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GAINING TRUST AFTER THE FINANCIAL CRISIS IN THE NIGERIAN ECONOMY: A CONCEPTUAL FRAMEWORK

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ABSTRACT

In any business environment trust should never be taken for granted. Lack of trust in people, organizations, and government is one of the many reasons innovations and growth is stifled. To be sure, the global financial crisis was a much needed tragedy to reveal the true nature of organizations and management performance. This paper aims to examine the impact of the financial crisis on the banking sector of Nigeria at a macro level by prescribing a new regulatory framework, promoting regulatory neutrality, eliminating information asymmetry, reinforcing good corporate governance practice in the financial system and finally providing a guideline in regaining the public's trust at a micro level.

Keywords: Trust, Banking, Financial crisis, Regulatory framework, Stewardship theory, Corporate governance.

1. INTRODUCTION

The financial crisis was a much needed tragedy in order to showcase the "true" performance of organizations and their management teams globally. The regulatory framework of the financial system in Nigeria evolved over four decades ago, in response to numerous reasons but mainly the demands of interest groups and market developments. However, the overlapping multiple regulatory bodies that oversee the financial sector have not succeeded in maintaining stability and soundness in the financial system to date. For instance, the Organization for economic cooperation and development (OECD) has made clear that "the division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure the public interest is served."

This guideline is clearly ignored in the Nigerian business environment by having multiple regulators which has given rise to regulatory arbitrage. An argument can be made that the governance regulatory institutions in Nigeria such as: Central Bank of Nigeria (CBN), Corporate Affairs Commission (CAC), Securities and Exchange Commission (SEC), Nigeria Deposit Insurance Corporation (NDIC) and National Insurance Commission (NAICOM), are staffed with self-serving executives who collaborate with the senior executives of the companies they regulate to undermine shareholders' interest. In the same breadth, in an environment which has numerous regulators such as the likes of Nigeria, is it truly possible to earn the public's trust?

Lack of trust in people, institutions, and government is one of the many reasons for the financial collapse. Credit is generally believed to be the lifeblood of every economy. But during the height of the global financial crisis, banks in both the United States and Nigeria refused to lend to each other and to the general public, due to lack of trust, moral hazard and adverse selection amongst the market operators and as such, credit dried up. Consequently, the global economy went into prolonged recession.

In any business environment the trust factor should never be taken for granted. Nobody with a level of business acumen would enter into a contract with a counterparty they do not trust. Simply put, trust is essential in building and sustaining relationships with employees, customers, suppliers and the public at large.

It is now common knowledge that the performance of the Nigerian economy is generally undermined by the perception of corruption and benign enforcement of property rights by the courts. During the economic panic of 2008, numerous news headlines displayed bank executives from the now defunct Oceanic bank (currently owned by Eco bank), Intercontinental bank (currently owned by Access bank), and Fin bank charged with corruption and embezzlement of depositors' funds by the Economic and Financial Crimes Commission (EFCC) (Aminu and Akinsuyi, 2009). These allegations have given greater impetus among policy makers and regulators in Nigeria on the role good corporate governance plays and the steep hill ahead in gaining the public's trust. Consequently this paper aims to assess the impact of the financial crisis on the banking sector at a macro level by prescribing a new regulatory framework, promoting regulatory neutrality, eliminating information asymmetry, reinforcing good corporate governance practice in the financial system and finally providing a guideline in regaining the public's trust at a micro level.

1.1. Brief Overview and Analysis

From a macro level of examination, trust ultimately begins at the top of organizations. Whether it's the management teams of banks having trust in the regulators, or the regulators trust in the policy makers in the end trust in ones counterparty is the beginning of a fruitful relationship.

Since the creation of Central Bank of Nigeria (CBN) in 1958 and subsequent commencement of operations in 1959, Nigeria has recorded three major periods of crises; (1987-89, 1993 -95, and 2008 - 09) ultimately resulting in the closures of over 300 financial institutions (Nnanna, 2012).

The total losses recorded has not been fully determined till date, however, the most recent crisis has prompted the apex bank to bailout ten financial institutions to the tune of 6 billion dollars. To put that in perspective, the average Nigerian survives on just over a dollar a day while the minimum wage is roughly 120 dollars a month. The economic panic of 2008 in the banking sector of the Nigerian economy which subsequently spread to the capital markets has presented sufficient rationale to transform the current overlapping regulatory framework.

