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Capital Market Crisis and Recovery Strategies in Nigeria

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ABSTRACT: *Capital market is cyclical with boom and burst period. This is the standard practice before the global downturn in 2008. While other markets across the globe have started growing strongly, the Nigerian capital market remain stagnated since 2008. Anecdotal studies identified the major factors responsible for the Nigerian capital crisis to include, namely; the numerous unlisted private placements; indiscriminate margin loans by banks, insider dealings; public offerings by banks, divestment by foreign portfolio managers; Central Bank of Nigeria (CBN) poor stress test procedures, SEC (Securities & Exchange Commission) illegal collection of 0.3% from market operators and bad corporate governance practice in the Nigerian Stock Exchange. Recovery strategies to rebound the capital market were advanced. These strategies include the listing of private placement by issuing companies, provision of standard CBN/SEC (Securities and Exchange Commission) Guidelines on Margin Loans, handling insider dealings through voluntary compliance with market laws – rules, regulations, practices and conventions – instead of "proof beyond reasonable doubt" that is difficult to establish, the listing of major oil and telecommunication companies, adoption of the U.S. financial market liquidity restoration model, improved CBN credit policy to capital market makers and the demutualization of the Nigerian Stock Exchange. Successful application of the aforementioned strategies will rebound the Nigerian capital market as a financial window. States, federal and local government councils will also benefit through tax revenue and enhanced employment opportunities for Nigerians.*

I. INTRODUCTION

No nation was spared of the 2008 financial crisis. It brought economic misery for people across the world. However, based on the counter prescriptions of each country over the crisis, the aftermath thereafter differed.

Atuche (2012) disclosed that the value of the Nigerian capital market fell to ₦0.3 trillion in the aftermath of the crisis, after which it diminished further to N0.0 trillion in 2009. Inspite of additional listing, the market remain stagnated at N6.5 trillion. The market lost over N5 trillion. The financial downturn in Nigeria was mainly in the banking sector that accounted for 60% of the listed securities. According to Sotubi (2012), prior to the global financial meltdown, international rating agencies including the Renaissance Group, Fitch and Economic intelligence unit rated return on investment in Nigeria among the highest in the world.

The aggregated toxic assets of Nigeria's eight illiquid and undercapitalized banks, namely; Afribank (Nig) Plc (now Mainstreet Bank Ltd) Wema bank Plc, bank PHB Plc (now Keystone Bank Ltd), Oceanic Bank International Bank Plc (now Ecobank Nig.Plc), Union Bank Plc, Intercontinental Bank Plc, Fin Bank Plc and Spring Bank Plc (now Enterprise Bank Ltd) respectively was above N2 trillion.

The capital market mainly the Nigerian Stock Exchange (NSE) is the mainstay of the Nigerian economy. To recover from the aforementioned market losses, drastic measures by the CBN and SEC together with other regulatory authorities became necessary.

II. CONCEPTUAL ISSUES AND THEORETICAL FRAMEWORK

To proceed further, it will be necessary to make some conceptual clarification by defining "capital market crisis", "Recovery Strategies" and disclose the theoretical foundation on which this paper is rooted.

Capital market Crisis"? Okereke Onyuike (2012) defined capital market crisis as:

The cyclical boom and burst period of the capital market which started from the US in2006 as a result of the glut in the mortgage industry, spread like a contagion to Europe, Asia and them to emerging markets in Africa, including Nigeria. That ill wind got to Nigeria in 2008 and no stock market was spared of the catastrophic meltdown, just like the Great crash in 1929. The effect was mainly in the banking sector in Nigeria which account for about 60% of listed securities. Whatever affected the banking sector has profound impact on the market capitalization.

"Recovery Strategies" Atuche (2002) explained it as:

Despite the fact that the 2008 global financial crisis spared no nation, yet for each country, depending on the potency of unique counter prescriptions, the aftermath differed vastly. Countries either out of misguided intent or for lack of will to look beyond the frail or sentiment called upon themselves the full wrath of the crisis to which Nigeria and most third world countries belong. Others waged war against it reaching for every

imaginable policy tool to confront the crisis. As expected, these later countries, namely; US, Brazil, Canada, Chile South Africa and the Euro-Zone averted the full fury of this global calamity. Nigeria's counter-response, as a recovery strategy, is an example of the former while the US responsive prescriptions to weather the storm as a typical recovery strategies of the later (i.e. US, Brazil, Chile etc).

