Nigeria's Banking Recapitalisation: What Lies Ahead

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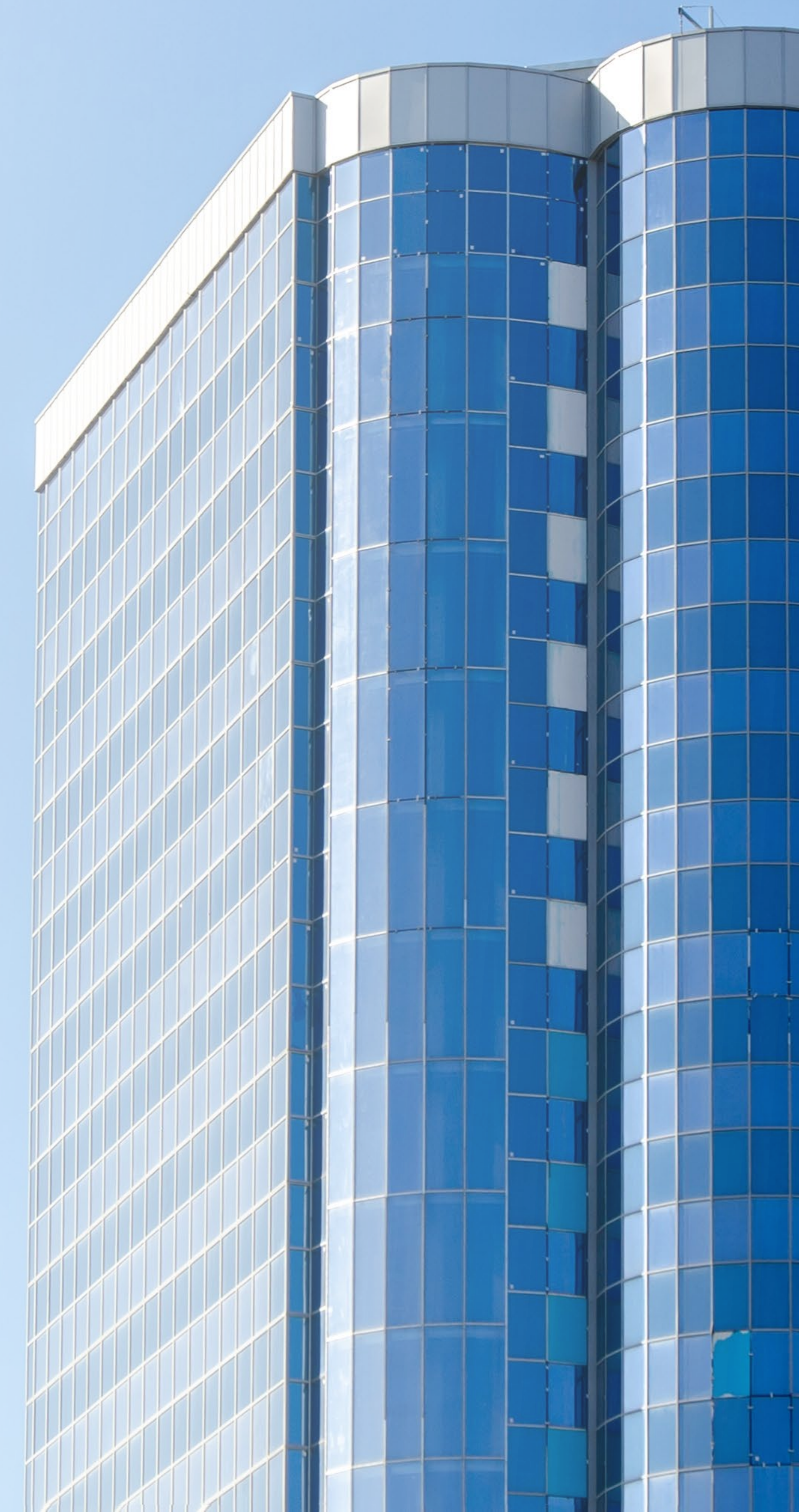

Foreword

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The ongoing recapitalisation exercise in Nigeria's banking sector has the pivotal objectives of strengthening banks and mitigating systemic risks. With nearly two decades since the last recapitalisation effort, the sector is once again poised to play a crucial role in accelerating economic growth and achieving the government's 2030 vision of a trillion-dollar economy.

