



Polaris Restructuring Plans and the Customer-Interview with CEO Polaris Bank.

A Look at Polaris Bank's Restructuring Plans.



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By Proshare Market Intelligence Group.

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Unlisted companies are just as important as companies listed on formal stock exchanges. They reflect the moods, tones, and vibrations of economic success or lack, thereof. In the Nigerian banking sector, unlisted banks are increasingly significant in meeting the financial service needs of niche markets. Indeed, in a recent **Analyst Note** Proshare highlighted the variance in the corporate reporting governance of these banks. While it is not statutorily required that unlisted institutions provide the public with their audited financial statements, however, such sensitive financial rituals build stronger stakeholder confidence, and we are committed to ensuring that such becomes commonplace.

In this interview with one of these financial institutions, Kunle SONOLA, Chief Executive of Polaris Bank, explained that carefully rethinking and re-strategizing corporate plans in periods of growing uncertainty creates the bedrock of business sustainability. He noted that working with professional bodies such as PwC, Ernst & Young (E&Y), and KPMG across several corporate verticals has supported a competitive burst that goes beyond size. According to SONOLA, **'Size is great, but it is not limiting, how well a bank performs requires a dollop of strategic and tactical spice with a pinch of the X factor'**.

The interview underscored the critical nature of repositioning institutions to align with forward-facing goals. Fielding questions from Proshare's team of analysts, Sonola pointed out that **"a business lives and dies on the battlefield of competition based on integrity, imagination, teamwork, and consistency. We at Polaris understand that the markets of the future will be crucial to the strategies we adopt today, and in our way, we are picking up the challenge collectively"**. In the general scheme of things, and arising from our session, it would appear that Polaris Bank is coming back from a hard place and the lessons the bank has learned along the journey have been compelling, but not quite as compelling as the path towards a very prosperous future forged through the organisational resiliency, rebirth and reimagination that came across during our two-hour conversation with Kunle SONOLA, MD/CEO, Polaris Bank Ltd.

Below we provide excerpts from the transcript of the interview.

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TESLIM: Our last *Analyst Note* talked about the fact that the bank has lived on the edge for some time; as with a few other banks in tier 3. Polaris Bank has recovered from what analysts saw as a raging storm, what lessons have been learned, and what tone does this set for the bank's rebirth?

SONOLA: It's great to be here and I thank you ahead for what I hope will be a two-way beneficial knowledge session. To your question, the bank has learned several lessons. It has long recovered from the challenges of the erstwhile Skye Bank to winning an increased market share, growing its franchise's top-of-mind recall, and solidifying its digital banking footprint. We have repositioned the bank from its legacy period to the ideation and visioning era of Tokunbo ABIRU and the execution period of Innocent IKE. and now to today's agenda-stretching, value-creating, and technology-adapting era of the present team I now have the privilege to lead. It will be right to therefore look at this phase as the consolidation and extension of earlier processes and periods. We believe that with a strong institutional framework, we are building a ready-for-market reality that we have collectively bought into from the board to management.

You asked about the critical lessons learned from our transitions. From where I sit, I see four lessons as being pre-eminent.

Corporate Governance

Corporate Governance excellence sounds cliché but at the very heart of corporate sustainability is the art of running a business with purpose, and integrity. Without purpose a business loses its way and without integrity, it loses its soul. When management fails to recognize that the customer is the centre of the reason for existence, it easily finds itself struggling to provide fit-for-purpose solutions to customer problems. The customer's pain gets ignored and the gains from being a solution provider get smothered in the pursuit

of other concerns. We are recalibrating with the customer's needs as our primary consideration. We are looking to win back our migrant customers and support our resident ones.

Risk Asset Diversification

Having loans and advances concentrated in a sector, business, or individual is like balancing twenty crates of eggs on your head, tripping over a pebble smashes all egg crates but if you decide to spread the crates over three of your siblings each carries five crates, if you trip over a stone and all eggs get smashed, the worst that could happen is that five egg crates get damaged but seventy-five percent of the crates survive, spreading risk is not just a strategy to ease stress, it is crucial to sustainability. We have internal diversification red lines stricter than the statutory rules to give us early warning signals about our risk asset balance. The same considerations apply when we review our liabilities or deposits. **The dark days of portfolio concentration are dead and buried.**