Across the global economy, Canada and the Scandinavian countries have established a consolidated regulatory framework which has strengthened their financial industry. However, modernization of the framework was observed in the mid 1990s with the United Kingdom (U.K) establishment of the Financial Services Authority (FSA), with sole power to supervise the U.K. financial services industry. Due to the relative success of the FSA, countries like China, Japan, and South Korea to name a few adopted similar frameworks with a few exceptions, consolidated regulatory model which ultimately, removed the regulation of commercial/investment banks from the central bank.

It is irrefutable that the differences in the financial institutions are becoming blurred over the years. We have witnessed commercial banks operating like investment banks, and hedge fund managers making casino style gambles disguised as strategic bets. As a result, this trend has rendered the multiple regulatory framework obsolete. Indeed, there is a general consensus that an efficient financial system is paramount to the growth and sustainability of any economy. Moreover, an argument can be made that when financial systems are efficient and effective, confidence in the markets will ultimately reign supreme.

The financial crisis revealed the inherent weakness in the financial system and highlighted the need for a new regulatory framework that will guarantee integrity and stability in the financial market. Some of the problems that have been identified after the crisis include: (a) an overlapping regulatory agencies that ultimately suffered regulatory laxity given that there were too many regulators in the market with nobody supervising and (b) the dearth of good corporate governance practice in the financial system (Aditya et al., 2012).

2. LITERATURE REVIEW

Over the past few decades numerous researchers (Taylor and Flemming, 1999) noted that there have been an unprecedented rise in financial conglomerates globally which has taken the markets by surprise, and as a result, the effectiveness of multiple regulatory agencies have not kept pace. Similarly, the Nigerian experience revealed that dispersed regulatory agencies that are not equipped in the assessment of financial risks in conglomerates will inevitably reach a tipping point causing what could be a new crisis (Siregar and Williams, 2004).

According to Abrams and Taylor (2000), the continuous supervision of banks will limit the risks of financial irregularities. Additionally, the authors argue that while the supervision of banks and security firms tend to focus on the risk associated with the asset side of the balance sheet, the financial risk for the insurance company occurs mostly from the liabilities side. Furthermore, there is no one regulatory framework that can be used for all countries. In other words, there is not a one size fits all prescription. It should be left to each country to determine the required antidote to solve their problem. Consequently, Milo (2007) recommends an integrated financial regulatory agency which will oversee the stability of the banking, securities and insurance conglomerates. Creating such an agency will eliminate the problem of overlap in the financial system and cut the bureaucratic red tape that often create problems in the system. Similarly, (Taylor and Flemming, 1999; Bruk, 2009) opine a unified supervisory framework can assist in eliminating the problem of competing financial institutions trying to exploit the differences in regulatory requirements and administrative styles inherent in multiple supervisors. Finally, Cihak and Podpiera (2008) noted that accountability and transparency can be more achieved under a single regulator whether or not the apex bank plays a role.

As earlier mentioned, Canada, the United Kingdom (U.K), as well as the Scandinavians were the early adopters of the integrated regulatory framework. The UK has adopted the "twin peak model for financial sector supervision. Simply put, the model splits rule-making and enforcement duties into separate regulatory entities. Besides the aforementioned countries, Martinez and Rose (2003) reveal that 22 other countries have successfully adopted an integrated regulatory framework.

As noted by the authors, the US is one of the only developed countries that have been lagging in this effort. Alas, still operating with a financial system regulated by five Federal Reserve banks and multiple state agencies, the U.S. Government Accountability Office (GAO) in recent years characterized its regulatory framework as outdated and not equipped to manage systemic risk (Stead and Brasch, 2009). However, there is still an ongoing debate between the GAO and congress on what framework to adopt.

Opponents of the FSA or "Twin Peak" model argue that a single regulator can be seen as bureaucratic, as too powerful and less transparent in discharging responsibilities (Goodhart, 2001).

