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THE FUTURE OF THE FINANCIAL SERVICES INDUSTRY IN NIGERIA

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INTRODUCTION

I wish to express my profound gratitude and appreciation to the Chartered Institute of Bankers of Nigeria and the Nigerian Association of Management Consultants, joint organisers of this workshop, for inviting me to the workshop and giving me the honour of addressing its formal opening session. I am delighted that the organisers have chosen as the subject for this workshop, a matter which is of crucial interest to all of us. The subject is of significant interest not only for managers and owners of financial institutions but for many others, including managers of non-financial business enterprises, public sector financial planners and administrators and of course, the relevant regulatory authorities.

The policy of financial liberalisation and de-regulation pursued since 1986 has, as expected, produced an environment favourable to the emergence of competitive financial markets, increased efficiency in the delivery of financial services, a more rapid pace of financial deepening and safer and financially stronger institutions. Furthermore, the specific programmes aimed at the needs of micro-enterprises and the rural economy have helped to broaden the scope of financial services more effectively than before.

However, while the early indications from these reforms have been positive, the modest gains have tended to be over-shadowed by the volatility of the financial markets. The recent gyrations in interest rates and the exchange rate in particular appear to have created considerable uncertainty as well as risks which the industry, at its current stage of development, is unable to accommodate adequately through the provision of affordable hedging instruments. In these circumstances, the industry's potentials for supporting the Nigerian economy remain substantially under-exploited while managers of individual institutions in the industry face unusual difficulty in putting together long-term strategies for profitable operation and growth. The importance of the outcome of this seminar, therefore, could hardly be exaggerated.

In the remaining part of this address, I will attempt to characterise the present state of the industry, consider some of the trends that are exerting the pressure for change and adaptation in the industry and share some thoughts with you on the nature of response called for by the on-going forces of change.

THE CURRENT STATE OF THE FINANCIAL SERVICES INDUSTRY

The paucity of data on the activities of large segments of the financial services industry in Nigeria, constitutes a major obstacle to any effort at presenting a satisfactory survey of the industry as a whole. Even for those segments for which considerable data are available, the quality, continuity, and scope of such data all present difficult problems. Hence, the analysis of such trends as profit performance, revenue growth, interest spreads, non-interest incomes, non-interest expenses, asset quality and capital adequacy could hardly be done satisfactorily except for banks and even then not readily. I will, therefore, limit myself to a few qualitative statements mainly about commercial and merchant banks. Among these institutions, the broad categorisation into financially sound and problem institutions remains relevant. Most banks have continued to show good income performance, reasonably good asset portfolios and adequate capital while a relatively small but not insignificant number, have remained weak, unstable and some severally distressed.

In terms of growth and diversification, the finance industry has made significant advances. Commercial and merchant banks, the dominant institutions in the industry grew in number from 40 at the end of 1985 to 120 at the end of 1992 and their total assets from N37.0 billion to N219.2 billion at the end of November 1992. Perhaps, more remarkable in the last three years, has been the vast expansion in the number of community banks, a tier of banks whose services are targeted at micro-and small-scale enterprises and the rural sector. Their number rose from 66 at the end of 1991 to 401 at the end of 1992. The Peoples' Bank established in 1990 has also made an impact among the low-income and micro-enterprises. The number of its branches stood at 206 at the end of 1992.

Savings institutions have become quite a force in the financial services industry, with the emergence of mortgage institutions whose number has been growing rapidly. From 23 in 1991, the number of such institutions licensed rose to 145 at the end of 1992. One novel development finance institution, the Urban Development Bank, was established in 1992, bringing the number of development finance institutions to five. Two large segments of the industry, which have also experienced rapid growth, are contractual savings institutions including insurance companies and provident/pension funds and credit institutions dominated by a large number of financial services enterprises often described as finance companies. The number of the latter currently in business exceeds 500. Other institutions in the financial system in Nigeria today include unit trusts - which are the only collective investment vehicles so far in the system - stock brokers and securities dealers, bureaux de change and discount houses. The regulatory agencies include mainly the Central Bank, Nigeria Deposit Insurance Corporation, Securities and Exchange Commission, Federal Mortgage Bank and the Federal Ministry of Finance. There are as yet no credit-rating agencies.

