

# Reassessing Tier 1 Banks: The New Class of 2023.



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## Executive **Summary.**

Banks are dead, and banking is alive and well. The age of the traditional bank is far behind us, and the age of the neo-bank is far ascending as telecommunication companies (telcos), and banks increasingly use technology to build the highway to satisfy bank customers' journey experiences. The reality of bank customers will grow on the shoulders of technology, which will be shaped by how banks, telcos, and fintech companies decide to meet the financial needs and expectations of money depositors and borrowers.

The new banking structure mixes financial technology (fintech) firms with specialized banks like investment and merchant banks in a universal banking-like feature condensed into Holdco structures. Under the traditional model of banks, they gain an advantage by their asset sizes; Tier 1 banks would be those with larger assets above certain industry thresholds. Today, banking is complex. Asset or share capital-based metrics may be insufficient to calibrate banks into Tiers.

The classification of banks into Tiers has evolved. The problem with absolute figures, like asset size, gross earnings, and share



capital, is that they can undermine the importance of efficiency and may disproportionately favour larger banks. For instance, when considering a bank's assets, a larger size is a compelling basis for ranking it higher than a smaller institution. Nevertheless, this approach neglects the crucial aspect of asset quality. A similar oversight occurs with Gross Earnings, as it does not distinguish between Interest and Non-Interest Income.

To provide a better approach to calibrating Tier 1 banks based on consultations and responses from several bankers on the 2021 methodology, the review in 2023 based on 2022 year-end and H1 2023 management accounts has resulted in a refinement in the assessment of the variables that put banks into buckets. In our 2024 review, a further adjustment will be made concerning the contributions of banks to deposit premium payments to the Nigeria Deposit Insurance Company (NDIC). NDIC has adopted a risk-based review of insurance premium payments based on its assessment of the riskiness of the lending institution, this would be considered in subsequent Tier 1 Banks report.

Another adjustment that would be made would be consideration of the Financial Holding Company (Holdco) structure of banks. The different financial institutions under the Holdco structure of financial lenders create fresh layers of risk and potential non-interest incomes. A more detailed review of how these structures define bank ranking would appear in the next report as it reflects the transition of banking as distinct from banks.

The previous modest rigor in classifying banks makes it necessary to develop a fit-for-purpose method of placing banks in Tiers. Proshare Analysts have, therefore, classified banks based on their percentile score on the **Proshare Bank Strength Index (PBSI)**. Banks with scores in and above the 50th percentile are considered Tier 1 banks, while the rest are Tier II banks, and some are Tier III (particularly those with negative or marginal shareholders' funds). In the maiden edition of the report, titled: **The Case for Redefining Tier 1 Banks**, the PBSI summarizes measures of Asset Quality, Profitability, and Liquidity. With further insight, a fresh look at the 2021 metrics was broadened to allow our coverage to take on efficiency ratios, risk management, and digital income to incorporate Assets, Gross earnings (in absolute terms and on logarithmic scales), Capital Adequacy Ratio (CAR), Loans to Deposits Ratio (LDR), Cost to Income Ratio (CIR), Cost of Risk (CoR), Net Interest Margin (NIM), Non-Performing Loans Ratio (NPLR), Digital Income to Gross Earnings Ratio, and Independent Non-Executive Directors (INED) to

Board Ratio. The banks with scores in the 50th percentile is thus ranked as Tier 1 (see table 1).

Table 1

Banks	FYE 2021 Tier 1 Rank	FYE 2022 Tier 1 Rank	H1 2023 Tier 1 Bank
Access	1	4	1
UBA	2	1	3
Stanbic	3	3	Out
Zenith	4	5	5
GTCO	5	2	6
Fidelity	6	Out	Out
ETI	-	-	2
FBNH	-	6	4

Given the delay in the release of some financials for the purposes of the FYE 2022 accounts, we undertook a review of H1' 2023 management accounts, and the PBSI table shows Access, UBA, Zenith, GTCO, ETI, and FBNH are currently Tier I banks on the strength of their performance across the assessment metrics, particularly e-banking, asset growth, and risk management so far in the year. The state of play in Stanbic, Fidelity, WEMA, Union, FCMB, and Sterling Bank put them in the Tier II banks as of mid-year 2023 (see table 2).