However, a significantly challenged macroeconomic environment, characterised by high inflation following the significant devaluation of the naira, presents a more difficult hurdle for banks this time around. Banks face the twin challenge of raising capital within the prescribed timeline and developing new business models for the post-recapitalisation environment. This will come with the pressures of delivering attractive returns to shareholders amidst a post-recapitalisation macroeconomic environment that may yet be in recovery mode.

In this sector update, we review the rationale, process, and impact of the current banking recapitalisation programme, highlighting its critical role in strengthening financial stability and driving economic growth. We also explore some options banks are considering to meet the requirements.

Amidst these developments, as banks and their shareholders navigate the implications of the new capital requirements, we emphasise the need for broader action beyond the industry. Achieving the full benefits of the recapitalisation programme will require deliberate and coordinated efforts across the financial services spectrum, including non-bank financial service providers, regulators, and the government alike.

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The 'What'...

In March 2024, Nigeria's banking system regulator, the Central Bank of Nigeria (CBN) announced an increase in the capital requirements for banks operating in Nigeria across the different licence categories.

An integral part of the announcement was the definition of qualifying capital which is specified as paid-up share capital and share premium only, there by excluding the industry's significant retained earnings reserves and other forms of capital.

Banks are also required to comply with the Capital Adequacy Ratio (CAR) relevant to their licence category while trying to meet the new capital requirements.

Minimum Capital Requirements

Banks	Licence category	Minimum capital (₦'bn)	
		Old	New
Commercial	International	50	500
	National	25	200
	Regional	10	50
Merchant	National	15	50
Non-interest	National	10	20
	Regional	5	10

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The 'Why'...

Engine of Growth

Nigeria's banking industry has remained relatively resilient in the face of domestic and global economic headwinds over the last decade, achieving growth in capital and assets at 11% and 17% CAGR respectively in the period.

However, the performance has been against a background of sluggish economic growth, with GDP growth decelerating steadily from the 3.4% rebound in 2021 following the COVID-19 pandemic, to 2.74% in 2023.

Given the critical role of the banking sector in spurring economic activity and growth through financial intermediation, the sector is expected to be pivotal to propelling Nigeria's growth over the next few decades.

In line with the ambition of the current administration of achieving a trillion dollar economy by 2030, the CBN has highlighted the need for stronger and better capitalised banks which are better equipped to service the needs of a fast-growing economy, thus necessitating the call for recapitalisation.

The qualifying capital position of banks prior to the announcement indicates a significant capital shortfall of c.N4tn across all licence categories, with capital deficits of between 35% - 90% of the new minimum capital across the different banks.

Capital Deficit by Licence Category (₦'bn)

Licence	Lowest	Average	Highest
International	229.26	316.73	384.19
National	6.97	140.40	185.56
Regional	18.13	27.97	38.50
Merchant	30.55	37.50	47.63
Non-interest	1.38	4.77	6.97

