconsistency yesterday with a press release from the CBN reproduced below:

The CBN Press Release - 280610

“Our attention has been drawn to *Newspaper reports expressing concern on the deadline of June 30, 2010* given to Unity Bank Plc and Wema Bank Plc to recapitalize.

We wish to inform the general public that **due to unanticipated three months extension in timeline for setting up Asset Management Corporation of Nigeria (AMCON)**, the Central Bank of Nigeria has granted a three months extension for the two banks to recapitalize. The Central Bank of Nigeria is fully abreast of the *significant progress* made by the boards of the two banks on their recapitalization and is *satisfied* with the efforts.

It is our hope that with the progress made so far, the two banks should be recapitalized by the end of September 2010 through the combination of sale of toxic assets to AMCON and injection of fresh capital.” - Signed: *M.M. Abdullahi, Head, Corporate Communications, 28th June, 2010*

Background

It will be recalled that following the audit report jointly instituted by the CBN and the Nigeria Deposit Insurance Corporation (NDIC) on the 24 money deposit banks (MDB) in the country last year, Unity Bank Plc and Wema Bank Plc were directed by the apex bank to **recapitalize to the tune of N25 billion minimum capital requirements on or before June 30, 2010 or close shop**.

The October 03, 2010 declaration by the CBN Governor (excerpts):

- ➊ After a review of the findings of the Special Examination report in respect of these 14 banks, the CBN said it came the following conclusions:
 1. “The following 9 banks were found to have adequate capital and liquidity to support the level of their current operations and future growth: Access Bank Plc, **Citibank Nigeria Limited**, Ecobank Nigeria Plc, Fidelity Bank Plc, First City Monument Bank Plc, Skye Bank Plc, Stanbic IBTC Bank Plc, **Standard Chartered Bank Limited** and Zenith Bank Plc.
 2. The 10th bank — which is **Unity Bank** — was adjudged to have **insufficient capital** but not in grave situation because it has a **healthy liquidity position**.
 3. The remaining four banks were found to be in a grave situation: **Bank PHB Plc; Equitorial Trust Bank Plc; Spring Bank Plc;** and **Wema Bank Plc**.
 4. “After a careful consideration of the matter, and in exercise of the powers conferred on him by **Sections 33 and 35 of the Banks and Other Financial Institutions Act 2004**, the **Governor of the CBN, by order in writing**, has taken a number of measures aimed at arresting the grave situation of these four banks. The measures are:
 - d). the order to the board of **Wema Bank Plc to recapitalize by 30 June 2010**. It is noted that Wema Bank Plc came under new ownership and management in June 2009 who took over a bank already in a grave situation and **should not be held responsible for the present condition of the bank**. The CBN will work with the Bank to ensure a successful completion of the recapitalisation exercise.
 - e). The provision of a total of **N200billion (USD 1.45bn)** by the CBN as liquidity support and long term loans for the four banks adjudged to be in a grave situation to enable them

continue normal business, while pursuing recapitalisation options – NB: No breakdown/allocation was provided.

f). The order to the board of **Unity Bank Plc. to recapitalize by 30 June 2010**. It is noted that Unity Bank Plc was adjudged to have insufficient capital for its current level of operations but was adjudged to have a healthy liquidity position and with no indication of poor corporate governance practices.

- ① The CBN has therefore exercised its powers under Section 13.3 of BOFIA to order the Board of **Unity Bank Plc** to recapitalize by the said date and the CBN will continue to monitor this situation.
- ① "In addition, the **CBN will assist the five banks** with insufficient capital **in their loan recovery efforts**, just as it did with the previous five.

The June 30 deadline – Another in a long line of shifting targets

We reviewed the intelligence available to us and sought clarifications from the CBN on the outcomes of the pre-qualification exercises done for the banks, the much published sale of the R8 banks, the delay in getting a presidential assent and the implications of the June 30, 2010 deadline for Wema and Unity banks.

We did not get any response both to our text messages, e-mails and formal letter. We therefore decided to run a market-engagement communication and specifically, an advertorial on the self-imposed N25billion recapitalisation deadline set for the two banks – Unity Bank plc and Wema Bank Plc – by the Central Bank of Nigeria (CBN) on October 03, 2009; on the heels of an earlier decision on August 14, 2009 to take over five banks considered of systemic importance to the financial system; a significant part of the snowball effect of the 'fast-paced' intervention/'reform' in the market. *See the 100 days after report - http://www.proshareng.com/admin/upload/reports/100_days_after_Report_-_Proshare_251109.pdf - pages 13 to 15.*

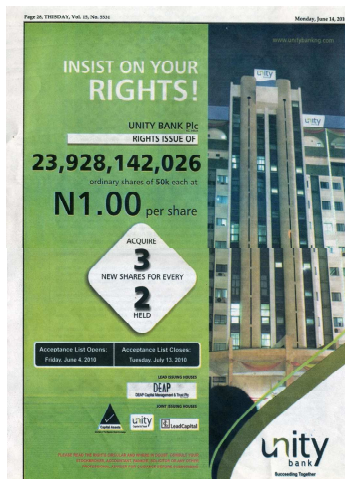
The reasoning was simple enough - **the action taken by the CBN had put on the line its institutional integrity!**