Table 2

Banks	Percentile	FYE 2021 Ranking	Percentile	FYE 2022 Ranking	Percentile	H1 2023 Ranking
Access	100.0%	1	72.7%	1	100.0%	1
UBA	90.9%	1	100.0%	1	81.8%	1
Stanbic	81.8%	1	81.8%	1	27.2%	2
Zenith	72.7%	1	63.6%	1	63.6%	1
GTCO	63.6%	1	90.9%	1	54.5%	1
Fidelity	54.5%	1	36.3%	2	45.4%	2
ETI	45.4%	2	45.4%	2	90.9%	1
FBNH	36.3%	2	54.5%	1	72.7%	1
WEMA	27.2%	2	0.0%	2	18.1%	2
Union	18.1%	2	9.0%	2	0.0%	2
FCMB	9.0%	2	27.2%	2	36.3%	2
Sterling	0.0%	2	18.1%	2	0.0%	2

**Banking: - Rethinking, Re-strategizing, and Repurposing Financial Intermediation**

The future battles for financial service companies in months ahead will gravitate around customer 'stickiness'. Customers will be wrapped into multiple product or service line engagements that allow banks to understand their transaction cycles and business journeys. Banks must identify key customer pain points and resolve their service delivery challenges with minimal disruption to their daily routines. Bank

services will require agility and flexibility. Though economically sensible, the previously rigid, one-size-fits-all approach to traditional banking is increasingly unsustainable in an environment of younger customers with low brand loyalty, high communal values, and little patience for excuses and delays.

Analysts note that the future of banking is techno-centric, with the increased use of artificial intelligence (AI) and Machine Learning (ML) becoming the cornerstone of competitive advantage. It has been agreed that in years ahead, customer data will drive corporate decisions around loans and deposit management (ALM), with human intervention colouring in the grey spots that represent 'fuzzy logic' or corporate decisions not comfortably addressed by binary codes. Financial markets will hold up, but only within the context of measurable value propositions; the decision over which banking platform customers choose will have minimal or no relationship with the years of existence of the deposit-taking institution or the size of their assets, but the quality of their products and the speed, precision, and reliability of their service offerings. Imagination will beat age, innovation will beat loyalty, and integrity will beat hype; at the end of the day, satisfied customers will decide the financial service sector's corporate winners.

Initially, it was thought that only back office staff were toast in the age of generative AI, but this is only half true. All categories of bank staff may see their jobs sautéed and fried by emerging technology. In the frisky age of agile companies, organisations must plan for disruption, embrace imagination, commit to creativity, and adapt to decentralised collaboration. As banks migrate to the Financial Holding Company (Holdco) default mode, they must realise that agility trumps bureaucracy and that even Holdco structures must be flexible and agile enough to tackle rapid consumer and prudential change.

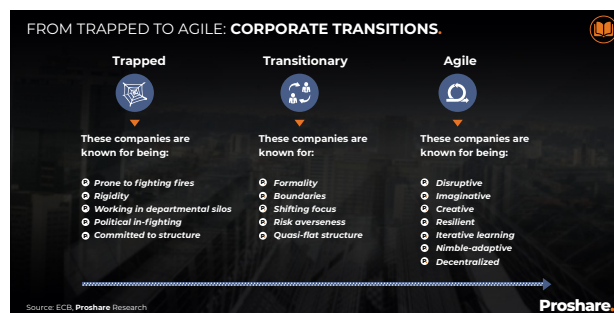
To be sure to fit neatly into the world of customer-centricity, companies must show themselves to be stable and dynamic, two concepts which appear contradictory at face value. Stability suggests that companies need to show resilience, reliability, and resourcefulness. This means that companies need to create backbones or templates, processes, and procedures that keep them anchored but flexible.

In other words, strong procedures and processes should not prevent companies from promoting creativity, innovativeness, and a flat corporate structure that allows for agility supported by speed. Analysts note that the push and pull of formal governance frameworks and operational flexibility can co-exist to create nimble companies focused on

promoting change rather than following it. Business analysts have increasingly realised that finding the appropriate solutions to a problem created by themselves is always easier. Companies that create a flexible walkthrough workspace must retain sufficient discipline to see that the organisation does not suffer from the arrogance of success and fall victim to the winner's curse.