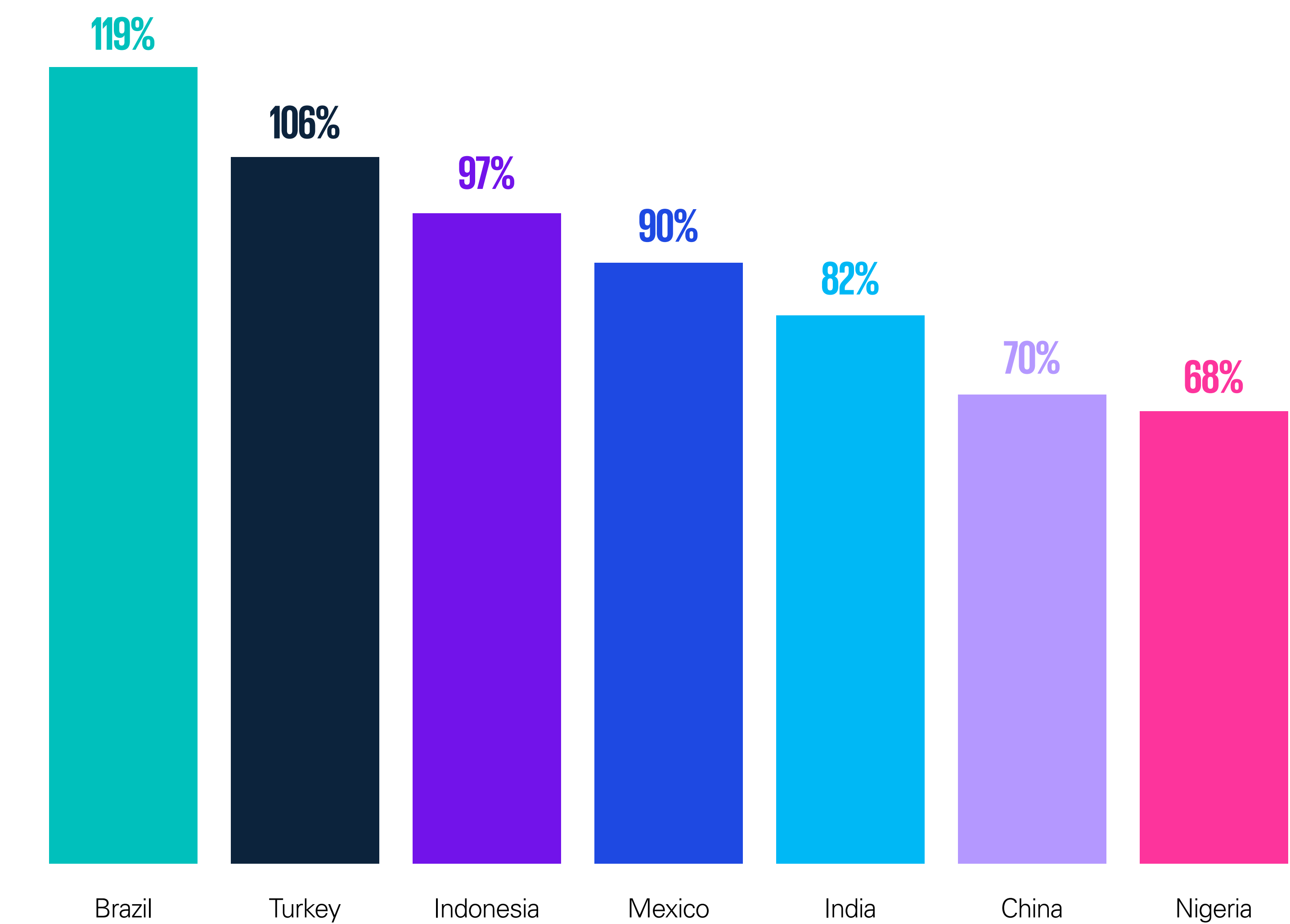
Source: Companies' financial statements

This significant level of capital injection should spur growth in lending activities required for production, investment and consumption activities.

However, the effectiveness of the recapitalisation exercise for driving growth requires efficient allocation of funds to productive sectors of the economy such as Manufacturing, Retail, Agriculture as witnessed in China, Brazil, India, etc.

Nigeria's banking industry loan to deposit ratio averaged 68% over the last decade, lower than high growth emerging markets, attributable to several factors including the perceived high risk of SMEs (which constitute over 90% of formal enterprises), economic volatility and impact on lending rates, regulatory policies, etc.

Loan to Deposit Ratio (10-year average)



Source: Economist Intelligence Unit (EIU)

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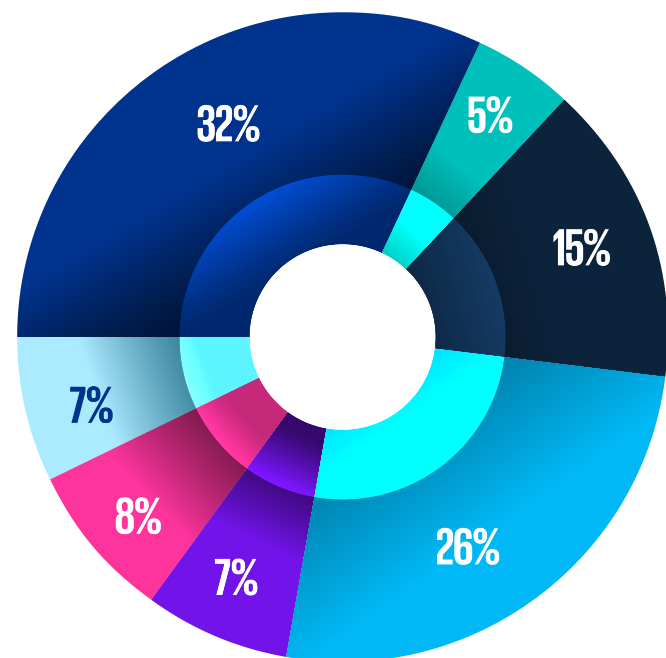
Furthermore, a review of the sectoral distribution of loans indicates a narrower spread for the banking industry. Between 2014 and 2022, commercial banks disbursed c.N165tn as loans and advances, with 50% channelled to only three sectors – Oil and Gas (26.1%), Manufacturing (15.5%) and Government (8.4%), while a critical sector such as agriculture, attracted significantly less funding, with 5% of total loans.

