Determining the Strategic Consolidation of the Capital Base of Nigerian Commercial Banks

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Abstract

The reformation of the banking industries by the Central Bank of Nigeria requiring banks' to consolidate their capital base to ₦25 billion (about $166.7 million) became an optional concern to various managers in the banking industry. It thus became a necessity on the corporate managers of banks to decide on the different alternatives available to them by considering different criteria in order to strategically consolidate. This paper employed Analytic Hierarchy Process (AHP) as an evaluative tool for strategic reconsolidation of capital base by banks, using the recent experience of six merger/acquisition banks. The aim of the study specifically was to evaluate whether decisions taken by the various groups of banks in meeting the $166.7 million capitalization level could be proved right scientifically. The results confirmed that decisions taken by most of the groups of banks conformed to our scientific result with the exception of only one bank confirming the appropriateness of the AHP approach in such decision-making scenario.

Keywords: strategic consolidation, capital base, Nigeria commercial banks, analytic hierarchy process.

INTRODUCTION

In recent years, the Nigerian economy has witnessed introduction of a large number of reforms aimed at improving the economy. To this effect, the Nigerian banking industry experienced a major policy change in 2004 when the Central Bank of Nigeria announced that banks operating in Nigeria had to consolidate their capital base (Soludo, 2004). Prior to this, there were 89 deposit banks operating in Nigeria, institutions of various size and degree of soundness. Structurally the sector was highly concentrated as the ten (10) largest banks accounted for about 50 percent of the industry's total assets/liabilities. Most banks operated with a capital base of less than $10 million. The largest bank in Nigeria, as of 2004, had a capital base of about US $240 million compared to the $526 million for the smallest bank in Malaysia. Apart from this, Soludo (2004) had noted that the problems facing most Nigerian banks include persistent illiquidity, poor assets quality,

and unprofitable operations. Nigerian banks seemed overtly dependent on the government and government-owned parastatals. The complications were that the resources of such banks were weak and volatile, making their operations highly vulnerable to swings in government revenue arising from the uncertainties of the international market. Against this background, the Central Bank of Nigeria introduced a minimum capitalization requirement for banking institutions. Full compliance was required before the end of year 2005, with a view to enhancing banking efficiency, size and developmental rates.

The banking reform required banks in Nigeria to have a minimum capital base equivalent to US $ 167 million. This requirement meant that a number of existing banks had to consolidate their capitalization through merger, acquisition or issuing of shares. Affected banks were therefore required to make strategic decisions on how to consolidate. Corporate managers had to critically consider the options available and then make decisions by considering various criteria in order to strategically consolidate the capital base. The decision to merge or be acquired was of concern to the corporate managers, bearing in mind such decisions, when not well considered can go awfully wrong. Thus, the ultimate purpose was to come up with the best option that would be effective in successful consolidation. The Analytic Hierarchy Process (AHP) model can be helpful in this regard. This study used AHP model to evaluate the optimality of decisions made by management of the sampled banks.

As the Central Bank of Nigeria gears up to increase the minimum capitalization base for banks in future years, the transformation problem remains how to achieve the strategic consolidation. The AHP is a decision model is a framework that could be utilized by organizations like banks when addressing such problems. This paper therefore adopts the Analytical Hierarchy Process (AHP) framework to assess the fecundity of strategic consolidation decisions made by Nigerian banks.

LITERATURE REVIEW

Since 1990s an unprecedented trend of banking consolidation activities has been witnessed across the global. According to Atmel *et al* (2002, cited in Tetsuji and Michiru, (2006)), more than 8000 bank consolidations occurred globally between 1990 and 2001 and the total value of the deals reached about $1,800 billion. The number and amount of deals increased sharply towards the end of the period. Banking reforms have been an ongoing phenomenon around the world right from the 1980s, but it has intensified in recent times due to the increased integration of the world market and economies driven by the globalization wave (Adegbaju & Olukoyo, 2008). In Nigeria, the banking reforms emerged after a banking crisis caused by highly undercapitalized deposit taking banks, weakness in the regulatory and supervisory framework, weak management practices, and the tolerance of deficiencies in the corporate governance behavior of banks (Uchendu, 2005 cited in Adegbaju and Olukoyo). According to Gyoray (2001), the quality and

effectiveness of bank regulation and supervision plays an important role in preventing bank crises. Introduction of such regulations forces bank management to the drawing board to re-strategize how to bolster their revenues taking into account the additional constraints.

