

BANKING REFORM POLICIES IN NIGERIA: THE STRATEGIC OPTIONS

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Abstract

History and evolution of banking in Nigeria have been marked with series of reforms ranging from legal, structural, operational and regulatory to supervisory and capital base wise. The main thrust of banking reforms remains to reposition and strengthen banks and the financial system to withstand competitive pressure and play their role of financial intermediation effectively and efficiently. However, the purpose for which these reforms have designed to achieve have not been attained remarkably as records of poor performance in the industry after each successive reform abound in the country. This article was designed to evaluate the various banking reform policies in Nigeria and the strategic options needed to ensure stability, soundness and high performance in the industry. A long-term broad-based economic and social reform with internal, continuous and voluntary consolidation options as well as grass root entrepreneurship development with bank participation have been put forward.

Introduction

The business of banking evolved from the activities of Italian gold smiths and merchants. It therefore metamorphosed from the crude form to assume the level of sophistication obtained in the world today.

While series of changes must have taken place in banking operations globally, the objectives, uniqueness and the role of banks in economic

development remain the same and outstanding. Banks are financial intermediaries that exist to mobilize savings and channel them into the economy for consumption and investments to take place. This intermediary role of banks is the anchor of economic development (Adekanye, 1984:51).

Viewing from this perspective, banks are regarded as economic development agents. This is in line with the views of Mbat (1995:49), when he observed that:

Banks carryout important economic functions. Their various lending activities stimulate and sustain domestic economic growth and development.

However, it should be noted that the extent to which banks could perform their functions and make meaningful contributions to economic development depends heavily on the level of their operational efficiency, soundness, safety and stability.

It therefore follows from the above that monetary authorities and regulatory agencies need to monitor the operational strategies and activities of the financial institutions carefully in order to detect possible lapses which may hinder smooth banking operations in the country. This is necessary in order to adopt some measures to correct, reverse and forestall reoccurrence of any negative tendencies so as to

promote or enhance individual and aggregate performance of the financial intermediaries.

At this point, it is important to note that structural, managerial, operational, institutional, regulatory and environmental factors, among others exert negative influences on banks thereby hindering their performance. These defects are usually addressed through reforms. Different forms of reforms have been introduced and implemented in the banking industry in Nigeria mainly from 1952 when the first attempt to regulate the business of banking in the country was made. However, it is sad to observe that the problems in which these reforms have been designed to solve (i.e. high level of crisis, instability, unsoundness and low profitability, etc) still continue to resurface in the industry from time to time.

Reflecting on banking crisis in other countries of the world such as the US, Argentina, Japan and France, among others and the successful management of such problems through reforms, it becomes instructive to examine the reform strategies so far implemented in Nigeria. This is necessary in order to find out why we have not been successful in using reforms to find solutions to the banking problems in our country and to come up with strategic options or alternatives.

This paper is therefore designed to examine banking reform policies and the strategic options in Nigeria. At the end of this introductory section, is section two with focus on the review of some concepts and theoretical perspective. In section three, empirical evidences are presented followed with discussions, recommendations and conclusion in section four.

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Conceptual Review and Theoretical Perspective

As stated above, the focus of this section is to present a review of some conceptual and theoretical issues. In the review, issues such as general nature and operations of banks, the concept and nature of banking reforms as well as banking reform objectives and strategies are discussed.

General Nature and Operation of Banks

Traditionally, the business of banking involves savings mobilization. That is, acceptance of deposits from customers and granting of loans, investment in securities (mainly short term money market instruments) and other businesses including safe keeping of valuables, foreign exchange services, trustee services, portfolio management and stock broking services, among others (Ubom, 2006:2).

Banks have two operational objectives, namely: maintenance of adequate liquidity level at all times and profit maximization. These objectives are conflicting in nature. For example, for a bank to maintain adequate liquidity level at all times, it must invest predominantly in short term assets while profit maximization requires long term investments. The ability of banks to achieve their corporate objectives depends heavily on how the banks are able to strike a balance between these two traditional and conflicting objectives (Ubom and Ubom, 2004:36).

