FAILURE OF ALLIED BANK OF NIGERIA PLC

1.0 INTRODUCTION

Allied Bank of Nigeria commenced operations in Nigeria in 1962 as Bank of India (a wholly-owned foreign bank). The management was known to be conservative in conducting the bank's affairs and had a narrow target market. The bank's growth was moderate. In 1976, a major change of ownership took place. Under the second phase of the Nigerian Enterprises Promotion Programme, the Federal Government of Nigeria acquired 60% equity interest in foreign-owned banks including Bank of India. As at 1992, the Federal Government equity stake reduced to 51% due to sale of 9% stake to the Nigerian public while Bank of India retained its 40% equity interest. The acquisition of majority interest by government had resulted in change of name to Allied Bank of Nigeria.

Subsequently, a new policy of Privatization and Commercialization of Enterprises was adopted by the Federal Government. Under the privatization effected in 1993, the Federal Government equity interest reduced to 0.3%, Bank of India's equity stake reduced to 13% while the Nigerian public acquired 86.7% equity interest.

The acquisition of majority equity ownership by Federal Government had resulted in a fundamental shift of business focus and governance practices which to some extent heralded the declining fortune of the bank as shown below in the overview of the bank's performance and deterioration of its financial condition until its eventual failure. While in operation, the bank established a network of 70 branches across 29 states of Nigeria.

The rest of this case study is organized into four sections. Section 2 presents an overview of the bank's performance while section 3 highlights the core reasons for the bank's failure. Section 4 covers the failure resolution measures adopted while section 5 focuses on Lessons Learnt and conclusion.

2.0 OVERVIEW OF BANK PERFORMANCE

The CAMEL (Capital Adequacy, Asset Quality, Management, Earnings and Liquidity) parameters are adopted to review the bank's performance in this study. The highlights of the bank's performance are provided below:

2.1 Board and Management

The Federal Government's acquisition of majority equity interest in the bank marked a turning point in its existence. As majority shareholder, the government had the positions of Chairman and Managing Director allocated to it. Thereafter, the government appointed both the executive and non executive directors allocated to it. Unfortunately, most of the appointments were not based on professionalism and competence. Some of the appointments were based on political considerations. Consequently, policies and decisions were often influenced by political considerations rather than business imperatives. Such decisions contributed to the deterioration of the bank's asset quality. For example, profit after tax recorded a downward trend from 1989 due to high provisions for loan losses. However, after the privatization process of 1993 which reduced Federal Government shareholding to 0.3%, its two representatives on the board (Mr. Ehizuelen and Ms. Okunuga) were replaced.

Meanwhile, the pervasive influence of the government on the Board and Management resulted in waning interest of Bank of India in the bank. This look-warm attitude, manifested in irregular attendance at Board meetings by its representatives. For example, one Vice-Chairman was absent from six out of nine Board meetings held between 1987 and 1989. Also two directors appointed in 1987 attended only the board meeting held in India in 1989. The CBN, concerned about this development, recommended in its 1994 Routine Examination report that the Bank of India should revive its interest in the bank and keep its representatives on the Board for longer term for Corporate Governance reasons. It is noteworthy, that the CBN declared the bank insolvent in that report. In spite of the precarious condition of the bank, Board meetings were still irregular.

The Board held only two scheduled meetings in 1995 and one emergency meeting to discuss staff rationalization. The three meetings were clearly inadequate in view of the enormity of the bank's problems which included illiquidity, huge portfolio of non-performing credits, break-down of internal controls and massive frauds.

Unfortunately, the Board was not kept abreast of developments by the Management. Management reports to the Board were not comprehensive as Board members were often not well-informed about important aspects of the bank's operations. They were oblivious of the magnitude of delinquency in the bank's credit portfolio. Indeed, Management performance since the Government took over control had been less than satisfactory. Apart from the large volume of delinquent risk assets, the bank was be-devilled by other major problems which included:

i. The bank maintained a grossly inefficient and unreliable management information and accounting system whereby transactions were processed either manually mechanically or electronically. This mesh of three account operating systems resulted in shoddy bank records and inadequate information. It provided opportunities for several frauds and accounting errors. For example, all Nostro accounts contained accounting errors and inexplicable entries with some carrying credit balances instead of debit balances. There were instances of deliberate misclassification of transactions to conceal financial malpractices and misclassifications due to employees' ignorance of operational manual. Furthermore, only 4 out of 14 computer centres serving 40 branches and the Head Office were functional while the proprietary NCR systems were long overdue for upgrade and contributed to the inefficient accounting system.
ii. Internal Control was very weak while the Management failed to ensure that inspection report exceptions and operational lapses were corrected. The lapses in internal control were exploited to perpetrate monumental fraud between three branches. Several officers in Ilorin, Eruku and Ijagbo branches defrauded the bank and depositors of over N1.6billion through suppression of debit notes,

raising of fictitious entries and manipulation of withdrawals from customers' accounts to conceal their malfeasance.