Similarly, researchers such as Reddy and Cornia (2001) and policy makers in the US congress have levied the charge that a single regulator will ultimately impede innovation in the financial markets. Now, given the recent global financial crisis, is it really too much to ask for prudent supervision in the financial markets keeping in mind that without confidence in the markets, turmoil and uncertainty will spread throughout organizations and into the hearts and minds of the stakeholders?

2.1. Regulatory Consolidation and Supervision

Since no two countries are alike, it is imperative that country specific solutions are formulated. The most prevalent models are the multiple and single regulatory frameworks. However, a number of countries: Australia and Malaysia for example have adopted a semi unified approach (Martinez and Rose, 2003). Under this model, one agency supervises or regulates two types of financial intermediary. In the case of Australia and Malaysia, their banking and insurance sectors are supervised as a single unit.

In the case of Nigeria, a strategic pivot to an integrated financial system will

1. Ensure the separation of methodical supervision and risk management goals from the maintenance of ethics and good corporate governance practice.
2. Establish a flexible regulatory structure which will be proactive and not reactive to the activities of emerging financial conglomerates

3. Strengthen the powers and accountability of the agency charged with meeting the objectives.
4. Restore confidence in the financial market which will enable organizations thrive.

3. THE TRUST FACTOR

Trust is vital for the financial system to flourish and economic growth to thrive and be sustained. To that effect, trust can be deemed as a key antidote for financial sector crisis. The researchers Knell and Stix (2009) in their study of trust in banks during normal times and times of crises investigated the level of trust customers have in their respective financial institutions by surveying Australian households on their perception of their household finances and banking relationship and their respective assessment of the global financial crisis. In their analysis, the researchers found a reduction in the level of trust during the first quarter of 2009. Gillespie et al. (2012) examined this phenomenon utilizing a systemic, multilevel framework to assess the nature of the trust failure, and the contributing causes to the global financial crisis (GFC). Their diagnosis revealed the GFC was a consequence of (in) action by governments, rating agencies, boards of directors, CEOs, management, and market operators. Furthermore Kramer and Pittinsky (2012) analyzed trust restoration techniques within organizations and posit 'distrust regulation' control mechanisms and structural approaches play a central role, including increased government regulation, reforms in board governance, cultural change within institutions, which includes replacing senior leaders, and redesigning incentive structures to better align management and stakeholders' interests.

In an empirical study on trust in international organizations, Torgler (2007) analyzed a cross section of individuals using micro data from the world values survey covering 38 countries to investigate the level of trust individuals have in international organizations. The results revealed that political trust as well as societal trust matters for organizations to function effectively.

However, the study further notes when corruption is perceived, in developing countries, the level of trust reduces (Torgler, 2007).

Examining trust from a micro level, Hopkins and Weathington (2006) assert that the trust between management and employees plays a vital role in the decision making process of any organization. Hence, the psychological contract needs to be nurtured in order to benefit the parties involved. Furthermore, Hurley (2011) postulates that the maintenance of trust can only be anchored principally on, understanding the psychological factors of trust which entails a fundamental understanding and appreciation for honesty.

Numerous studies such as (Porta et al., 1997; Mosch and Prast, 2008) have revealed employee skepticism when management attempt to change processes in certain business operations (Hurley, 2006). Now, for trust to be earned, management must first be a "team player" by creating a sense of urgency for the change to occur (Kotter, 1996). When trust is lacking in an organization the most common complaint employees have is the lack of information. Naturally, when employees are deprived of information the guess game begins and distrust in management sets in. Above all, the sequence of events leads to employees becoming less productive in their jobs (Hopkins and Weathington, 2006).

In the end the researchers (Hopkins and Weathington, 2006) proclaimed action must be taken to build trust. In any organization an employee's direct report is the initial point of contact in the trust building journey. However, it is important to note that all levels of management must strive in the support and nurturing of trust in an organization. Studies conducted by the researchers (Mayer et al., 2007) opined that management's commitment to employees must be followed through frequently otherwise the element of distrust will spread throughout the organization like the proverbial plague.

4. HYPOTHESIS

By examining the Nigerian financial and regulatory sector and the impact of the financial crisis on the banking industry at a macro level, the researcher tests the following hypothesis.

H1: The current financial and regulatory framework is inadequate and there are too many regulators which has given rise to regulatory arbitrage.

H2: Since the perception of corruption is high in the country as a whole, the level of distrust will also be high.