Apart from the above objectives, banks are also very unique in other dimensions. As highlighted by Kwan (2007:1), banks are unique because:

- i. They provide transaction services and administer the nations payment system
- ii. They provide back up liquidity to the economy and
- iii. They are transmitters of monetary policy.

By discharging these functions, banks exercise serious control over the availability, cost, flow and direction of goods and service within a given economy.

Structurally, the banking industry in Nigeria comprises the Central Bank of Nigeria (CBN) at the apex, the deposit money banks (i.e. former commercial and merchant banks), development banks (e.g the Nigeria Industrial Development Bank (NIDB), and Nigeria Agricultural Co-operative and Rural Development Bank (NACRDB), etc.) and the microfinance banks. With the introduction of universal banking scheme in 2001 in the country, the distinction in the operational focus between retail and whole sale banking of commercial and merchant banks had been removed (Ubom, 2006:140) even though there are plans to phase out the universal banking scheme.

It should be noted also that the banking industry in

Nigeria, just like in other countries of the world has witnessed different forms of crisis from the free banking era, banking regulation period, deregulations and during the period of guided deregulation and beyond. The new phase of banking development in the country is the era of consolidation. The first phase of the consolidation exercise focused on recapitalization, mergers and acquisition. This is one of the series of banking reforms experimented in Nigeria. In the discussion that follows, the concept and nature of banking reforms are examined.

The Concept and Nature of Banking Reforms

Conceptually, reform refers to changes, re-organisation, restructuring, re-shaping and overhauling of a system to eliminate or reduce imperfections and possible distortions affecting smooth operations and performance of the system. Usually, reforms are introduced into a system (or organization) when there is an observed departure in the focus and direction of the organization or sector of the economy from the original or desired focus and objectives.

Banking reform refers to changes, adjustments, review and restructuring of operations, management, ownership, organization, supervision and regulation of banks or the banking sector as a whole. The general focus of banking reform is on improving the effectiveness and efficiency of banks (Soludo, 2004:2). Such changes or reform may be by stiffing or relaxing some regulatory, operational and supervisory conditions. These conditions may specify new requirements and conditions for establishment of new banks, new branches, minimum capital base, areas of operations, reporting requirements and level of assets and liability structure and operational strategies. An example of reform through change in operational focus has been the introduction of universal banking scheme in 2001 (Ademola, 2001:26).

Banking reforms could emerge consequential to general economic and social reform introduced in a country. This was the case in 1985 when the Structural Adjustment Programme (SAP) was introduced. One of the attendant policies was the liberalization of the banking sector. This led to the influx of banks and stiff competition within the sector.

The privatization policy is another example of banking reform associated with the general economic

policy of the government. With this policy, banks have been privatised thereby changing or altering the ownership structure of the financial institutions in favour of private individuals more than the governments.

The 2004 recapitalization, mergers and acquisition exercises were direct reform approaches as part of the banking sector consolidation agenda. The banks were directed by the Central Bank of Nigeria to increase their capital base from N2 billion in 2004 to N25 billion before the end of December, 2005. Banks that were not able to raise the required capital on their own were asked to merge. Thus, the reform here was through recapitalization and merger.

Above all, in the history of banking in Nigeria, it is evident that reforms experimented range from regulatory and legal (e.g the enactment of Banking Ordinance of 1952 as amended in 1958 and other subsequent promulgations, for instance Bank and Other Financial Institutions Decree of 1991 as amended in 2004, etc), institutional (e.g the establishment of Central Bank of Nigeria (CBN) and the Ministry of Finance in 1959 and the Nigeria Deposit Insurance Corporation, (NDIC) in 1988), structural (e.g reduction in the types and number of banks, reporting and supervisory levels), operational (e.g the case of Universal banking scheme) to recapitalization and ownership (e.g the case of privatization when government shareholding of banks had been reduced to about 10%). These reforms have been introduced to achieve some objectives as discussed below:-

Banking Sector Reform Objectives and Policies

The historical trend of banking in the world is characterized by numerous reforms. These changes are usually made when there exist some problems, distortions and imperfections capable of hindering growth and stability in the industry.