iii. Against the back-drop of operational losses, the Management adopted desperate measures to generate income. Under a bogus Profit Improvement Programme excessive and unauthorized charges were being levied on depositors. According to 1994 CBN Examination report, the bank generated N122million through the Programme in 1993 about 80% of which were unauthorized or excessive charges. Some branches charge as high as 30.5% interest on overdraft and N250 instead of N10 for the use of Bankers cheques.

Bank Examiners observed that Regional Managers had no job description while the junior and middle Management cadres comprised below average and unqualified staff. As part of its strategy to improve staff quality, the Management established a Training School at Matori in Isolo area of Lagos, an area that is not conducive to learning. To compound the situation, the school lacked equipments, books as well as transportation for the trainees. The training programmes offered witnessed poor staff attendance and had minimal impact on performance improvement.

The Management was unable to resolve the bank's liquidity crisis and that led to the bank being sent out of the clearing system on 30th March, 1996 with devastating consequences.

Belatedly, in April 1996, the Management embarked on a turn-around initiative code-named "Breakthrough 2000" with the objective of resuscitating the bank. Messrs Arthur Anderson & Co was commissioned to implement the initiative. However, the initiative was discarded shortly afterwards. Other options were explored such as deposit-equity conversion. Under the option, customers with substantial deposits were to be swayed to convert part of their deposits into equity or long-term debt. Given the bank's precarious condition, the prospect of that option was bleak. It was therefore decided that raising additional capital and attracting new investors should be done under a new Management.

Pursuant to that decision, two Executive Directors had to disengage. However, the Chief Executive Officer, Alhaji Shehu Muhammed was retained for continuity under a four-year contract appointment which was renewable for only one term. Effective from April 1996 a 5-member Board comprising the following was constituted:

Dr. Simi Johnson	-	Chairman
Alhaji Shehu Muhammed	-	Managing Director/CEO
Dr. Abba Aji	-	Representing NSITF
Mallam Ibrahim Muhammed	-	Representing NTA Pension
Mr. S.B. Wagle	-	Representing Bank of India

This board lacked turn-around skills. It was therefore no surprise that its efforts could not prevent the inevitable failure of the bank.

2.2 CAPITAL ADEQUACY

The bank had a paid-up capital of N10million in 1986 which increased to N20million in 1988. The increase was effected by capitalization of N19million in two tranches of N5million each in June 1987 and August 1988 through bonus shares. In 1987 a bonus of one share for two previously held shares was issued while in 1988, a bonus of one share for four previously held shares were issued. The paid-up capital increased to N25million and N75million in 1991 and 1992 respectively while authorized capital stood at N100million. According to 1994 CBN Routine Examination report, shareholders fund had been completely eroded and was negative to the tune of N1.06billion which was recommended as the minimum capital injection required to sustain the bank's operations. The bank was declared technically insolvent by CBN. The capital erosion was attributed to huge loan loss provisioning for delinquent risk assets and massive frauds perpetrated by staff. However, the shareholders were unable to recapitalize as directed by CBN which led to the eventual revocation of the bank's licence and liquidation.

2.3 ASSET QUALITY

As of the date of closure, Closing Report by NDIC put the risk asset portfolio at N3.1billion. Various bank examination reports had noted unethical practices in credit administration which include:

- poor credit risk assessment
- lending in excess of authorized limits by branch managers
- non-adherence to credit guidelines
- lending in excess of single obligor limit
- concentration of credit in a group of borrowers
- draw-down of facilities without fulfilling conditions precedent
- unsecured and under-collaterized facilities
- absence of credit documentation
- creation of loans to fictitious borrowers.

The combined effect of these lapses was sustained deterioration of the credit portfolio. For example, classified delinquent credits as captured by 1994 Routine examination amounted to N2.02billion made up as follows:

Substandard	-	N478,549,973
Doubtful	-	N623,017,778
Lost	-	N915,256,096
		N2,016,823,847

Credits in the doubtful and lost categories amounted to N1.54billion or 76% of classified credits. Most of the debts were irrecoverable due to the reckless manner of their creation. The bank sought the assistance of NDIC to recover debts owed by major debtors. Even though NDIC assigned the debts referred to it to Solicitors, adequate information and proof of indebtedness was not provided by the bank to enable appointed solicitors pursue recovery. The paucity of documentation frustrated the efforts of the prosecutors.