Consequently, addressing structural issues like poor market information, weak framework for loan recovery, poor database on credit quality, etc., which currently limit lending activities to key sectors of the economy, should be undertaken in tandem with the recapitalisation programme for the effectiveness of the growth pillar of the reform agenda.

Accordingly, initiatives aimed at enhancing credit information systems, strengthening risk-sharing mechanisms such as credit guarantee schemes and deepening securitisation should improve access to credit for SMEs and underfunded sectors and allow the banking industry better support the broader economy and contribute to sustainable economic growth.
The recapitalisation process is also expected to be a major attraction for much needed foreign direct investment. Nigeria's banking sector is one of its most sophisticated economic sectors and amongst the most developed banking markets in Africa.

The availability of investment opportunities in the sector arising from the exercise is expected to be a major draw for long term foreign investments in the country.

% Sectoral Distribution of Commercial Banks' Loans and Advances



- Agriculture
- Oil & Gas
- Government
- Others*
- Manufacturing
- Trade/General Commerce
- Finance, Insurance & Capital Market

**Others include Mining and Quarrying, Power & Energy, Construction, Real Estate, Education*

Source: CBN Statistical Bulletin

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'Stronger and Better'

The banking sector recapitalisation exercise will improve the overall financial system stability as banks become better positioned to withstand financial shocks or unexpected crises.

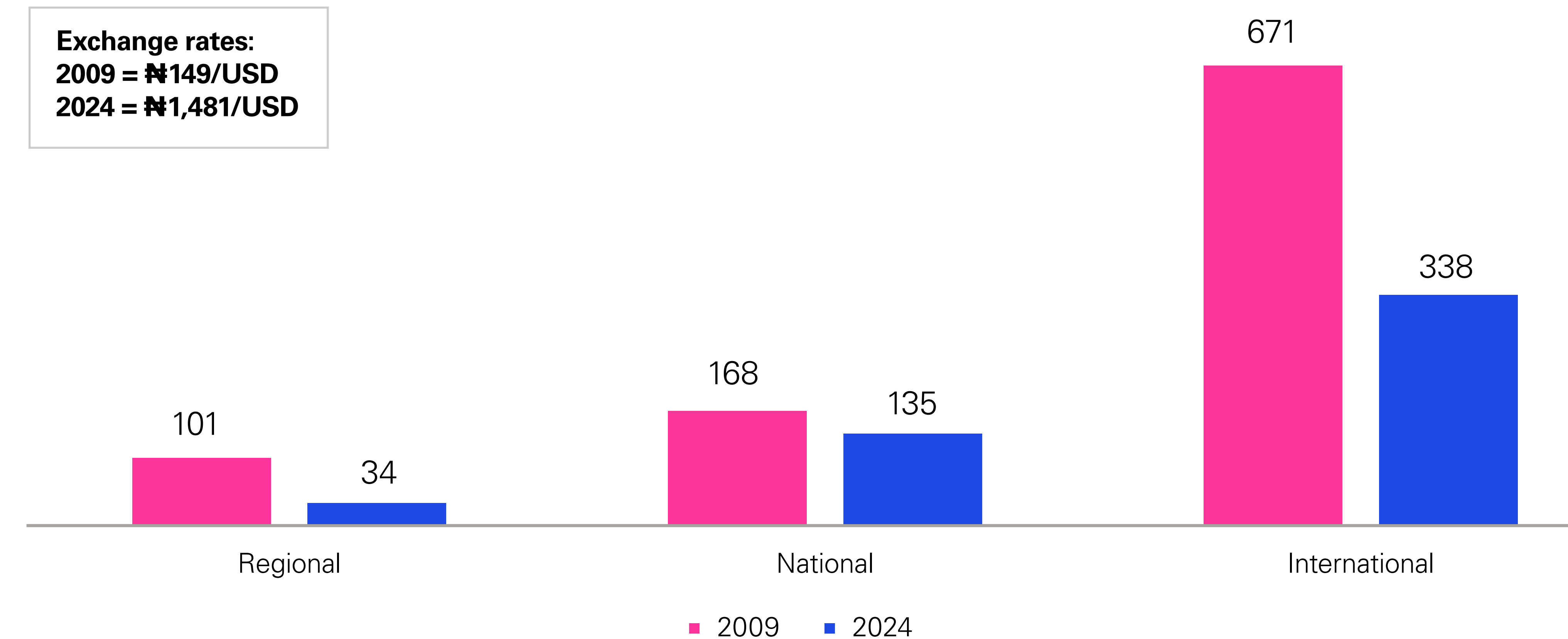
The significant devaluation of the naira over the last two decades, has resulted in an erosion of the banking sector capital base in dollar terms with implications for the stability and competitiveness of the sector in terms of foreign currency operations, managing exchange rate risks, access to global funding and partnerships, etc.