Bolster, Janjigian and Trahan (2005) used AHP framework to determine investment suitability. The results of their study showed varying pattern of investment for the different age groups. Kurz et al. (2003) used a similar framework to evaluate determinants of stock market volatility and risk premium. Meziani (2003) used the AHP framework to determine critical investment barriers affecting foreign capital flows as well as national markets situations.

RESEARCH METHODS

In order to determine the best strategic consolidation option for the banks, this study utilized the Analytic Hierarchy Process (AHP) framework to guide the decision process. The AHP model deals with prioritizing of decision making by reducing complex decisions to a series of pairwise comparisons and then synthesizing the results. In addition, AHP gives room for sensitivity testing by computing a consistency ratio to do a check and balance on the consistency of the respondent to his/her subjective judgment (Al-Harbi, 2001; Anderson, Sweetly & Williams, 1994; Hallowell, 2005). When the consistency ratio CR $\leq 0.1,$ then the judgmental values of the respondent are considered consistent (Taha, 2005). Adaptation of the Analytic Hierarchical Process to this study required identification of the objective, the criteria (the factors that affect the objective) and the alternatives. Those are as follows:
(a) The objective to be achieved was strategic recapitalization to meet the minimum capitalization base ($ 166.7 million).
(b) The criteria were include:
  i.   Banks considering merger or acquisition.
  ii. The share capital of the bank, the total assets of the bank, liquidity level of the bank, and the market share of the bank.
(c) The alternatives strategies available were merger, acquisition, take over and affiliate.

This study adopted exploratory approach using both qualitative and quantitative approaches. The sample frame included was the 25 banks that emerged from the consolidation exercise and located in Lagos city. AHP framework was considered appropriate for the study because the criteria and alternatives used in the decision making process involved both tangible and intangible factors. Intangible factors being non-quantifiable variables that could only be rated based on human perceptions and judgments. The AHP framework can be used to integrate different types of factors in order to arrive at a good decision. The choice of AHP was apt given that it is gaining acceptance.

The AHP model for the Study

The AHP methodology adopts the use of diagram in form of hierarchy to model real-life situations (Saaty, 1980). The four levels of the model are as follow:

First level. The objective: Achieving strategic consolidation of capital base to $ 166.7 million.

Second level. The banks considered in achieving the objective

Third Level. The criteria considered in order to achieve the objective.

Fourth Level. The alternatives that can be used to meet the criteria.

The six banks considered in the study were:

(1)   UBA Plc.: Made up of UBA and Standard Trust Bank

(2)   Access Bank Plc: Made up of Access Bank, Marina International Bank and Capital International Bank.

(3)   Platinum/Habib Bank Plc.: Made up of Platinum and Habib Bank.

(4)   Skye Bank Plc.: Made up of Prudent Bank, EIB International Bank, Bond Bank and Reliance Bank

(5)   Union Bank Plc.: Made up of Union Bank, Union Merchant Bankers, Universal Trust Bank (UTB), and Broad Bank.

(6)   Wema Bank Plc.: Made up of Wema Bank, National Bank and Lead Bank.

The first level of the AHP hierarchy is the objective to be achieved, which is achieving the minimum capitalization base requirement. The second level relates to the factors that affect the objective, that is, the banks under consideration. The third level relates to the criteria considered as factors that the banks could consider in achieving the objective. Finally, the last level has to do with the main options or alternatives that the banks had in order to achieve the objective.