The bank's credit portfolio was further compounded by fraudulent practices across various cadres of employees. Available records show that as at March 31, 1996, over N1.6billion was outstanding on fraud and unauthorized lending. Expectedly huge provisioning had to be made for delinquent credits and frauds which contributed to the accumulated losses and erosion of capital.

2.4 LIQUIDITY

The liquidator put deposit liability at N2,78billion as at date of closure. With a huge portfolio of non-performing credits (N2.02billionin 1994) and large-scale frauds, the bank's illiquidity was inevitable. It was compounded by the use of short-term deposits to finance medium-term loans. That resulted in maturity mismatch. The bank also failed to meet CBN prescribed requirement that commercial banks should hold 10% of total deposits in treasury bills and treasury certificates as its holding was only 4.5%. The bank's current account with CBN was overdrawn to the tune of N673,370,906 which resulted in its being sent out of clearing on 31st March 1996. Unfortunately, suspension from clearing system was a regular occurrence for the bank. That triggered a run on the bank as most branches were bombarded by depositors seeking to withdraw their funds. Many branches had to shut their doors because of lack of funds to pay depositors. The bank's failure had become public knowledge before the formal revocation of its licence in January 1998.

2.5 EARNINGS

The bank's net profit witnessed a declining trend from 1989 due to high provisions for loan losses. While income was on downward trend, expenditure was on the increase. The fraudulent activities of employees denied the bank of legitimate income. For example, the liquidator found that staff in 15 branches had engaged in debt-deposit swap whereby loan obligations were being swapped with trapped deposits. Debtors, instead of making payments to the bank arranged to swap their debts at a discount with desperate depositors whose funds were locked in. Depositors accepted the discounted value of debts in order to cut their losses while the debtors were relieved of their financial obligations to the bank.

These swaps were arranged by staff who connected depositors with debtors and collected fees from both parties. If the classified and provisioned debts had been paid to the bank, the proceeds would have impacted positively on earnings.

3.0 CORE REASONS FOR FAILURE

The preceding overview of the bank's performance shows that a combination of factors resulted in the bank's failure. Some of the factors are summarized below:

3.1 The primary factor that induced other factors that led to the bank's failure was the acquisition of majority equity interest by the Federal Government accompanied by take-over of the Board and Management control thus relegating the original founder (Bank of India) to the background. Before government take-over, Bank of India in Nigeria was a subsidiary under the close supervision of its parent, the Bank of India. It benefited from the technical support and business contacts of its parent. The business focus was value-creation for its shareholders and profit-making while the government goal was developmental. The government intervention was driven by the desire to take over the commanding heights of the economy. The conflicting goals of the two shareholders induced the loss of interest by Bank of India in Allied Bank of Nigeria and subsequent withdrawal of support for the bank. Any organization immersed in shareholder conflict cannot operate optimally in a competitive business environment.

3.2 The Federal Government, after taking over control of Board and Management failed to appreciate that banking is a technical and specialized business in selecting its appointees to the Board and Management. Professional and technical competence as well as requisite skills were not based of selection of its appointees. Its appointees ran the bank as a state-owned enterprise rather than a commercial venture.

Many of the Board's and Management decisions were driven by extraneous considerations rather than business imperatives. Hence, shortly after take-over of control by government appointees, the bank's performance witnessed a declining trend of key indicators such as asset quality, liquidity and earnings. The deterioration of financial condition was progressive until the bank failed. A bank saddled with incompetent Board and Management stood no chance to survive.

3.3 Inability to provide strategic direction and formulate prudent policies manifested in imprudent and fraudulent lending practices which resulted in a large portfolio of delinquent credits which in turn triggered illiquidity and erosion of capital. Apart from concentration of credit, unauthorized and unsecured credits were pervasive which made debt recovery mission impossible. The huge portfolio of delinquent credits and its adverse effect on financial condition was a major cause of the bank's failure.

3.4 The collapse of internal control system provided a fertile ground for monumental frauds such as the one that cut across Ilorin, Eruku and Ijagbo branches. That fraud alone wiped out the bank's capital several times over. Equally note-worthy was the debt-deposit swap scam perpetrated by 15 branches. A bank that was willfully assaulted by employees cannot survive.

3.5 The bank's illiquidity as manifested in its persistent overdrawn position at the CBN led to its suspension from the clearing system. Any commercial bank that was unable to participate in clearing and settlement system was at risk of a run on its deposits. The bank suffered from deposit run and loss of customers which further compounded its liquidity crisis.