The current recapitalisation programme also presents an important opportunity for banks to restructure and address issues related to asset quality, liquidity, and capital deficits, which vary among existing players.

In addition to enhancing stability, the resulting higher capital base will increase the sector's capacity to lend, including underwriting larger volumes and bigger transaction sizes, undertake critical investments in areas such as technology and personnel, and pursue new growth opportunities such as geographical and vertical expansion.

These initiatives will drive long-term value creation for shareholders and support the economic growth agenda of government.

Capital Requirements for Commercial Banks ($'mn)



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The 'How'...

The stringent definition of qualifying capital has left significant reserves unavailable for capitalisation which has led to a wider impact on the sector than anticipated.

Based on the prescribed definition, our assessment indicates most banks currently fall short of the revised minimum capital requirements and will be required to take action to comply within the stipulated timeline of March 2026.

As indicated in the CBN guideline, banks have a few options for complying with the revised minimum capital requirements including capital raise, mergers and acquisitions, changes in licence categorisations etc.

Capital raise

Likely to be the preferred option for industry players, banks have access to both the private and public capital markets.

Public capital market

With most Nigerian banks listed on the stock exchange and sufficient timeline for private banks to approach the market, the capital market presents an option for raising capital through rights issues to existing shareholders and/or public offers to new shareholders.

Being a critical channel for capital mobilisation in the last recapitalisation programme, with over N100bn raised on the stock exchange prior to the deadline, we expect to see most banks approach the market.

However, the level of industry capital shortfall of N4tn relative to the capital market depth indicates limited capacity to meet industry requirements.

Furthermore, prevailing macroeconomic headwinds including high inflation and foreign exchange instability may deter investor appetite for equities, while the high interest rate environment enhances the attractiveness of fixed-income securities relative to equities.

The preference for this option also presents the risk of a market overhang which will exert pressure on pricing of banking stocks which are currently trading below book value. This will require an increase in the number shares to be sold by banks with significant implication for existing shareholder dilution.

Accordingly, considerations such as speed to market, market conditions, investor confidence, timing of offers, and pricing will be important to developing and implementing a strategy around this option.

Private capital

Nigeria is one of Africa's major investment destinations, with the financial services industry being a top sector for investment. Particularly, the banking sector has attracted interest and investment from financial investors as well as strategic players looking to enter the market over the years.

However, investor outlook on Nigeria has been relatively cautious in recent times, evidenced by declining FDI flows. Despite this, the banking industry, characterised by relatively high returns and stability, remains attractive particularly given the lower valuations resulting from the devaluation of the naira and the significant upside potential from increasing banking penetration and expected economic recovery and growth.

However, banks will need present a comprehensive equity story that highlights key strategic thrusts and return potential, access a wide network of potential investors and mid-wife a credible transaction process to optimise this capital source.

The private capital raise process may offer better price discovery for well-prepared banks compared to the public capital market. However, this could involve a trade-off, with loss of some level of governance/control to an investor(s) with a significant stake. Whether private or public, banks will have to consider factors such as:

- ownership dilution which could be material in view of current market pricing and size of capital gap
- change in control and governance, dependent on the process and investor type
- cost and timeline
- implementation risks.

Key considerations for a successful capital raise:

1. Well defined capital raise strategy
2. Robust equity story on the Bank's strategy and return potential
3. Robust investor pool
4. Well documented transaction financials
5. Structured transaction process

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Mergers and acquisitions

Mergers and Acquisitions (M&A) were prevalent and critical to the last recapitalisation exercise in 2005 and is expected to feature prominently in the current programme.