Feedback Received from the Market

The feedbacks received from the proshare investment community up till and including Friday, June 24, 2010 were that:

- 1. Wema Bank Plc** would not be able to meet the N25billion capital base deadline for recapitalisation as it had always been since the Soludo era.
- 2.** The management of Wema Bank Plc under SW8 Consortium was trying hard to meet the deadline under very excruciating circumstances that derailed their initial investment plans.
- 3.** Wema Bank had embarked on an aggressive debt recovery effort which yielded some positive results (figures could not be substantiated) as well as a capital raising drive in 2010 which is yet to materialize.
- 4.** Wema Bank Plc was exploring the option of reverting to a regional bank in the event that the CBN proposed bank model comes into force in time before the deadline; as a fail-safe strategy to address the inability to plug the hole in the bank and meet the deadline.
- 5.** The Board of Directors of **Unity Bank Plc** and its financial advisers rose from a completion board meeting to roll out 23.928 billion ordinary shares of 50 kobo each at N1 per share to shareholders on the basis of three new shares for every two shares already held - <http://www.proshareng.com/news/singleNews.php?id=10773>

6. Unity Bank Nigeria Plc issued this advert now reproduced below - Rights Issue - <http://www.scribd.com/doc/33209822/Unity-Bank-Nigeria-Plc-Rights-Issue-June-July-2010-Advert-ThisDay-Newspaper-June-14-2010>



7. Unity Bank Plc sought to raise about **N23.9bn** from existing shareholders through a Rights Issue aimed at meeting the Central Bank of Nigeria (CBN) 10 per cent capital adequacy ratio for the bank. **The offer opened on Friday, June 04, 2010 to end on Tuesday, July, 13, 2010.** Specifically, the bank set out the purpose for the funds as follows: 50% or **N11.66bn** will be used as working capital/project finance; 25% or **N5.8bn** will be used for branch expansion; 10% or **N2.3bn** each for technology enhancement and human capital development, while the 5% or **N1.16bn** balance will be used for re-branding.

8. A consortium made up of northern businessmen under the auspices of *Arewa Investment Alliance*, is said to be holding talks with the board of directors of the bank, offering to pay **N11n** for a 40 per cent stake in the bank.

9. Both banks had released their financials for December 31, 2009 and Q1 2010. The results can be found here - <http://www.proshareng.com/investors/company.php?ref=UNITYBNK> and <http://www.proshareng.com/investors/company.php?ref=WEMABANK>

The alert we issued continued to generate interest with concerns generated from within and outside the country. Based on this, we reproduced a report by the *Tribune newspaper* yesterday on the subject - <http://www.proshareng.com/news/11128> - with a commentary where we concluded that '**we are concerned**'.

Questions! Questions!! Questions!!!

Reviewing the realities above and juxtaposing same against the communication from the Central Bank of Nigeria (CBN), the following questions become pertinent:

1. Why did CBN approve the Unity Bank Plc Rights Issue when it knew it would not be concluded as at the June 30, 2010 deadline it self imposed?
2. What informed its hasty decision on October 03, 2009?
3. When did the CBN disclose any information about a 3-month extension in AMCON and what has that got to do with Wema & Unity Banks?
4. Given that the CBN Governor has in the last nine months given three different dates for the AMCON take-off, is there not enough evidence to doubt the institutions credibility in target setting?
5. Given that the banks did not formally apply for an extension, when did the CBN know it was going to grant an extension and why did it not do same till the last day before the www.proshareng.com

expiration? It could not have had an opening for compliance as both Wema and Unity were obviously not ready.

6. In granting this extension, two days after it issued letters to bank directors it now found not to have been involved in the corporate malfeasance allegations it made; is there pressure upon the CBN to take these decisions? If their in none, are we therefore finding a CBN recognising that it had taken actions inimical to individual careers, failure of the financial system to provide the enabling environment to address the unintended consequences from the much regarded and diagnostically supported thesis for intervention?

7. What is the believability index to be ascribed to a CBN that is not bothered about shifting the goal post as often – without conceding the implications on fairness and impact on customers and investors alike?

8. What was unanticipated about the AMCON bill and why is it taking so long to get a presidential ascent to a bill that has been one year in the waiting and designed to lift the economy, nay country; out of a quagmire as other nations have done.

9. Given that the Bank of England, under the David Cameron government has reverted to the model of financial services administration used by Nigeria with the CBN as the apex regulator – how difficult is it to convince the Minister of Finance and the Goodluck Jonathan led government to consider an articulated plan of both monetary and fiscal policy to set Nigeria on the path of recovery and clarity of objectives/targets?