H3: The creation of a new regulatory agency will aid in mitigating future crises.

5. METHODOLOGY

For the purpose of this study the researcher employed a qualitative analysis by administering survey questionnaires and conducting phone/in person open ended interviews with past and present senior/executive level employees of several regulatory agencies in Nigeria.

In this study 196 employees were sampled of which 123 responded resulting in a response rate of 63%. The participants surveyed were employees of the regulatory agencies such as the Central Bank, Nigeria Deposit Insurance Cooperation and Securities Exchange Commission. Survey questionnaires as well as interviews were administered to ascertain the views of the selected individuals. The selection process for this study was specifically designed for key employees in the respective organizations. Individuals who were sampled were either still gainfully employed, or recently retired. The validity of the responses to any questionnaire is an issue in conducting research however; observation by the researcher ultimately determined the reliability of the participant's responses.

Over a one year period from January 2011 through 2012 data was collected and interviews were conducted from 196 participants initially surveyed of which 123 responded and of those 123, 25 participants where interviewed.

6. RESULTS & DISCUSSION

The paper aims to examine the Nigerian financial and regulatory sector and the impact of the financial crisis on the banking industry at a macro level by prescribing a new regulatory framework, promoting regulatory neutrality, eliminating information asymmetry, reinforcing good corporate governance practice in the financial system and finally providing a guideline in regaining the public's trust at a micro level. In this context the researcher critically analyzed the data retrieved from all participants including several hours of recorded interviews.

Overall the results for H1 revealed 52% of respondents contend that the current regulatory framework in place is inadequate for the sophisticated nature of the financial sector. The current agencies have been arguably weakened by the rampant corruption and continuous abuse of power given rise to its inadequacies. Additionally, the results for H2 revealed 47% of surveyed respondents do not trust their supervisors, various leaders in their respective agencies and finally the federal government. Although the results for the interviewed participants who consist of mainly executives revealed 96% in fact trust their agencies employees and the federal government in carrying out its duties judiciously.

Finally, the results for H3 revealed 51% of respondents believe the formation of a new regulatory agency is needed to reduce information asymmetry and serve as an enforcer to the financial and regulatory operators. Generally, banking supervision and regulation entails managing systemic risk, promoting good corporate governance and reducing information asymmetry since these are the major triggers of potential market failure. Whereas risk is an intrinsic feature of financial markets, the role of financial market operators and regulators is to manage, allocate and price financial risks efficiently. Regulation per se, can not eliminate financial risks and it is not the duty of the regulator to eliminate risks, however, it is argued that the regulatory framework should have the capacity to develop early warning signals that will prevent the emergence of systemic crisis arising from irrational market behavior.

After a critical review of country experiences in the adoption of a specific regulatory framework, the literature reveals that there are three major models: namely: unified, semi unified and multiple regulatory frameworks. However, the vast majority of countries prefer the semi unified model. Regardless of the country it is imperative that the fundamental objectives of Safety, Soundness, Stability and Efficiency are met.

Based on the aforementioned objectives, the need for a paradigm shift based on a new architectural regulatory framework cannot be overemphasized. The paradox of the financial system of Nigeria is that it is over regulated and yet under supervised. This represents the classical case of too many cooks spoiling the broth. Currently, we have the Central Bank of Nigeria (CBN) is responsible for monetary policy, maintenance of macro-economic stability, the promotion of the payments system, the banker of last resort and finally the regulatory enforcer and maintenance of market integrity. It is also charged with developmental functions of growth and full employment which may be inconsistent with the maintenance of price stability – its primary function. The Nigerian Deposit Insurance Company (NDIC) is responsible for insuring depositor's funds and enforcing the implementation of prudential guidelines by the market operators. The Securities and Exchange Commission (SEC) is responsible for regulating the securities market and protecting investors. The Corporate Affairs Commissions (CAC) regulates and supervises the incorporation, management and winding up of companies and also arranges and conducts investigations into the affairs of any company where the interests of the shareholders and the public so demand. Lastly, the National Insurance Commission (NAICOM) supervises and regulates the insurance companies. Going forward, the researcher recommends a new regulatory architecture which will eliminate the likely tendencies of regulatory arbitrage, loss of trust and rent seeking behavior amongst the market operators.