Key concerns around loss of identity and control, dilution of ownership, mismatch of organisational culture and practices etc., limit the attractiveness of this option, yet, it is inevitable that several banks will have to consider this route to achieving the new capital mandate.

It is important that banks view M&A not only as a means to achieving the new capital, but also as an opportunity for transformative impact in terms of size/scale benefits, enhanced competitive positioning, synergies, etc. as has been witnessed from some of the banking industry M&As undertaken over the years.

Accordingly, we anticipate that some of the major winners from this recapitalisation exercise will include banks with a deliberate approach to identifying value creation opportunities from the programme.

A proactive assessment of strategic fit is a key consideration for determining the right M&A partner(s). Critical areas such as stakeholder alignment, culture & people, customer/ market, transparent transaction process, robust due diligence as well as adequate pre and post integration planning cannot be overstated for a successful outcome.

Key considerations for a successful M&A:

1. Right partner selection
2. Comprehensive due diligence
3. Fair valuation
4. Transparent process
5. Pre and post integration planning

Licence upgrade or downgrade

The option to downgrade licence authorisation appears to offer banks a 'get out of jail card' as they can potentially side-step issues around ownership dilution, change of control, loss of identity, associated with the other options. However, this must be considered carefully to avoid potential downside risks such as:

- weakened competitive positioning
- lower stakeholder (customer, investor, employees) proposition
- impact on strategy and performance
- lower profile with implication for funding, partnerships, etc
- loss of value from rationalisation requirements (branches, subsidiaries).

Where banks identify this option as the most viable option, there will be need for a robust strategy and implementation plan to mitigate loss of value and navigate the associated implications effectively.

On a positive note, the recapitalisation exercise offers the option to upgrade licence authorisation which may be the outcome of a successful capital raise and/ or M&A between two or more banks. Accordingly, the recapitalisation exercise may present a path to value add from new licence permissions e.g. new markets, customer segments, new activities, etc. which should be taken into consideration by banks throughout the process.

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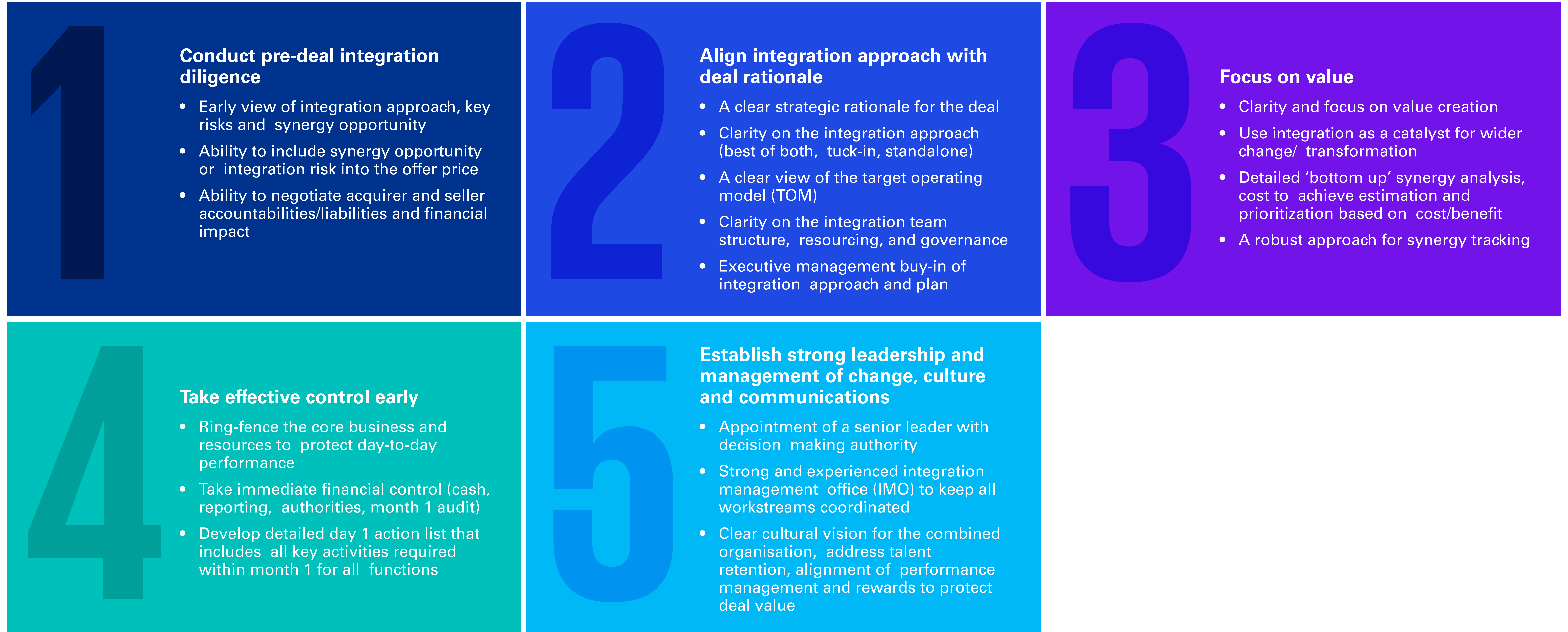
Key considerations for maximising value in an integration