Our analysts observed that nimble Nigerian banks had dynamic teams aligned with identifiable corporate, product, or service targets. They pointed out that dynamism would be a key feature of surviving business disruptions beyond 2023 for these banks. In discussions with bank chief financial officers (CFOs), Proshare's researchers noted that if commercial lenders are not going to be trapped by the next wave of socioeconomic dislocations, they must be prepared to transition from rigid routines and fixed outlooks to less formal and hierarchical structures that allow for better internal collaboration and the breaking of operational walls. According to the analysts, agile banks' teams should partner to deliver consumer journey satisfaction (see illustration 1).

Illustration 1



### Life on the Fast Lane

The report notes that the new bank customer is fast, furious, and non-fanatical. Gen-Z and millennials could not be bothered about corporate names but worry about service speed, convenience, and consistency. Ageing millennials are worried about higher incomes or generating stronger earnings as fast as possible to prepare for early retirement or a life of ease; to a certain extent, the same is true of Gen-Zers. Gen-Zs are already fast-tracking success through technology adoption and adaptation, with several young Nigerians developing skills in data analytics, data engineering/modelling, and machine learning. Traditional back-office functions such as accounting, finance, and economics are being 'souped-up' or 'pimped' to provide better insights for corporate action.

For example, product development in banks has been reimagined from what analysts think to what

customers' expect (this has been seen with Polaris Bank's VAULT and Wema Bank's ALAT). The product development process starts with market data, analytics, customer profiling and nowcasting to product development and sandboxing before a product or service launch.

Proshare researchers note that in a world of fast-changing consumer tastes and needs, Nigerian banks cannot afford to dally if they are to keep stakeholders happy. A CFO of one of the Tier 1 banks with a large African presence pointed out that *'competitive sustainability across Africa will be a game of value creation and cost containment, but in an environment of falling continental exchange rates, this may be difficult to pull off consistently'*. According to the bank executive, *'There is no "get of jail free" card to play in a world of closing trading blocs because banks in countries with small contributions to global trade will have to find value in capital markets. The plan would be to take advantage of asset securitization and public sector asset financialization. Unfortunately, in Africa, even a large economy like Nigeria is well behind in asset creation, valuation, and trading'*.

It must be understood that corporate success is not a destination but a goal. It will change and evolve. Proshare analysts believe that Nigerian banks will find new ways of holding on to their customers and ensure the creation of uncontested markets, as seen in the rise of banking's AI-supported fintech services. A few banks may encounter difficulties, but many, especially Tier 1 banks, will continue to thrive. According to W. Chan Kim and Renee Mauborgne in their book 'Blue Ocean Strategy', *"The most appropriate unit of analysis for explaining the creation of blue oceans is the strategic move - the set of managerial actions and decisions involved in making a major market-creating business offering. Compaq, for example, is considered by many people to be "unsuccessful" because it was acquired by Hewlett-Packard in 2001 and ceased to be a company. But the firm's ultimate fate does not invalidate the smart strategic move Compaq made that led to the creation of the multibillion-dollar market in PC servers, a move that was a key cause of the company's powerful comeback in the 1990s."*

The report's writers have noted that Nigerian Tier 1 banks will have to take a second look at their corporate strategies and come up with products and services that beat their closest rivals. For example, who says a bank's most threatening competitor is a bank? What about the telcos? Fintechs? And perhaps somewhere down the line, insurers? Financial services may become increasingly fungible

(changeable between products, services, and service providers, with service providers becoming less important than the service or product. For instance, digital payment platforms, such as Opay and Palmpay, are fast gaining patronage as lower service charges and fast payment and settlement confirmation make them the toast of the younger customer demography.

Given increasing Financial Holding Company (Holdco) arrangements, operations of financial companies and their regulation are taking new approaches. Proshare analysts note that all the Tier 1 banks except Zenith Bank have chosen to operate a Holdco structure. Zenith Bank's reluctance to adopt a Holdco structure could be related to its **Goldman Sachs approach** to business, where it waits for competitors to initiate change, and then it improves upon what is the dominant product, service, or business model. How well this works for the bank would play out with time.