Against this background the role of regulatory enforcement and maintenance of market discipline and integrity should be assigned to the SEC. In this regard, a merger of the SEC and NAICOM is imperative in order to eliminate information asymmetry. The CBN should be more concerned with the maintenance of price stability and financial system stability at the macro level. Furthermore, the elimination of the CAC is also essential to remove the problem of overlapping regulators. Finally, the establishment of a new agency charged with ensuring, promoting and sustaining good corporate governance will represent a welcome development in the financial system of Nigeria.

Figure-1. Provides a clear picture.

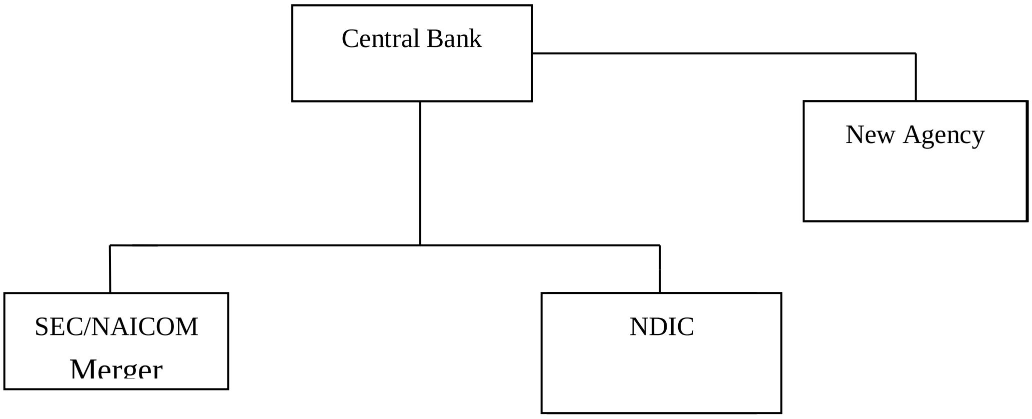

Figure 1 New architectural framework

To restore trust in the general public the researcher firmly believes we must first build and ensure confidence in the financial system. As such, this system must be anchored on four critical pillars namely: putting in place a tougher regulatory and supervisory framework, effective distress resolution mechanism, a more transparent market infrastructure and a macro prudential and risk management system anchored on good corporate governance, ethics and professionalism.

The researcher opines that the adoption of the proposed regulatory architecture, coupled with the implementation of the tenets inherent in the stewardship theory can be constructively utilized to restore trust, confidence and stability in the future financial system of Nigeria. Indeed, the combination of the proposed regulatory system and the application of the stewardship theory will lead to the enforcement of strategic incentives and punishment in the reformed financial system of Nigeria.

7. CONCLUSION

The CBN like numerous organizations globally have adopted Agency theory in their business philosophy which does not seek the greater good in people but rather punishes for its limitations. Indeed a shift in the mind-set of the regulators/supervisors of the financial system is also imperative. Over the years, the mind-set of Nigerian regulators was driven by the "agency" model. Regulators saw the market operators as agents that can't be trusted. Consequently, the focus of regulation/supervision was more on the use of 'sticks' than 'carrots'. Hence, little effort was put in guiding the operators to pay attention on risk management and good corporate governance.

For the proposed regulatory architecture to succeed it must be implemented with a new mind-set driven by the 'stewardship' model which pays greater attention on "trust" and the use of more "carrots" and less "sticks". This represents the highway to restoring trust and stability in the financial system.

Finally, the restoration of trust to all stakeholders is imperative for the continuous growth and stability in economies globally. By restoring confidence at the macro level, organizations that operate in these industries at the micro level will thrive. Ultimately, when organizations feel a sense of security and confidence in the regulatory framework in which they operate in, then trust slowly trickles back. To achieve this objective, the need to eliminate the subsisting overlapping regulatory structure cannot be over stressed. Consequently, we must create a regulatory framework which this paper has proposed for the Nigerian financial system. This system must be anchored on four critical pillars which are: putting in place a tougher regulatory and supervisory framework, effective distress resolution mechanism, a more transparent market infrastructure and a macro prudential and risk management system anchored on good corporate governance, ethics and professionalism.

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