In Nigeria, the banking system has undergone remarkable changes over the years in terms of the number of institutions, ownership structure as well as depth and breadth of operations. These changes have been influenced by the challenges posed by the deregulation of the financial sector, globalization, technological innovations and adoption of supervisory and prudential requirements that conform to international standards (Okorie, 2006:26). As at the end of June 2004, there were 89

banks operating in the country, comprising institutions of various sizes and degrees of soundness. Structurally, the sector was highly concentrated as the ten largest banks accounted for about 50 percent of the industry's total assets/liabilities.

This aside, most of the banks were under capitalized with high rate of non-performing loans and advances which eroded shareholders fund seriously. Other areas of weaknesses were managerial inefficiency, poor corporate governance, insider trading and ethical degeneration.

Reforms are always introduced to check weaknesses or correct imperfections in a given system. Banking reforms therefore are designed to make banks solid, strong, sound and operationally fit to compete favourably among themselves and with other financial institutions within and outside Nigeria. The objective is to reposition banks in order to make them more reliable, competent and competitive (Soludo, 2004:2).

Stressing on the objective of banking reforms, especially the consolidation exercise, the then Governor of the Central Bank of Nigeria (CBN) Prof. Charles Soludo stated that the reform was:

Designed to ensure a diversified, strong and reliable banking sector which will ensure the safety of depositors money, play active developmental roles in the Nigerian economy and be competent and more competitive players in the African regional and global financial system.

Another form objectives in the banking sector is in

terms of increasing returns for shareholders and bigger contributions to economic development. Hence, the overall objective of banking sector reform is to reverse the negative performance trends of banks in the country for the benefits of the customers, owners, and the society as a whole.

As stated earlier, the policies adopted in any reform strategy depends on the problems intended to be solved. For instance, when the problem relates to inadequate capital base, recapitalization policy is adopted, when the problems are regulatory, structural, operational and/or environmental policies relating to these issues are introduced. When the reform policies fail to bring a lasting solution to the problems, alternative options become necessary. Before discussing these options, empirical survey of banking performance in Nigeria is paramount.

Empirical Survey

The major focus of banking reform is on how to increase or improve the performance of banks and make the industry sound and stable. It is only when the banks are sound and stable with improved performance that they can contribute to economic development and growth.

In Nigeria, a good number of reform policies and strategies have been introduced in the banking industry. The most popular and frequent reform strategy adopted in the country is the policy of recapitalization. This involves a periodic upward review of minimum paid up capital of banks. Hence, the empirical survey made in this section incorporates the trend of recapitalization, bank performance and economic development in Nigeria. In table 1 below, the trend of bank recapitalization in Nigeria is presented.

Table 1: Trend of Bank Recapitalization in Nigeria from 1952 to 2004

| Year | Legal Instrument | Minimum Capital |
|-----------|-------------------------------|---|
| 1952 | Banking Ordinance | N25,000 for indigenous banks and N200,000 for expatriate banks |
| 1958 | Banking Ordinance | N400,000 for expatriate banks N25,000 for indigenous banks |
| 1962 | Banking Ordinance (Amendment) | N50,000 for indigenous banks N500,000 for expatriate banks |
| 1969 | Banking Decree | N600,000 for indigenous banks N1.5 million for expatriate banks |
| 1979 | Banking (Amendment) Decree | N2 million for Merchant Banks other banks category retained their 1969 figures |
| Feb. 1988 | Monetary Policy Directive | N5 million for Commercial banks 3 million for merchant banks. |
| Oct. 1988 | Monetary Policy Directive | N10 million four commercial bank |
| 1989 | Monetary Policy Directive | N20 million for Commercial banks, N12 million for Merchant banks |
| 1991 | BOFID | N50 million for Commercial banks, N40 million for merchant banks and N250,000 for community banks |
| 1997 | Monetary policy directive | N500 million for commercial banks and Merchant, N3 million for community banks |
| 2000 | Monetary policy Directive | N 1billion for all new banks (Commercial and Merchant) |
| 2004 | Monetary Policy Directive | N 25 Billion for all banks (Commercial Banks Merchant) |

Source: Various Enactments and Government Pronouncements
BOFID: Banks and other Financial Institution Decree of 1991.