Theoretical Framework – Fiduciary Managerial Model of Corporate Governance

The theoretical foundation on which this paper is rooted in the Fiduciary Managerial model of corporate governance. It is a shareholder centered model.

According to Joo (2010), this model in both trust law and agency law, the principal party gives a "fiduciary" (i.e. trusted persons), the power to control the principal property. The fiduciary, however, lack ownership interest in the property and is obligated to use his control for the benefit of the principal (or a third party). Corporate law referred to corporate directors and officers variously as fiduciaries, agents or trustee of shareholders. This shareholders model, emphasized that directors and officers owe "fiduciary duties" to shareholders who are the rightful owners of the firm which centers only on the relationship between shareholders and management. However, there are limitations about this model. It says little about the content of the relationship, whether such relationship be governed by law or left to the parties. Again, the legal rights and duties of trustees differs from those of agents and the rights of any given fiduciary may vary based on the nature of the task and agreement with the principal. Furthermore, the rights of principals are similarly mutable. They can trade away some or all of their ownership rights to third parties or even to their fiduciaries. Moreover, the Fiduciary model does not explain why shareholders are the focus of corporate governance which is taken for granted. According to Dodd (1954), before shareholders limited liability became the general rule in 1890s; some courts referred to corporate capital as a trust for the benefit of corporations creditors. The practice, before stock-issuing business corporations became widespread, focused on the relationship between the incorporator and the state. According to Horwitz (1972), Corporate Law gave shareholders limited power to control the directors or officers who are purportedly shareholders agents. State laws vest management authorities in directors and by early 20th century directors authority was considered original not delegated by shareholders. Even majority shareholders cannot override directors authority to manage the corporations. Even courts gave great difference to management business decisions, even those that turn out to have been hasty or ill-considered.

The Nigerian Stock Exchange (NSE) that is supposed to be the bedrock of the economy is in crisis while other markets are growing strongly. SEC and CBN like the NSE must not ignore their fiduciary functions to grow the market in the interest of shareholders and other stakeholders. This function must not be left to stock exchange and market operators alone. A collaborative effort between the NSE and the regulatory authorities (CBN, SEC and NDIC – National Deposit Insurance Corporation) is required. Stock broking firms should be made stronger and viable through merger and acquisition to enhance good corporate governance and professionalism in the discharge of their fiduciary responsibilities.

III. ANECDOTAL STUDIES OF THE NIGERIAN CAPITAL MARKET CRISIS

Okereke-Onyuike (2012) stated that between 2000 and 2008, issuers of securities had ready market through the Nigerian Stock Exchange (NSE). There were positive developments in the Nigerian capital market as exemplified by the activities and transactions both in the primary and secondary market of the NSE. The NSE functions as a prudent financing window for individual, corporate, state, federal and foreign investors. In addition, as a financing window, the NSE benefited the Federal and State governments in Nigeria through tax revenue, employment opportunities and transaction fees that also went to the SEC as government regulator of the capital market. The market capitalization of the NSE rose from N800 million in 2000 to N13.3 trillion in 2008. The All-share index hit an all-time high of 58,990.22 basis point in 2008 from 100 point in 1984. Annual Capital raised by companies and government on stock exchange rose to the peak of N2.8 trillion at the end of 2008. Okereke-Onyuike (2012) disclosed further that all these impressive capital market performance was due to a combination of factors, namely; local and foreign investors alike, investors confidence and re-emergence of middle class in Nigeria.

Egwatu (2010) differed in his study and revealed how the report of Akintola William Deliotte (Auditors and Chartered Accountants) on four years financial statements as a result of non-obligatory nature of the 2003 SEC code of corporate governance. The forensic audit report revealed that NSE limited by guarantee is prohibited from declaring surplus as bonus to Governing Council members. This is contrary to SEC 26 (3) of the companies and Allied Matters Act of Nigeria LFN 2004 and section 6 of the Memorandum and Articles of Association of the NSE and no portion thereof should be paid or transferred directly or indirectly by way of dividend, bonus or otherwise. The illegal appropriation of NSE fund was an abuse of fiduciary responsibility of the NSE to shareholders capital that are quoted in the exchange and other stakeholders interest. The total amount of funds misappropriated by the exchange from 2006 to 2009 amounted to N2.590 billion. Jimoh (2012) also reported that the submissions by major stakeholders in the capital market to the House of Representatives adhoc