While the range of services provided by the industry is now quite broad, there is considerable room for further expansion and development in terms of both the number of institutions and instruments of financial intermediation. The money and the capital markets both require a larger presence of institutional and other investors as well as dealers so as to raise the level of secondary market activity and thereby increase the liquidity and efficiency of the markets. The industry as a whole is also yet to blossom in the area of derivative markets and products such as futures contracts, options and swaps, which by providing essential risk hedges, increase the contribution of financial services to overall development. Securitisation, the rising star in the financial services industry around the world, is currently in its infancy in Nigeria.

MANAGING CHANGE IN THE FINANCE INDUSTRY

In finance, as in other industries, future survival and prosperity hinge not only on the ability to respond effectively and creatively to the challenges and opportunities presented by the forces of change from within and outside the industry but also to anticipate and dictate the forces of change. There are several such forces at work within the domestic, as well as the global setting. These include, growth and structural change in the domestic economy, financial liberalisation and deregulation, financial innovation, regulatory reforms and the growing integration of financial markets across the world following increased capital mobility. I will elaborate briefly on these factors of change.

On growth and structural economic change, it is important to stress that the size and nature of demand for financial services are both dependent on the pace of economic growth and the character of structural transformation taking place. Hence, a fair understanding of the underlying trends and the future direction of the economy are essential inputs for a successful medium and long-term strategy in the industry.

Deregulation gathered momentum in the advanced industrial countries in the 1970s and 1980s as a response to structural shifts which had already taken place in the financial services industry. In Nigeria, the situation was much less so. Nevertheless, deregulation, as such is transforming the competitive landscape across the financial services industry and demands creative responses on the part of institutions to ensure continued survival, profitability and growth.

Financial innovation has been the hallmark of the financial services industry in the advanced countries for over three decades. The creation of various new products in these countries was induced by competition and the opportunities presented by existing tax and regulatory regimes and was facilitated by advances in computer technology. Financial innovations often gave rise to regulatory reforms, which in turn have engendered further innovation, followed by yet other reforms in regulation in an apparently never-ending cycle. In Nigeria, the last few years have witnessed the adoption and adaptation of some of the known innovations on a significant scale.

The last important factor of change mentioned earlier is the globalisation and integration of financial markets. This development has so far been largely limited to the industrial countries and emerging markets in Asia and Latin America. Nevertheless, the integration of the money and capital markets with the world markets in Nigeria would increase significant as the current policies of trade liberalisation, financial market deregulation and exchange rate reforms take a firmer hold. As this happens, developments in financial markets around the world will have an increasingly important influence on the local markets.

CHALLENGES FOR THE INDUSTRY

Given the trend outlined above, the financial services industry in Nigeria is likely to undergo significant structural changes over the next few years as competition both within and between subsectors of the industry grows more intense. The financial markets are expected to grow and become more active as the liberalising reforms of the last few years exert a more decisive impact and as new institutions and instruments find their way into the markets. Of particular importance here are derivative products which are fast becoming an essential feature of an efficient financial services industry.

In particular, the industry would have to evolve modes of operation largely devoid of the rigidities and inefficiencies which over the last few years had contributed to costly volatility especially in the money and foreign exchange markets. It is acknowledged that the monetary authorities have an important role to play in creating a stable macroeconomic environment. Nevertheless, the influence of the industry over conditions in the financial markets has become substantial since the industry is by and large, no longer subject to bureaucratic control in the setting of prices or rates. In this regard, let me point to one example that has given the authorities cause for concern. This is the existing phenomenon of wide disparity in deposit and lending rates in the banking sector and unduly high effective lending rates. In December 1992 for example, commercial banks' savings deposit rates varied from 13.5 to 25 per cent while their prime rates ranged between 25 and 46 per cent. Merchant banks' rates on 90-day time deposits varied from 19.5 to 65 per cent while their prime rates ranged between 30 and 61 per cent. Apart from these large disparities and very large spreads, there are other anomalies in the interest rate structure which I can not go into here. Suffice it to say that these structural anomalies are an indicator of a system with very limited capacity for bringing about improvements in efficiency in the allocation of resources.

The financial institution of the future would have to be able to make substantial investment in new technology and personnel skills and be capable of undertaking a fair amount of research and development. In the new operating environment, success will also require substantial capabilities for analysing and making forecasts of major domestic economic trends and to some extent, the conditions in financial markets around the world. All of these point to the imperative of maintaining, on the part of all institutions, the highest standards of operation and aggressive build up of capital.

CONCLUDING REMARKS

In concluding this keynote address, I wish to highlight some of the leading issues for the financial services industry now and in the near future.