As indicted in table 1 above, banks in 1952 were required to provide a minimum capital of N25,000 in the case of indigenous banks and N200,000 in the case of expatriate banks. In 1958, there was a new requirement for banks to increase their capital base and the recapitalization directive increased the capital base of expatriate banks from N200,000 to N400,000 while that of indigenous banks was retained at N25,000. In 1962, the positions shifted with indigenous banks required to provide not less than N50,000 and expatriate banks N500,000.

In 1969, banks were disturbed gain. They were to qualify for license and continuous stay in business by making available to the CBN as much as N600,000 (indigenous banks) and N1.5 million (expatriate banks). By 1991, the dichotomy between indigenous and expatriate banks had ceased following the indigenization law of 1972 which demanded all banks to be locally incorporated. Instead, the banking system was shared principally between Commercial and Merchant banks and the BOFID of 1991 based its minimum capital requirement on this classification. Thus, commercial banks were to provide a minimum capital of N50 million and Merchant banks N40 million. Community banks, established earlier in the year were to provide N250,000 for grant of licence.

These figures were a far departure from the 1988 and 1989 statistics of N5 million and N3 million (February, 1988), N10 million and N6 million (October, 1988) and N20 million and N12 million (1989) respectively for commercial and Merchant banks.

The continuous surge into banking by newly established banks following the financial deregulation exercise of 1986, created a situation where too many banks came into the system thereby saturating the banking market. Mixing with other problems, it poised government to introduce minimum capital for banks in 1997. For Commercial and Merchants, N500 million was set as the new capital base, while community banks had N3 million. In January, 2000, government prescribed one billion naira (N1 billion) as the new minimum capital for new banks (Commercial and Merchant). In 2004, the CBN directed all banks to shore up their capital base to a whooping N25 billion before the end of 2005. This was to check the incessant springing up of mushroom banks and to restore the public confidence in the banking sector. This measure gave rise to bank mergers and acquisitions which reduced the number of banks in Nigeria from 89 to 25.

With increase in the capital base of banks in the country from time to time, the performance of the financial institutions was expected to increase. The

performance indices of banks, namely volume of deposits and credit granted to the economy from 1990 to 2007 are presented in table 2 below.

Table 2: Deposit Mobilized and Volume of Credit Granted to the Economy by Banks in Nigeria from 1990-2007.

| Period | Amount of deposits mobilized (N billion) | Growth Rate (%) | Aggregate Net Bank Credit (N billion) | Growth Rate (%) |
|--------|--|-----------------|---------------------------------------|-----------------|
| 1990 | 43.87 | - | 43.41 | - |
| 1991 | 59.48 | 35.60 | 49.1 | 16.0 |
| 1992 | 87.74 | 47.50 | 59.25 | 19.9 |
| 1993 | 143.85 | 64.0 | 125.75 | 112.2 |
| 1994 | 166.13 | 15.50 | 162.83 | 29.5 |
| 1995 | 196.82 | 18.47 | 194.05 | 19.2 |
| 1996 | 239.28 | 21.57 | 266.44 | 37.3 |
| 1997 | 295.16 | 23.35 | 302.31 | 13.5 |
| 1998 | 349.31 | 18.30 | 378.08 | 25.1 |
| 1999 | 569.81 | 63.0 | 608.44 | 60.1 |
| 2000 | 838.60 | 47.2 | 807.01 | 32.6 |
| 2001 | 1,017.20 | 21.3 | 1,033.64 | 28.1 |
| 2002 | 1,226.60 | 20.6 | 1,302.20 | 26.0 |
| 2003 | 1,415.80 | 15.4 | 1,591.20 | 22.20 |
| 2004 | 1,661.50 | 17.4 | 2,078.10 | 30.6 |
| 2005 | 1,089.5 | 34.43 | 2,286.8 | 10.04 |
| 2006 | 1,739.6 | 59.67 | 2,524.3 | 9.41 |
| 2007 | 2,981.2 | 71.37 | 4,813.5 | 47.56 |

Sources: Central Bank of Nigeria Annual Report and Statement of Accounts for various years.