Funding Sources

Our funding sources were heavily challenged by the oversized reliance on certain deposit types. Given the unpredictable nature of the tenor of such balances, we poked ourselves in the eye. Now, with the benefit of hindsight, relying on certain deposit liability types was risky and ill-advised, and we have taken note of that. This escalated funding risks to a narrow class of depositors. These kinds of deposits were good, make no mistake about it, but overdependence on them like a person hooked on painkillers, courted trouble. We have, therefore collectively, for some time, agreed that more organic and stable deposits at lower interest expenses emerge naturally from the retail end of the banking business. Building large savings and tenored account deposits is easier to handle in terms of costs and predictability. Funding diversification and cost optimization are now an integral part of our future. We have taken a fresh view of these issues and adopted

the Holy Grail of dynamic modern gap analysis. Asset and liability tenors need to stay as matched as possible, as their risk profiles remain appropriately aligned and sequenced. Recent developments concerning the failures of **Silicon Valley Bank (SVB)**, **First Republic Bank**, and **Signature Bank (SB)** in the United States of America (USA), and **Credit Suisse Bank** in Switzerland remain instructive. A detailed dynamic gap matrix is a compelling tool for balance sheet protection. In a twist of a well-worn local adage, 'a rear horse seeing a lead horse dash into a ditch does not repeat the error'.

Cost Optimization

On the issue of cost minimization, we have streamlined operations to either filter out or filter down costs in line with our strategic needs. Certain internal processes have been realigned to cut down operating expenses and certain legacy human capital realignments have had to be painfully made in the interest of business sustainability.

TESLIM: I want to pick up on something you referred to when you said the bank has learned its lessons and is still doing so. Polaris Bank must still deal with the tyranny of the three Cs - Capital Adequacy Ratio (CAR), Cost-to-Income Ratio (CIR), and Cost-of-Risk (CoR), what is the outlook for these performance indicators in days ahead?

SONOLA: Well, you seem to be right that all banks must deal with the big Cs, and at Polaris Bank, we are dealing with the issues. The outlook for the indicators you mentioned is positive as it sits well with our competitiveness projections. Currently, the bank operates well above the statutory 10% capital adequacy requirement. Furthermore, we are concluding arrangements to inject Tier II capital to support our asset growth aspirations. The equity interest holders of the bank are also able and willing to inject additional capital into the bank whenever the need arises.

The high Cost of Risk, to which NPL is directly related was a major reason for the challenges of the erstwhile Skye Bank ((NPL was over 50% at a time). Today, Polaris has worked NPL down to a single digit through recoveries and resolutions of most of the challenged accounts. The bank has strengthened the risk management framework by adopting leading Risk Management Practices and making a significant investment in best-in-class Risk Management Solutions and Risk Governance frameworks. Given that the banking industry is increasingly dynamic, Polaris will continue to adopt the best practices in risk management with cutting-edge technology.

I must say that for any organization, there are two ways to improve financial performance; grow revenue or reduce cost, or both. Therefore, we have decided to continue to improve our cost profile. Although the recent spike in inflation has put costs under enormous pressure industrywide, cost control which is one of the bank's strategic pillars will be continuously pursued. For instance, we are extensively deploying technology, automating many manual processes for efficiency, branch optimization, and office co-location. We are also putting a squeeze on our energy cost, which is a major component of our cost profile. Some of the initiatives involve, switching to alternative power service (Solar), Outsourced power generation under a fixed contract (Power As A Service), subscription to premium service, caps on diesel consumption, and implementation of an automated system of diesel monitoring, amongst other measures.

OLUFEMI: Arising from the consequences of the banking turmoil you just went through, for lack of a better term, you will agree that *tactics cannot be sacrificed at the altar of strategy*, in an uncertain world, what are Polaris Bank's short-term tactics and how does this dovetail into its longer-term strategy?

SONOLA: Well, expectedly, our short-term tactics come from our longer-term strategies. At the tactical level, we are strengthening our digital deliveries, and upgrading the capabilities and offerings on our Digital Bank, Vulte, for an even more intensive and intuitive experience across customer journeys. We are improving our processes across Front, Middle, and Back Office operations to reduce turnaround time and better cater to the expectations of our customers. We are upskilling personnel through continuous training and recruitment of top talents. We have tweaked our go-to-market structure for better alignment with industry developments and dynamics. We are also forging value-creating business partnerships on an opportunistic basis. Cost control is a critical part of our tactical and strategic roadmap.

Broadly our key tactical approaches involve:

Aggressive customer acquisition and strengthened relationships. What this has meant is that the bank has filtered migrant customers intending to bring many of them back onto its books.

Improved digital play. This reflects the improvement of technological interfaces that feed into the customer's journey expectations and experiences. This is a top priority.

Process improvement. The Process as a Service paradigm shift should create a more powerful customer service experience. We live for that improved

customer service experience.