For banks that opt for an M&A, there are key areas considerations to ensure success. Integration execution requires a combination of financial, operational, technological and cultural change management skills. The following key five areas have become increasingly important. Without managing these, almost two-thirds of acquirers fail to realise synergy targets in M&A deals.



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We have identified five key pillars that will be considered by banks in defining and executing their recapitalisation strategy.

- **Dilution**
- **Governance/control**
- **Synergy**
- **Execution risk**
- **Timeline**

The strategy implemented by the respective banks will likely reflect the importance of each pillar.

We expect that all banks will commence with a capital raise process, particularly from the public capital markets, with some banks already ahead of the curve in this regard.

The capital raise process will be continuous over the next two years as banks try to achieve the revised minimum capital base.

Some banks will successfully raise all the additional capital required from the different sources including private capital sources such as DFIs, private equity firms etc.

However, given the size of the overall deficit and the time frame, several banks will have to implement alternatives including mergers and acquisitions or consider changes in licence authorisation where feasible to comply with the mandate.

Accordingly, as banks continue to define their recapitalisation strategy, we will like to highlight **the need for robust scenario planning, one of the key lessons from the last exercise**, as critical to achieving and maximising opportunities from the recapitalisation mandate.

Recapitalisation Exercise: Key Strategic Decision Pillars

	Dilution	Governance/ control	Synergy	Execution risk	Timeline
Capital raise	High	Low	Medium	Medium	Medium
Mergers and acquisitions	Medium	Medium	High	Medium	High
Change in licence authorisation	Low	Low	Low	Low	Low

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The 'Effect'...

As the impact of the recapitalisation programme is expected to transcend the banking sector, the imperatives for action to fully realise the benefits also go beyond the industry. This presents a call to action for other non-bank financial services players, operators, and regulators to ensure preparedness to take advantage of the opportunities that arise.

Banking industry

The recapitalisation exercise will engender a change in competitive landscape for the banking industry with bigger and expectedly fewer banks, in contrast to the increase in number of operators witnessed over the last few years.

The nature of competition is also likely to change in terms of the focus areas/ markets from any changes in licence authorisation resulting from the exercise.

With increase in capital, banks have increased liquidity to grow lending and investment activities. However, the additional capital is likely to place pressure on return on capital in the short term. Hence, a strong focus on capital optimisation and improving operational efficiency will be crucial to driving profitability and enhancing shareholder returns.

In addition, as competition heats up, banks will have to re-examine their strategies to find innovative ways to derive business value and to ensure that they remain competitive.

The 2005 banking sector reforms drove significant transformation in the banking sector characterised by a rapid pace of growth, digital transformation and international expansion.

Higher capital levels should stimulate greater investments in digital innovation especially as banks aim to cover their cost of capital. Rapid technological advancements such as artificial intelligence (AI) and machine learning (ML), distributed ledger technology, and applications from quantum computing will shape the delivery of financial services in a multitude of ways.

For banks with international authorisation, increased capital should continue to drive international expansion with focus on benefits of revenue diversification, improved competitiveness, access to growth markets, etc.

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Beyond Banking

The banking sector's anticipated growth presents significant implications for the broader financial services landscape. Higher capital levels should enable banks take on more and newer forms of risk assets, even amidst challenging macroeconomic conditions. This aligns with the Federal Government's expectations that well-capitalised banks will drive economic growth by financing the real sector and public infrastructure spending. With larger and more complex lending products comes demand for bigger and more sophisticated loan-related insurance products, necessitating the need for substantial increase in insurance and reinsurance capacity from the insurance sector.