3.6 With the erosion of capital by loan loss provisioning and fraud, the bank had neither capital nor reserve fund to absorb losses. Its shareholders lacked the capacity to inject fresh capital as directed by the regulatory authorities. To compound the situation, the Board and Management did not create a conducive environment to attract new investors as attested to by the abandonment of "Breakthrough 2000" turn-around initiative for self-serving reasons. Consequently, losses continued to accumulate till the bank's inevitable failure.

4.0 FAILURE RESOLUTION

Given the foregoing scenario, the bank's failure was inevitable. In the absence of new investors and shareholders' lack of capacity to turn around the bank, its licence was revoked on 16th January 1998. Sequel to revocation of licence, NDIC was appointed Liquidator by the Federal High Court. It also obtained a winding-up order from the same Court. Deposit pay-out was adopted as the failure resolution option whereby the assets (risk and fixed) of the failed bank would be realized and the proceeds utilized to pay depositors in accordance with the priority of claims as specified in BOFIA and the Companies and Allied Matters Act (CAMA) 1990. A summary of the liquidator's activities as at 31st December 2012 is provided below:

Total Deposits at closure	-	N2.78billion
Deposit Paid to date	-	N1.06billion
Total credits at closure	-	N2.54billion
Cumulative recoveries to date	-	N0.39billion
Disposal of Fixed Assets and Chattels	-	N0.79billion

Source – NDIC 2012 Annual Report and Statement of Accounts

5. LESSONS LEARNT AND CONCLUSION

The failure of Allied Bank provides some useful lessons for policy-makers, regulators, shareholders, bank Management and other stakeholders. Some of the lessons are presented below:

5.1 Government acquisition of controlling interest in Bank of India created a joint-venture known as Allied Bank of Nigeria Limited without a Business Plan. With a Business Plan, the two shareholders would have agreed on the strategic objectives of the new bank and action steps to achieve those objectives. The new bank could have leveraged the technical expertise and business contacts of the legacy Bank of India. But the over-bearing control of Board and Management by the government alienated Bank of India which led to its loss of interest in the nascent Allied Bank of Nigeria Limited. The bank was run as a state-owned enterprise. The lesson here is that partnership with government in a commercial venture should be driven by business imperatives.

5.2 Most of the government appointees to the Board and Management lacked the technical expertise to run a banking institution. Hence, they failed to formulate prudent policies and effective procedures to guide the bank's operations. This created a disconnect between the policies and procedures of the legacy bank and the succeeding one. Shortly after the change of control, the bank's financial condition started to deteriorate. Apart from non-adherence to established canons of lending, there was collapse of internal control mechanism while fraud was pervasive in the bank. The lesson here is that sound governance is critical to a bank's success.

5.3 After the bank had become technically insolvent and chronically illiquid, a still-born attempt to restructure it was frustrated by self-serving considerations. The question that arose is whether the Management whose ineptitude caused the bank's distress was adequately equipped to effect a successful turn-around? In the case of Allied Bank, the disengagement of the two Executive Directors and retention of the Managing Director did not portend a desire for a successful turn-around. The lesson here is that given that turn-around of a bank requires specialized skills, it should be undertaken as a surgical operation devoid of sentiments or retention of a sacred cow.

5.4 Suspension of illiquid and insolvent banks from clearing had turn out to be the death–knell of such banks. Suspension from clearing and settlement system triggered deposit-runs that overwhelmed such banks while some banks had also abused the Clearing House rules to the extent of turning CBN to a lender of first resort because they lacked funds in their CBN account to absorb adverse clearing positions. Consequently, the CBN was saddled with a huge debt burden arising from clearing operations, Given the intractable problem, the CBN had to introduce a new Settlement System through which few healthy banks were appointed as Settlement Banks and rendered cheque clearing services for other banks that met their terms and conditions.

5.5 Allied Bank's case shows that any bank whose Management and Staff willfully engage in fraudulent practices is at great risk of failure. The pervasive frauds that engulfed the bank was a major contributor to its failure. The lesson here is that a bank's viability and survival requires probity, accountability and integrity on the part of its Management and Staff at all levels.

In conclusion, this study shows that the bank's journey to failure began with the take-over of control of Board and Management by the Federal Government. The take-over alienated the erstwhile owner (Bank of India) which had solid banking experience. The government appointees that took over control failed to leverage the existing governance and internal control processes to promote the bank's well-being. Hence, the bank's condition started to deteriorate without purposeful efforts to reverse the trend. Consequently, capital was completely eroded while insolvency and illiquidity overwhelmed the Management to the extent that the bank could not be resuscitated.