## Second Guessing Nigeria's AI Banking Future

Disruption will be integral to Nigeria's banking future, with AI and digital banking becoming central to competitive advantage. The pacy growth of digital banking income appears to have sputtered out over the last two years; digital revenues have grown but at a slower pace—the slower growth of digital revenues mirrors non-bank payment platforms' rising acceptance and popularity. With telco companies like MTN entering the payment ecosystem, the struggle for digital revenues will be gripping.

Beyond digital payments, retail, corporate, and consumer transactions must scale up to reduce the intersection between customers, client service executives, and loan officers. Several parts of the service delivery journey could be automated to ensure faster service completion time. An individual or company requesting a loan should be able to receive preliminary acceptance or rejection notification quickly. In case of preliminary acceptance, other details could be communicated speedily before a face-to-face meeting with bank loan officers would be required. Operating spreadsheets and industry data could be sent before such review to enable credit officers to sensitise the data under alternative scenarios.

A fast credit appraisal process would facilitate the ease of doing business and support the scaling up of the activities of individuals and companies, thereby heading off a potential inflationary impact at the time

of loan approval. Indeed, strong digitally refined know-your-customer (KYC) frameworks would allow for the strengthening of the credit appraisal process. This point was emphasised roughly three years ago when the Proshare research team collaborated with the **Debtors'Africa** project to create a digital registry of toxic loan assets and the demography and persons behind the defaulting credits.

Going forward, banks will deepen and broaden their deployment of AI/ML and push for a reduction in their operational costs-to-income ratio (CIR), cost of risk (CoR), and non-performing loans ratio (NPLR). The current Tier 1 report for Nigerian banks suggests that the sector must jump off the treadmill of the past and get on board the wagon train of the future (see *illustration 2*).

Illustration 2



**Section 1** of this report begins with the crisis which hit the global banking sector in H1 2023 involving Silicon Valley Bank – a Mid-sized tech start-up-centric US bank and smaller crypto-focused banks like Signature and Silvergate Banks both of which had enjoyed relaxed regulation. The intervention of the Swiss National Bank in the takeover of European banking giant Credit Swiss (CS) by UBS after a liquidity crisis also comes under sharp focus in this section. The section pulls the lessons for African banking sector operators and regulators, especially regarding the regulation of mid-sized banks, the impact of rate hikes, Central bank intervention, and moral hazard. The section concluded with a different categorisation of banks and the need for a new methodology.

**Section 2** takes a deeper dive into the operations of Nigerian Banks, noting their relative sizes, and the sectors to which they have credit risk exposures. The report looks at the impact of the CBN's macro-prudential guidelines and interventions on the profitability of Nigeria's banks in 2022. Section 2 of the report contextualises the industry data by making comparisons with other African banks. It details the opportunities and threats arising from emerging developments like the AfCFTA, ESG concerns, Digital Transformation, and Cyber security.

**Section 3** takes a fresh look at bank classifications. The section revises Proshare's 2021 Bank Strength Index and gives it broader coverage. Proshare's Bank Strength Index (PBSI) is a testable model for ranking banks based on a variety of metrics like Capital Adequacy Ratio (CAR), Loans to Deposit Ratio (LDR), Non-Performing Loans Ratio (NPLR), Asset Size, Net Interest Margin (NIM), Cost to Income Ratio (CIR), Cost of Risk (CoR), and Board Diversity all of which empirically predict long-term profitability. This report makes a case for including banks' respective Risk Ratings and the proportion of their revenue attributable to digital income as metrics eligible for inclusion in the model.

**Section 4** drills down into the financial risk profile of Nigerian Tier 1 and Tier 2 banks. The focus was to highlight, where applicable, the difference in asset and liability matching in the different classes of banks. The section looks at the average tenor of securities in which Nigerian banks invest excess cash balances while reviewing the impact of economic headwinds, such as debt restructuring in Ghana and other countries, on Nigeria's banks.

**Section 5** traces the rise of tech foundries and digital income in the Nigerian banking industry. The section identifies the divergent patterns of digital revenues in Tier 1 and 2 banks.

**Section 6** concludes the report's findings and makes recommendations for operators and regulators.

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