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A Review By
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I Introduction

The existence of a strong banking system has been identified as a major factor influencing the attainment of meaningful economic development and growth. In recent times, the interest of many developing countries have been on attracting more capital/investment from different parts of the world and at the same time enhance the flow of these funds to the productive sectors of their economies. This has increased the desire for strong bigger banks that can participate in the global financial market. As a result most countries have embarked on different reform measures that would make their banking industry a channel for mobilizing such funds.

The focus of the author was to review the recent transformations in the operations of U.S. commercial banks within the last three decades, 1970 to 2002. The transformations, which occurred mainly in the type of organizational structure of the banks, increased scope and scale of commercial banking and the size and spread of these banks in different regions of the country, can be of great value to developing economies. In the analysis, the author used the population of commercial banks including those under the same bank-holding companies, as they were treated as individual banks by regulators since losses by each bank were shared among the group.

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II Summary of the Article

The article was divided into three sections. Section one reviewed changes in the structure of the industry, and section two studied the trends in the balance sheet of all commercial banks, taken as a group, while section three carried out an analysis on the evolution of the income statement of the banks. In the analysis, the author found that:

(i) During the period 1970 – 2002, a major change that occurred in the structure of commercial banks in the US was the gradual movement towards consolidation. This move was necessitated by the need for the banks to increase their branch network to the national level, as against regional operations. This wave of consolidation in the US commercial banking industry was propelled by advancements in communication technology, which made bank customers who had acquired national presence in their businesses through the use of wide area network (WAN) facilities, to look for banks with a national branch network to facilitate their business transactions.

(ii) The move towards consolidation was evidenced in the increase in the number of mergers resulting from improved technology of production, factors influencing demand and government regulations. However, despite the reduction in the number of banks through consolidation, the number of branches was increasing, which allayed one of the fears that competition in commercial banking might be reduced when banks consolidate, as fewer and bigger banks dominate the market. Also, with the introduction of some regulations such as cross-guarantee provision for multi-bank holding companies, the number of unit (single branch) banks declined, while that of banks with branches increased, as most bank holding companies were made up of several unit banks.

(iii) Commercial banks, through the consolidation process, were able to boost investment and investors' confidence in the economy. This was evidenced by the relative stability exhibited by the ratio of banks' total assets to nominal gross domestic product during the period under review, indicating that the banks were keeping pace with the growth in economic activity. It was also found that though the commercial banks held a smaller portion of the total liabilities outstanding in the economy when compared to the level prior to consolidation, between 1992 and 2002, bank assets was growing faster than the total debt owed by the non-financial sector and the amount of debt owed by the financial sector (excluding government-sponsored financial institutions) was also growing faster than the amount of debt owed by the non-financial sector. This implied that the banks were actually keeping pace with the growth in economic activity through borrowed funds than deposits, as reflected in the declining ratio of banks' deposits to nominal gross domestic product.

(iv) On the assets side of the aggregate balance sheet of the banks, the proportion represented by loans and leases was stable during the period, while holdings of securities were fluctuating. However, with the implementation of better cash management techniques, the cash held by the banks was consistently declining throughout the period under study.

(v) As a proportion of total gross loans, real estate loans increased steadily, while commercial and industrial loans maintained a decline. Significantly, the increase in real estate loans was more noticeable in the investment portfolio of small banks, while the decline in commercial and industrial loan predominantly occurred in large banks. This trend was attributed to the slow down in business activities relative to other activities in the economy, which was confirmed by the decline in bank loans to the non-financial corporate business sector.

(vi) Most of the banks relied more on money market instruments and inter-bank borrowing than deposits to manage their short-term liquidity needs. This was reflected in the general decline of deposits at the banks.

resulting from the increased participation of mutual fund managers in financial markets as a channel for savings; and the use of money market instruments, which caused a significant shift from the use of deposits by the banks as a source of funding to equity and borrowed funds. Though time deposits were found to be stable during this period, demand deposits were declining while savings accounts continued to dominate the market. However, the share of total banks assets funded by core deposits (that is total deposits less large time deposits) was decreasing when compared with the share of total deposits. This meant that the banks used more of interest-sensitive liabilities (borrowed funds) than deposits for their loan activities. This confirmed the high loan-to-deposit ratio, which was found to be above one, as the banks had higher propensity to lend, especially with the lower reserve levels required by such liabilities.