10. What is the purpose of the AMCON extension? Is it to give the president ample time to grant his ascent or to work out modalities for a bill already passed and expected to be passed? When one considers the statements by the CBN Governor that this bill will be passed in December 2009, then before March 2010 and later, not more than June 2010 – where is the credibility and confidence that this will come to pass?

11. What is the significant progress made by the boards of Unity bank plc and Wema Bank plc – since the CBN Governor is quick to make press releases on sensitive information and disclosures, why is there no measurable indices to work with here? On what basis is it satisfied with the banks and why were others not given such leverage?

12. What is linkage between the AMCON and Wema/Unity Banks? The press release seems to suggest that until the AMCON issue is resolved? both banks can and should take their time to resolve their obvious capital inadequacy issue. **How can the CBN encourage such a situation where a bank is operating for over a year with an inadequate CAR** and expect customers/investors to retain confidence in such an institution – simply because it says so?

13. With the pronouncement from the CBN about an extension of the timeline for the AMCON – the market will likely take on a wait-and-see approach in Q3 akin to what it has done in H1 2010. How does that help?

Therefore, how does this latest pronouncement help address the confused state of the market? It looks as if the whole 'reform' process ended today. What we have is a confused state of affairs and there can be no better way of putting it.

We now seem headed on a course that simply provides direction as events unfold with the regulators/leadership not being in 'control' of affairs; most especially in an election year.

The talk about the proposed new banking model which would make banks to operate in the category of the minimum capital base they could raise, further confounds than clarifies.

Apart from GT Bank plc, all the banks that made public pronouncements, including getting their shareholders consent at their Annual General Meetings about their **planned Bond offers** have not made the decision to approach the market to date – perhaps as an indicator of the market conditions we alluded to here – **FBN and the Planned Bond Offer** - <http://proshareng.com/blog/?p=31> – October 05, 2009.

See also the following: **Corporate Bond Craze and Its Implications on Financial Institutions in Nigeria**, Dr. Chukwumah Biosah, Monday, October 12, 2009 - <http://proshareng.com/blog/?p=35> and **New Bond Issues – Matters Arising**, Olufemi Awoyemi September 30, 2009 - <http://proshareng.com/blog/?p=20>

Could it be that the opportunistic investments identified then turned out to be a mirage, does not exist anymore; or simply disappeared/evaporated?

The Declining Relevance of the Banking Sector in Economic Development

What is happening when institutions cannot raise equity from the capital market nor through bonds except government treasury bonds for a government seeking to raise money internationally itself?

Suffice to say, the relative importance of the banking sector to the Nigerian economy as an enabler of growth has been structurally devalued and its linkages with the rest of the economy weak/broken.

The banking sector has been de-linked in terms of materiality and output to such an extent that some investors/depositors find T/bills and Commercial papers in others climes more attractive at this time; currency risk factored in.

You simply have to take a look at all the key indices of economic linkages that existed before now – if the banks were not acquiring assets for branch expansions, they were renting buildings on long leases, engaging construction workers, taking up accommodations in hotels or investing/lending towards the constructions of new ones, booking airlines for local and international travels or advancing loans (now discovered to have been high risk), creating employment; and investing in technology. This is no longer the case.

Today, the total banking sector cannot stand the individual and collective worth and economic relevance of the following sectors/companies – Breweries (**Nigerian Breweries Plc** & **Guinness Plc**, Conglomerates (i.e. the **Dangote Group**), and the teleoms sector (i.e. **MTN**) in terms of Turnover, contribution to the economy and market value/EPS.

The banking sector has the cash but not the outlet for extending risk averse credits – there are simply, perhaps ironically, not enough blue chip firms and multinationals that is able to absorb the cash available to the banks. The depositors/savers are seeking security and higher returns for their cash and have limited options to do so. Where do we go from here?

Conclusion

The impact of the strong regulatory regime employed (an understandable position coming from the knowledge of how the system of patronage and circumvention of policy regimes work in Nigeria) has not, at this time at least, achieved or provided an indication of achieving, the desired goals.

Could it be a function of early days? As romantic as the prospects seem, economic realities are not known to be fond of romantic ideals. They exist and survive on the basis of impact and consequence.

The banking sector therefore, by this pronouncement from the CBN, is yet to get out of the unintended consequence of the intervention clearly.

Maybe, it is time we reconsider the approach to managing the economic implications of this developments. We are aware that the Minister of Finance and the CBN Governor spend considerable time reflecting on these issues and continue to seek the best for the country. Maybe, they should consider employing a more quantitative approach terms and not mere expression of a wish list and empathy towards the decline in growth, quality and relevance of the key indices of a sovereign state.

The question/issues we should now be focusing on is no longer about the banks and the banking sector, it is about the economy and the policies – monetary and fiscal that drive it on a consistent and quantitative manner for the benefit of the state and the citizens.

Can the Central Bank of Nigeria and the Ministry of Finance kindly step up to this compelling requirement?

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