As indicated in table 2 above, the volume of deposits mobilized by banks in the economy increased from N43.87 billion in 1990 to N2981.2 billion in 2007. This represents 6,695.53% increment. The rate of increase in the volume of deposits however fluctuated significantly within the period. For instance, it increased from 35.6% growth rate between 1990 and 1991 to 64.0% in 1993. The following year (i.e. 1994), it declined to 15.5% and jumped to 63.0% and dropped remarkably from 63.0% in 1999 to just 17.4% in 2004. This was a serious warning signal.

In terms of the amount of credit granted to the economy, similar fluctuating pattern had been witnessed within the period. The growth rate of aggregate bank's credit to the economy as indicated in table 2 above also fluctuated wildly between 1990 and 2004. For example, from 1990 to 1991, aggregate bank's credit volume increased by 16%. It increased further to 112.2% in 1993 but slid sharply from this figure to 29.5% in 1994. It however rose to 60.1% in 1999 and declined to 30.6% in 2004. By 2005 and

2006 it slid further to 10.04% and 9.41% respectively.

As reported by the Central bank of Nigeria in its 2004 Annual Report and statement of Account and in conformity with research report by Ubom (2006:155), at least 59.8% of the total bank credit to the economy was allocated to the less productive sector of the economy; namely: distributive trade (especially import financing) and public sector where the risk are considered to be low. This implies that only 40.2% of the aggregate bank's credit was allocated to the productive sectors of the economy such as agriculture, solid minerals and manufacturing, etc.

Worst still, a significant proportions of the aggregate credit to the economy were classified as non-performing. According to Ebong (2005:21), the ratio of non-performing credit stood at 45% in 1992. It however declined to 23.08% in 2004. This impaired the shareholders capital and reduced the capital

strength of the banks. The reform policy of consolidation was with focus on recapitalization, mergers and acquisition was aid at addressing these problems. With the implementation of these strategies

some banks were merged to form new and stronger banks. The emerging banks, their shareholders funds, total assets and the amount of deposits mobilized as at 31st December, 2005 are presented in table 3 below.

Table 3: Emerging Banks, Shareholders Funds, Asset Base and Total Deposits Immediately after Consolidation as at 2005.

| S/No. | New Banks | Shareholders Fund (N billion) | Total Asset (N billion) | Total Deposit (N billion) |
|-------|------------------------|-------------------------------|-------------------------|---------------------------|
| 1. | First Bank | 44.67 | 377.49 | 265.67 |
| 2. | Diamond Bank | 28.6 | N/A | N/A |
| 3. | Platinum Habtb | 25.0 | 116.0 | 60.6 |
| 4. | Zenith Bank Plc | 38.0 | 370.72 | 233.0 |
| 5. | Oceanic Bank | 31.1 | 217.8 | 167.4 |
| 6. | Intercontinental | 51.0 | 350.0 | 220.0 |
| 7. | Fidelity Bank | 29.0 | 120.0 | N/A |
| 8. | UBA | 50.0 | 419.0 | 318.0 |
| 9. | FCMB | 28.0 | 90.0 | - |
| 10. | Citizens/Guardian Bank | 27.0 | 90.00 | 60.0 |
| 11. | Access Bank | 28.0 | 140.0 | 60.0 |
| 12. | NIB | N/A | N/A | N/A |
| 13. | Sterling Bank | 25.0 | 100.0 | 60.0 |
| 14. | Unity Bank | 30.0 | 100.0 | N/A |
| 15. | Devcom/ETB | 26.5 | 56.0 | 34.14 |
| 16. | Ecobank | N/A | N/A | N/A |
| 17. | Union Bank | 39.12 | 398.3 | 200.0 |
| 18. | North Omerga | N/A | N/A | N/A |
| 19. | First Inland Bank | 30.0 | 130.0 | 80 |
| 20. | Guaranty Trust | 30.88 | 167.9 | 95.65 |
| 21. | Standard Chartered | 26.0 | 34.72 | 23.5 |
| 22. | Afribank | Over 25 bn | 110.0 | 62.0 |
| 23. | IBTC Chartered | 35.0 | Over 100bn | N/A |
| 24. | Skye Bank | 37.7 | Over 100bn | 70.0 |
| 25. | Wema | 35.0 | 127.7 | 78.0 |

Source: Tell, January 2, 2006.