committee revealed poor corporate governance and unethical accounting practices in the NSE. There were incidents of financial skimming, misappropriation, false accounting, misrepresentation and questionable transactions against the leadership of NSE. NSE bought at yatch of N37 million and wrote down the book value within one year by recognizing it in the book as gift. Spent over N186 million on 165 Rolex wrist watches as gifts for awardees out of which only 73 were actually presented to the awardees. The outstanding 92 Rolex watches valued N99.5 million, remain unaccounted for. Other fraudulent transactions included reclassification of N1.3 billion originally expended on business travels to "software upgrade". Adetunbi (2012) disclosed further that the capital market crisis was a fall out from excess indiscipline and outright discountenance of fundamental operational ethics. Regulators went to sleep and other watch guards got compromised. This gave operators the latitude to go out of bounds through unprecedented margin trade facility regime. Okereke Onyuike (2012) stated that there were many other factors militating against the Nigerian Stock markets rebounds, namely; the numerous unlisted private placement; indiscriminate granting of margin loans; insider dealings; public offering by banks; divestments by foreign portfolio managers and the illegal collection of 0.3% by SEC from the market operators. Atuche (2012) also attributed the capital market crisis to the poor CBN stress test procedures in addition to the underlisted factors.

Numerous Unlisted Private Placement

Most companies undertook private placement that were not listed on the Nigerian Stock Exchange. It had negative effects on investor's confidence because many of the subscribers bought the shares hoping that they will be listed on the stock exchange. Most of the issuers of these private placement misled the unsuspecting public via this style of placing and at the same time wanted to list their shares at very high premium instead of listing at the prices the securities were issued. SEC that approved the private placement did nothing to compel all the companies to list those private placement at the prices the shares were issued or at a marginal premium because of time value of money. More worrisome was the market manipulation on the investing public whereby the directors and officers of the issuing companies became the first to off-load their holdings, while they deliberately withhold the release of share certificates to other subscribers because the issuers used their in-house registrars and issuing houses for their public offers.

Indiscriminate Margin Loans by Banks

The indiscriminate granting of loans by banks to all manners of investors and market operators caused market burbles just like what occurred in the US mortgage industry. Nigerian banks gave these loans indiscriminately and insisted that such margin loans were used to purchase their own shares. Most of these loans were not properly structured which created excess cash in the market and share prices became over bloated. The CBN and SEC, the regulatory authorities, had no guidelines on margin loans which led to the abuse of the margin loans by banks. There was confusion as the banks engaged in competition to determine the best public offering. Because of the indiscriminate granting of loans, shares were bided for at higher prices. CBN did not issue guidelines to banks, neither did the SEC issue guidelines to stockholders. The NSE is not a regulator. It only regulate how stock brokers trade and does not regulate instruments brought to the market. This wrongdoing was an abuse of fiduciary duty by the regulatory authorities to the investing public.

Insider Dealings

Section III (1) and (2) of the 2007 Investment and Securities Act (ISA) makes Insider Trading (by Directors of Quoted Companies) a crime. The proof of insider trading is difficult to establish and prove because as a criminal offence, the standard of proof is "proof beyond reasonable doubt". This is a difficult challenge for regulatory authorities thereby compounding the capital market crisis.

Public Offering by Banks

The CBN directive for banks to capitalize from N2 billion to N25 billion as the minimum share capital was another factor for the capital market crisis. This increase of minimum share capital from N2 billion to N25 billion drove most Nigerian banks to the Capital market to raise the required fund. They raised the fund through mega offer in a single tranche thereby crowding the market and a total of N2.2 trillion was raised through public offers dominated by banks through listing on the NSE. The disproportionate large size of the Nigerian banking industry that stood at 60% of the capital market , its demise had a vast ramification on the Nigerian economy as a whole and the capital market in particular.

Divestment by Foreign Portfolio Managers

Divestment by foreign portfolio managers contributed to the capital market crisis as most of the foreign investors that were already troubled in their home economies pulled out of the Nigerian Stock market leading to dumping of shares beyond the ability of the domestic investors in Nigeria to absorb.