(vii) On equity holding by commercial banks, smaller banks were found to hold higher capital ratios. This confirms that small banks tended to be less diversified in business and preferred to hold more equity capital to control the impact of agency costs in their access to external financing. Generally, the capital ratio of all the commercial banks was found to be increasing, which was largely due to the regulatory need to limit the risk exposure of banks through capital, as was reflected in the increased capital-to-asset ratio and the risk-adjusted capital ratio of the banks.

(viii) There was a significant increase in the annual return on assets at the commercial banks, especially in the large banks. This was attributed to the increased level of efficiency in assets management, improved technology and innovations and the involvement of the banks in more risky off-balance sheet transactions, which had higher rate of return. There was a steady decline of the non-interest expenses as a ratio of total assets, which implied that the banks were keeping their resource cost as low as possible by adopting best managerial practices, which was the key factor to the increased return on assets. Also, contributing to the high return on assets was the adoption of credit scoring in the banks and the increased spread of ATM networks, which earned high profits to the banks, especially those that, introduced such innovations early in their operations.

(ix) The involvement of the commercial banks in riskier activities was confirmed by the increase in the level of charge-offs (provision for loan losses) as a proportion of total loans corresponding with the same period that there were increases in the return on assets. This proportion of charge-offs to total loans was found to be higher in small banks, which confirmed their level of risk exposure in the bid to make higher profits. Expressing the net interest income (through deposits and lending) as a percentage of the average interest-earning assets showed that the resulting net interes margin was high in all the banks, especially in the medium-to-large banks. This contributed to the increased return on assets, which was consistent with the increase in default and interest-rate risks at the banks.

(x) There was a substantial increase in the non-interest income at the banks, especially on fees charged on deposit accounts as a proportion of total gross income. The contribution of salaries and employee benefits to non-interest expenses decreased during the period while other expenses increased. This was attributed to the move by the banks to outsource employment-intensive activities to other affiliates, which also contributed to the increase in the proportion of other expenses.

The author concluded by emphasizing that commercial banks still play a significant role in the US financial markets even though banking activities had changed from the traditional banking activities of mobilizing deposits and providing loans to businesses, to become a more riskier but profitable business.

III. Comments and Lessons for Nigeria

The strength of the article lies in the long run (over three decades) perspective it took in the analysis, which helped to capture the trends in commercial banking relative to the ups and downs experienced in the US economy over the years especially the move towards banking consolidation in response to the demand for strong banks that can stand in face of economic recessions. However, an important aspect of commercial banking not captured in the analysis was the impact of banking consolidation on interest rates and employment generation by banks, which is a major factor deterring most developing nations from embarking on banking sector consolidation.

The article contained many invaluable lessons for commercial banking operators as well as regulators in developing economies who would like to embark on banking consolidation. In Nigeria, with the on-going banking sector consolidation, the article has allayed some of the perceived negative fears associated with the process, especially on the implications for banking competition and spread through branch network, as consolidation was found to reduce the practice of unit (single) branch banking or family banking as the case may be.

Also, with the recent advancements in communication/information technology, which enhances operational efficiency in banking, there is need for Nigerian banks to merge in view of the huge financial resources required for the acquisition of such technologies. For example, the cost of operating and maintaining ATM machines, VSAT facilities, etc, by small banks would be minimized under a consolidated banking system.

The inadequacy of foreign capital flows into the Nigerian economy has hampered economic growth and development. The banking consolidation would help to enhance capital inflow to the country, as foreign investors would have more confidence in the system when there are reliable banks to transact their businesses. It would also enhance banks' ability to lend to the domestic economy and compel them to develop areas of interest or specialization where such funds can be effectively channeled into.

In addition, the banking consolidation would increase banks' profitability by promoting best managerial practices in the banking industry This means that a consolidated banking industry would make banks' to settle down to real banking, as banks would seek to develop value added banking services and products tailored to attract more customers On the other hand, monetary authorities in Nigeria should put in place adequate measures and policies to ensure that banks' role of mobilizing deposits is not mitigated by the proliferation of other deposit-taking institutions such as the mutual fund institutions, which may become avenues for banks to borrow funds instead of mobilizing deposits.

Another important aspect of banking consolidation, though not captured in the article is that in the short run there would be job cuts by banks especially with mergers and acquisitions, but in the long run with an increase in branch network of the banks employment generation would experience a leap On the other hand, interest on loans would continue to respond to the market forces in the short run, but would definitely stabilize as more funds generated by the banks in the course of consolidation are made available to the market. In summary, the article would form a useful guide for evaluating the banking consolidation in Nigeria in the near future