First, there has been a proliferation of market participants and the variety of institutions and products. Consequently, there has been intensified competition which calls for innovation, enhanced efficiency and customer/ consumer orientation.

Second, and arising from the first point, is the task of bringing about a common, level playing field to minimise the incidence of "regulatory arbitrage" and enhance allocative efficiency.

Third, there is the problem of increased systemic risk arising from increased off-balance sheet transactions, increased exchange rate and interest rate instability, declining quality of loan assets and the increased number of distressed institutions. The problem of distressed institutions, in particular, calls for enhanced and robust supervisory remedies involving the most cost-effective failure resolution options, including, restructuring, mergers, acquisitions, sale or liquidation.

Fourth, with the movement to the indirect approach to monetary and credit control, there will be increased need for the use of moral suasion by the authorities as a way of sensitising and signalling to the system.

Fifth, there is the issue of the continued suspension of the licensing of new banking firms which appears to be at variance with the on-going policy of financial deregulation. However, it should be stressed that there is no contradiction or ambivalence here. As I have stated on several occasions, deregulation does not mean the absence of controls, a situation of laissez faire. Indeed, there is scope for intervention by the regulatory authorities to give direction and ensure orderliness and stability. I should also explain that the continued suspension of licensing of new banking firms is in recognition of the fact that the underbanked (more correctly, underbranched) situation in the country could be remedied not merely by a proliferation of banking firms but by the expansion of the branch network of existing banking firms. In any case, in the face of the increasing incidence of financially distressed institutions, the compression of operating margins etc, it should be obvious that what we require now are rationalisation and consolidation. However, there is scope for innovation.

Sixth, I wish to touch briefly on the role of finance companies. As you may be aware, prior to the promulgation of BOFID, finance companies were largely unregulated and unsupervised. It was in recognition of their role that they were brought under the purview of CBN regulation and supervision. There is no doubt that finance companies have an important role to play in the economy especially in the intermediation of funds, filling credit gaps, equipment leasing, generation of employment etc. in aid of economic growth and development. However, in recent times, a crisis of confidence has emerged in this segment of the financial services industry arising from defaults by some companies in meeting their obligations and the criminal and polluting activities of unlicensed so-called "wonder banks" engaged in illegal pyramid or commodity trading schemes. Consequently there has been a deposit run on such institutions. Indeed, there has been increased "flight to quality" and the defaulting finance companies are being increasingly marginalised. Although these natural corrective processes are acknowledged, there have been increased calls for more forceful intervention by the regulatory authorities. So what is the role of regulators/supervisors (CBN/NDIC/SEC etc) in the prevailing situation? Briefly, it is to provide an effective framework for off-site surveillance and on-site examination and to impose appropriate sanctions including suspension or withdrawal of operating licence, on defaulting finance companies. We would also identify and expose charlatans and tricksters operating in this segment in order to put investors on guard. Moreover, the situation calls for the coordination of the activities of the regulatory and supervisory agencies for the financial services industry in the interest of systemic stability and to block operating loop-holes. However, even more important is the need for investors and other market participants to be more circumspect about who they do business with. Perhaps, it should be stressed that the essence of the increasingly market-oriented system which the country is now operating is that hardwork, competence, sound judgement and integrity are rewarded while mediocrity, indolence and greed are penalised. For what could explain why investors, most of them otherwise enlightened or intelligent, would choose to place their funds in pyramid and commodity trading and other bogus schemes designed by spurious finance companies rather than settle for more modest but realistic and rewarding rates of returns with good banks and finance companies with credible track records, except stupidity engendered by overwhelming greed? For such people, investment advisers and the regulatory agencies can provide no remedies. It would appear that they would have to learn the hard way and become wiser through incurring huge losses. This is market discipline at work and over time it should serve to sanitise the system.

Finally, I wish to stress that the challenge of change for the financial services industry is considerable viewed from the perspective of both individual enterprises and the regulatory agencies. However, given the way the industry has managed the rapid pace of growth and diversification in recent years and the impressive evidence of growing sophistication especially in the banking sub-sector, the future looks very promising. It is my hope that the deliberations on this occasion will make a very important contribution towards shaping perceptions on the issues I have touched upon and many more others in the course of your Workshop.

Let me commend once again, the vision of the organisers of this Workshop.

I wish you successful deliberations.

Thank you one and all for your kind attention.