CBN Poor Stress Test Procedure

Atuche (2012) emphasized that apart from mass exit of foreign investors who, as a result of the global financial crisis, pulled out of Nigeria in order to cover their shortfall in their home country and the simultaneous crystallization of cross country liabilities across the globe; the lack of transparent stress test procedures by the CBN aggravated the Nigerian capital market crisis. Rather than the CBN as a regulatory authority handling the crisis with caution to resuscitate confidence and wage war against the crisis, it inadvertently paired with the financial storm to tumble the Nigerian economy. The banking sector which constituted 60% of the capital market was carelessly handled by the CBN. The CBN as a regulator pronounces the outcome of the stress test on banks 45 days ahead of its completion. It was not an objective scoring of the banks health aimed at alleviating the burden of the banks to spur the Nigerian economy. Apart from the outcome of the stress test, the CBN faulted the outcome of the initial examiners because the outcome of the examiners test did not qualify the banks for takeover. Furthermore, far reaching penalties were issued on Nigerian banks on the basis of draft stress test report that was never discussed with the audited banks. The CBN also failed to defer the decision to remove Chief Executive Officer (CEO)/Managing Director of wanting banks to the affected bank's shareholders whose fate are directly tied to the banks fortunes. The CBN stress test procedure was an abuse of the fiduciary responsibility of the CBN to the shareholders of the sanctioned banks.

According to El-sudi (2012),the nationalization of Afribank, Bank PHB and Spring Bank and their subsequent change of names to Main Street Bank, Keystone Bank and Enterprise Bank respectively was in breach of AMCON Act, NDIC Act and Section 44 of the 1999 Constitution of the Federal Republic of Nigeria. Directors and managers of the banks were directed to recapitalize but nobody called the shareholders to Annual General meeting. The process of transfer of Ownership were fraught with potential forgery, unethical practices, abuse of office and various unacceptable bad corporate governance precedents. The CBN's action in disbursing N600 billion bail out funds and other intervention funds afterward did not follow due process of the law and the constitution as to the source of funds and the appropriate authority did not approve. Regulatory pronouncements and actions of the CBN was also a major factor that led to the crash of the market.

Illegal Collection of 0.3 Percent of SEC

According to Okereke-Onyuike (2012), SEC collect 0.3 percent from everybody that sell shares and companies that goes to the market due to lack of funding by the Federal Government. The illegal collection of 0.3 percent was an administrative arrangement unknown to law. There is no place in the Investment and Securities Act 2007 and the Companies and Allied Matters Act 1990 that says that SEC should collect money from market operators. Such collections was not remitted to the federation account. The illegal collections by SEC undermined the oversight function of SEC as a capital market regulator. This action by SEC per se is a breach of fiduciary duty to shareholders and other stakeholders of companies listed in the stock Exchange.

IV. NIGERIAN CAPITAL MARKET RECOVERY STRATEGIES

The recovery strategies for the rebound of the Nigerian capital market will require correcting the aforementioned anomalies that were responsible for the capital market crisis as stated below:

Listing of Private Placement

The SEC should abolish the practice whereby issuers of private placement use their in-house registrars and issuing houses for their public offer. SEC that approve private placement must compel all such companies to list their shares at the prices the shares were issued, if not the issuers should be made to refund monies to investors with interest. Adopting this arrangement will boost investors confidence and promote market capitalization as those who bought the shares could sell them if they want to. Many investors are holding certificates they cannot do anything with. They can only go back to the company and take whatever the company decides to give to them.

CBN/SEC Guidelines on Margin Loans

Guidelines on margin loans recently issued by CBN and SEC will prevent margin loan facilities abuses that were not structured that created excess cash in the market leading to over bloated share prices. Until recently, CBN did not issue guidelines to banks and neither did SEC issue any guidelines to stock brokers also. The NSE is not a regulator. It only regulates how stockbrokers trade but do not regulate the instruments brought to the market.

Insider Dealings and Proof Beyond Reasonable Doubt

According to Olakanmi (2009), in spite of the fact that S. III (1) and (2) of the Investment and Securities Act 2007 makes insider trading (by Directors of Quoted companies) a crime, the proof of insider trading and prove beyond reasonable doubt are difficult to establish. The law must be amended for it to be

effective. The "proof beyond reasonable doubt" by capital market regulators is an uphill task. Voluntary compliance with market laws, rules, regulations, practices and conventions should be encouraged. Regulatory authorities of the Nigerian capital market and the whole financial system must ensure that approved code of corporate governance are adhered to by entities under their supervision. Monitoring units of regulatory agencies must be strengthened and equipped to perform their functions to prevent market abuses and insider trading. SEC should be properly funded to stop it from relying on stakeholders and market players in the exchange for funding. SEC has been compromised since it collect 0.3 percent of the sale and purchase of shares on the exchange.