The priority values were derived by carrying out the comparison from the last level and ranking up to the first level. First, the alternatives (merge, acquisition, take-over bid, and affiliate) were compared with one another under each criterion in the third level (share capital, total assets, liquidity level, managerial skills and market share). The judgmental values were synthesized to determine the priority values for each alternative under each criterion. Next, the third level criteria were compared with one another and the judgmental values were also synthesized to derive the priority values. This process was also carried out for the second level. The final step in the analysis was to determine the overall priority ranking. The priority value for each criterion was considered as a weight that reflects its importance. The overall priority was derived for each alternative by summing the multiplication of the weight of each criterion with the weight of each alternative under each criterion. The highest value was considered the best alternative. For each synthesis, the consistency ratio was computed with a requirement that it be less than or equal to 0.1.

Sample

For the purpose of this study, the target population was determined subjectively and purposively and was made up of 25 Nigerian banks that had recently consolidated. A random sample of six banks was selected out of the 25 consolidated banks in Lagos city. Limitations of time, finances and given the fact that the study is exploratory informed the choice of the sampling method. The selected banks were; UBA Plc, Access Bank plc, Wema Bank plc, Skye bank, Union Bank Plc, and Platinum/Habib Bank. Since the decision to merge, acquire or affiliate was the responsibility of the top managers, data used in this study was gathered from senior managers using questionnaires. The questionnaire was adapted from Saaty's preference scale. Seventeen (17) questionnaires were distributed to the top and senior managers of selected banks with 100 per cent response rate. The survey instruments were administered after the banks had made decisions on how to consolidate. Our purpose was thus to assess whether similar decisions would have been arrived at if the AHP framework had been applied.

Data Analysis
The dichotomous questions were analyzed manually through counting and the use of frequency distribution and simple percentages. The AHP software package – "the Expert Choice" was used to process the resulting data. The eigenvalues, consistency indices and consistency ratios obtained from the processing of the information supplied by the respondents revealed that the consistency indices (CI) were less than 0.1, indicating consistency in judgmental values of the respondents.

The composite priorities, that is, priorities for the strategic options, were computed for each of the groups. The comprehensive composite priorities for all the groups, with respect to the various alternatives, are presented in Table 1.

TABLE 1
Comprehensive Composite Priorities for Sampled Banks

Group	Merger	Acquisition	Takeover	Affiliate
UBA Plc	0.2057	**0.3111**	0.1979	0.1748
Access Bank Plc	**0.3822**	0.2710	0.1895	0.1859
Platinum/Habib Bank Plc	**0.3774**	0.2224	0.3403	0.2154
Skye Bank Plc	**0.3485**	0.1823	0.157	0.2274
Union Bank Plc	0.2737	**0.3677**	0.1954	0.1889
Wema Bank Plc	0.2292	**0.3728**	0.2247	0.1624

The composite priorities show that for Access Bank Plc, Platinum/Habib Bank Plc, and Skye Bank Plc. merger was clearly the highest priority while the rest had acquisition as their highest priorities. For Platinum/Habib Bank Plc, the prior was not that clear as takeover was a very close rated priority.

DISCUSSION

First, we take note that the comparison of the results of the AHP model with the actual course of action that was taken by these banks. Five out of the six banks actually implemented the same course of action as shown in the results of the AHP model. Access Bank Plc, Platinum/Habib Bank Plc, and Skye Bank Plc consolidated through merger while Union Bank Plc and Wema Bank Plc consolidated through acquisition of the smaller banks. The only inconsistency found was consolidation of UBA Bank Plc whose actual decision was to consolidate through merger as opposed to AHP priority of acquisition. However, we take note that merger was the second ranked priority for UBA Bank within the AHP framework and thus the outcome is not widely divergent.

Conclusion

In this article, we sought to compare decisions made within the AHP framework with actual decisions made by a select number of Nigerian banks. Our results indicate that the Analytic Hierarchy Process (AHP) framework can equally useful in making strategic decisions of this nature. The beauty of it is the simplicity of the AHP framework that is devoid of numerical complexities associated with other decision criteria.

However, this study did not investigate whether the approach was successful over the longer term. This would be particularly interesting in the case of the bank, UBA Bank, where the results of the AHP process and the actual strategy were different. It would be interesting to conduct further investigation on how the AHP framework would perform in different decision-making scenarios. It would also be informative to see how the AHP derived strategies perform in the long term. This study suggests the AHP framework is feasible in decision-making process.

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