In addition, given the projected banking sector growth and deepening financial inclusion, the CBN and insurance regulator, NAICOM have a unique opportunity to re-evaluate the current bancassurance framework. This channel holds the potential to expand participation in financial services and significantly increase Nigeria's historically low insurance penetration.

Vietnam, a comparable emerging market, has witnessed substantial growth in insurance penetration in recent years due to changes in its bancassurance regulations. In 2021, almost half of Vietnam's first-year premiums originated through the bancassurance channel.

The mortgage sector which has struggled to achieve much desired impact should also benefit from improved access to finance for construction firms and homeowners. However, coherent and coordinated reforms in the sector are required to realise these benefits. Longstanding supply and demand side challenges that present high credit risk to financial institutions such as inefficiencies in the transfer of property and registration of security, lack of a functional secondary mortgage market (SMM) are issues that must be addressed.

Finally, a significantly more capitalised banking sector will become more attractive to investors, potentially at the expense of other financial services providers. This creates a strong imperative for transformation within these other sectors to match the anticipated pace of growth in banking. Regulators and operators across pension, insurance, capital markets must collaborate to drive investments and transformation within their various sectors.

The Ministry of Finance has a pivotal role to play in ensuring that the regulatory reforms across the wider sector are implemented collaboratively to foster a cohesive ecosystem where all players can thrive and achieve the country's broader ambitions.

The Regulator

The CBN's recapitalisation drive also presents challenges and opportunities for the regulator itself, starting with clarity on banks currently administered by the CBN, as the approach for these banks to meet the new capital requirements remains unclear.

Clarity is also required on the resolution mechanism for banks unable to meet the new capital requirements which will ensure continued public confidence and minimise loss of value. Ensuring transparent and well-communicated resolution strategies will help maintain stability and trust in the financial system.

Post recapitalisation, the increased capital requirements will necessitate a more robust and sophisticated approach to supervision and regulation. Higher capital requirements are synonymous with increased pressure on returns by shareholders. The CBN will need to ensure that banks are meeting the new capital requirements while also maintaining sound risk management practices.

The CBN will need to review and implement reforms related to the computation of risk-weighted assets with particular focus on credit risk, operational risk and counterparty credit risk. Current approaches to single obligor limits and collateralisation must align with international standards for large exposures to maintain the stability of the sector.

Potential changes in ownership or shareholding with the entry of new investors should also be carefully monitored and managed to ensure that the stability of the banking sector is not compromised.

Another critical consideration is the regulatory cost incurred by banks. As of 2023, regulatory costs such as AMCON levy, deposit insurance premium represented a significant portion of operating expenses. With larger balance sheets, the regulator should consider revisiting the size and appropriateness of these fees, and the consequent impact on the industry.

As banks seek value from their fresh investments, they are likely to pursue more profitable segments. Hence, the CBN should also consider the potential impact of the policy on financial inclusion, ensuring that access to financial services is not compromised for low-income and underserved populations. Furthermore, the CBN will need to closely monitor the potential impact of the policy on the broader financial sector. This includes assessing the impact on the capital markets, insurance and pension sectors, as well as identifying and mitigating any potential systemic risks. It is crucial that the recapitalisation programme does not create an uneven playing field between different sectors of the financial services industry.

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'Go'...

The recapitalisation exercise will shakeup Nigeria's relatively mature banking sector, engendering increased financial stability, innovation and growth, which will have significant impact on the economy given the relevance of the sector to economic activities.

However, realisation of the full benefit of the recapitalisation exercise will require a broader spectrum of reforms across the regulatory landscape, other financial sector segments as well as the wider fiscal landscape.

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Why KPMG

Assisting banks during and beyond the recapitalisation process

Capital raise support

- Equity story definition
- Investor identification
- Valuation/pricing analysis
- Dataroom management
- Negotiation support
- Transaction close assistance

Capital market assistance

- Reporting accountant
- Valuation services

M&A support

- Vendor assist
- Valuation/pricing analysis
- Due diligence
- Dataroom management

Integration planning and support

- Day 1/Day 100 planning
- Synergy and value realisation
- Operational planning and integration
- Culture and change management

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