As indicated in table 3 above, only 25 banks emerged after the consolidation exercise. Citizens/Guardian Bank later merged with some other banks to form Spring Bank, Plc. Few banks such as First Bank, Zenith and Guaranty Trust Bank were able to raise and exceed the required N25 billion capital base on their own.

Out of these new banks, Intercontinental Bank plc was rated the highest as at 31st December, 2005 in

terms of shareholders fund. It had N51 billion shareholders funds. This was followed by UBA and First Bank with N 50 billion and N44.67 billion respectively. On total asset rating, UBA came first with N419.3b followed by Union Bank, First Bank and Zenith with total asset of N398.3 billion, N377.49 billion and N370.72 billion respectively.

In terms of deposits volume, UBA stood out with N318.4 billion followed by First Bank with N265.67

billion, Zenith (N233 billion) and Intercontinental (N220 billion). The United Bank for Africa (UBA) Plc maintained the lead in Branch network with 400 branches. This was followed by First Bank Plc with 365 branches.

A good number of these banks have raised additional capital from the capital market through fresh and right issues as well as of debt instruments such as debenture. Some of them have gone to international capital market and have also established more branches within and outside Nigeria. This implies expansion of the frontiers of their operations. However, it should be stated that some of these banks still have serious problems. For instance, after the consolidation exercise, some of these banks found it difficult to withstand the pressure created by the global financial crisis between 2007 and 2008. The audit report on banks in the country by the Central Bank in 2009 showed a worrisome position of banks operating in the economy. This led to the sack of the Board of 8 banks and injection of over N600 billion into the banking system to save the troubled banks from total collapse. This was outside the discount window facilities made available to some of these banks. The threat of another round of distress in the banking system heightens on daily basis.

Discussions, Recommendations and Conclusion

The essence of reforms in the banking industry is anchored on having strong banks with high performance rating and sufficient competitive strength and capacity to contribute significantly to economic growth and development. The existence of sound and healthy banks implies better returns for shareholders, bigger contribution to national economic growth, return to traditional intermediation, greater reach to the grassroots, good corporate governance and cheaper credit to the borrowers (Soludo, 2004:2).

Put differently, the main thrust of banking reform is to reposition banks and strengthen the financial system to perform their intermediation functions effectively and efficiently. Regrettably, with all the various reform policies and strategies experimented in the country, the performance of the industry is still at low ebb. This has serious implications on economic development in the nation. The pace of economic development and growth is quite low as indicated by the declining growth rates of gross domestic products

(GDP) and capacity utilization rates, among others. This implies that we should explore some strategic options if the performance of the banking industry must be improved to enhance economic development and growth in the country.

The strategic options in this article are broad based economic and social reforms with focus on the real sector of the economy through the provision of infrastructure, improvement in technology and promotion of grassroot entrepreneurship through bank participation as obtained in Japan and Germany. This should be followed by a complete restructuring of the political and modernization of the legal systems as well as overhaul of the public sector to reduce corruption. Aggressive social reorientation campaign should be carried out at all levels for attitudinal reformation.

The effects of adjustments and reforms in the areas highlighted above will correct the imperfections in the banking industry. The little defects which may still remain thereafter will need just a minor tinkering to put the system in the right perspective. This requires a time lag of not less than ten years for remarkable results to be achieved. The emerging banks after this period of renaissance will be stronger, with full capacity to compete favourably in the world financial market. These strategic options should be backed up with some tactical approaches such as the continuous internal and voluntary consolidation strategies.

The conclusion is that with the options advanced above, the banking industry in Nigeria will stand out to become the leading financial market not only in Africa but also in the world. The country has the capability to achieve and sustain this level of innovation and performance if pursued with determination and objectivity.

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