Compulsory listing of Major Oil and Telecommunication Companies

Okere-Onyuike (2012) opined that the major oil and telecommunication companies in Nigeria should be compelled to list on daily official list of the exchange as they make up 90% of the nation's GDP. Government should induce the oil and telecommunications companies by introducing tax holidays and other incentives such as government contracts to make listing attractive to them.

Adoption of US Financial Market Liquidity Restoration Model

Nigeria should borrow the US financial market liquidity restoration model as a recovery strategy for the rebound of the capital market.

Atuche (2012) revealed that for the US to restore liquidity to the financial market and resuscitate confidence, the US Federal Reserve and other governmental agencies took the following actions: launched the toxic asset purchase programme (TARP), which was estimated at US $700 billion for lending to banks in exchange for dividend paying preferred stocks; an economic stimulus package worth $168 billion in form of tax rebate checks. Following the outcome of stress text conducted by the Federal Reserve Bank, 10 out of America's 19 largest bank did not measure up and as such required $75 billion within a period not exceeding 6 months. The U.S. Federal Reserve, unlike the CBN, also took the following reflationary economic steps as follows: the struggling banks to orchestrate a rescue plan within 1 month and also within 6 months, execute the plans; ailing banks that required funds to raise new common equity from existing shareholders or new investors; convert preferred shares held by private investors or the government into common equity or sell additional assets; upon application bail out fund to banks that required further funds after exhausting the other capital raising avenues above. Adoption of the American model will rebound the Nigerian Capital Movement.

Improved CBN Credit Policy to Capital Market Makers

According to Sotubo (2012), the capital market rebound will require the Nigerian Stock Exchange (NSE) working with SEC and CBN to review the CBN credit policy as it affects the capital market. They must work together to open up credit lines for operators in the capital market. This will guarantee any investor that there will always be someone in the market to sell to or buy from them with the prescribed price and volume limit. This will be a confidence booster. Market makers are liquidity providers. They intervene and ensure that any imbalance on any stock is taken care of within a set volume and price limit.

Demutualization of the Nigerian Stock Exchange (NSE)

According to Ebosele (2012), demutualization takes place where a stock exchange allows members of the public to be part owner through the sale of shares. Demutualization of the NSE would enhance Nigeria's capital market adding that it would come with a host of benefits among them; greater independence of management, stronger corporate governance, improved investors participation in ownership and management of the NSE and operational efficiency. Others are increased resources for capital investment and access to global market.

However, the leadership crisis at the SEC coupled with the controversy over the ownership of NSE has contributed to the suspension of the demutualization scheme. Besides, several stakeholders blamed the former SEC board of initiating steps to demutualize NSE without consulting dealing members whom they described as owners of NSE. The report of the consultants appointed by the World Bank to advice SEC on the demutualization scheme should be released and implemented. SEC should come up with guidelines on the demutualization of the exchange without undue delay for the rebound of the Nigerian Capital Market.

V. CONCLUSION AND RECOMMENDATIONS

Corruptions and bad corporate governance in the Nigerian Stock Exchange, poor and scanty regulatory practices of the CBN and Securities and Exchange Commission (SEC) together with the disproportionate large size of the Nigerian banking industry that stood at 60% of the capital market, which was characterized with indiscriminate granting of margin loans were some of the reasons responsible for the Nigerian capital market crisis. To rebound the capital market, recovery strategies must be adopted, namely: listing of private placement,

strict adherence to CBN/SEC guidelines on margin loans, listing of major oil and telecommunication companies in Nigeria and adoption of the US successful financial market liquidity restoration model, improved CBN credit policy to capital market makers and demutualization of the exchange. The benefit of a rebound capital market, apart from being a financing window, include tax revenue to the Federal and State Governments together with enhanced employment opportunities to Nigerians and transaction fees that will accrue to CBN and SEC as regulatory authorities of the capital market.

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