Improved staff productivity. At the core of the Polaris Bank reboot is its people, its staffers. We need to drive the process with the best hands. The process would involve some recalibration of staff needs in line with business sustainability considerations, while upskilling and retraining programmes. The bank now drives a productivity-sensitivity framework that marries staff effort with measurable business contributions.

Cost optimization. As said earlier the bank is aware of the need to improve its CIR and the various cost containment strategies are in play. We will drive an aggressive cost strategy accompanied by growth and diversification. Cost containment is good but cannot be exclusive, if the bank is to rise from what you in Proshare recently called borderline tier 2 status, then we need to improve on all fronts.

On the strategic front, we have zeroed in on:

Offering superior customer experience as a competitive tool. The new world of competitiveness requires that corporations are agile and flexible, we are building this into the bank's operational DNA. Our customer journey experiences have been deconstructed across demographics and the service propositions will soon grace banking halls in the next eighteen months at the latest

Revamp the Bank's pool of talents and better shape the corporate culture to support strategic aspirations. The corporate culture will evolve with a commitment to customer satisfaction and corporate margin improvement. This requires a tight ship, a clear-minded shift towards customer-centricity, and an operational bridge between markets and manpower.

We plan for a stronger balance sheet, with higher loan quality, greater liquidity, larger capital, and resilience to absorb economic shocks. Our loan asset quality has improved significantly, thereby improving liquidity, earnings, and the bank's capital. We are primed to improve our cost-to-income ratio (CIR), Capital Adequacy Ratio (CAR), and Cost-of-Risk ratio (CoR). In the recent past, we saw bumps in the risk area with CoR higher than we would like, but more recently risk quality has improved leading to lower CoR.

We intend to build a dominant digitally led retail franchise and continue to reshape the bank's business processes and support technology to continuously improve enterprise agility. The key thing is to drive top-notch processes and build agility in customer responsiveness.

And lastly, **Improve Risk Management practices, by ensuring regulatory compliance, and maintaining**

best practices in Corporate Governance. Our brand equity will be the point of aggregation of these strategic initiatives, and over the medium term, we are looking at a brand in the 'Top Mind Awareness' bracket that is digitally led, competitive, and outperforming industry averages on all metrics of performance – both financial and non-financial.

OLUFEMI: Thanks for that elaborate response. Permit me to to make an observation observed that Polaris Bank has made a strong push in its digitization efforts with the launch of the user-friendly *VULTE* digital platform. How far do you think the bank can go in the Fintech space?

SONOLA: Given the seriousness of this phase, I will imagine that you will find it useful to gain a better sense of how see things given the type of reports you produce (laughs). I am glad you brought up the *VULTE* product, which is just one of our service offerings. Indeed, we are creating a digital service reality that is customer service-focused. The technology driven this will scale digital service delivery to enhance our customers' product or service experiences as we front-load features that fit into their expectations and future possible journey outcomes. As financial service platforms gets better and continue to be an enabler, a part of the fabric of our modern economy, we will be an integral part in the way people carry out their businesses and we will make their digital journeys an integrated friendly experience. One cannot talk too much about this, but the tea leaves are pointing to a fresh pathway to consumer banking satisfaction.

TESLIM: Let me come in here. As banks strategically scale human capital talent, the fear is that with technology, low-end routine jobs may disappear as bank labour gets the heave-ho, with bank digitization, what is the Polaris Bank staffing playbook?

SONOLA: An interesting question, as you are aware, technology is rapidly driving far-reaching changes in banking and other industries at breakneck speed. The skill sets required for the workplace of yesterday are not what is required today. We cannot even tell with certainty the skills set that will be required tomorrow, but what we can tell with certainty is that technology will be at the heart of it. Hence this calls for sustained upskilling of the existing workforce, continuous learning, unlearning, relearning, and talent onboarding. This is not local to Polaris Bank but common to the industry. We are hiring talents with the right skills and experience. Furthermore, we are reviewing and updating the competencies framework of the Bank in line with the current realities and

business support and development.

TESLIM: Polaris Bank's recapitalization was unique as it provided the new owners with the unique opportunity to build capital buffers over a long-term horizon. Analysts wonder how much of a role this would play in rebuilding the bank's finances.

SONOLA: Well, you are kind of right, but we must understand that for a bank, adequate capitalization is a key measure of financial health, providing comfort to depositors and affording balance sheet and business growth. The bank is presently adequately capitalized, operating well above the 10% minimum requirement for National Banks. Nonetheless, as earlier said, we are concluding arrangements to inject Tier II capital into the Balance Sheet to support our growth aspirations. Our shareholders are ready and willing to inject Tier I capital into the books. Having instituted best-in-class risk management practices, and maintaining adequate capitalization to support our growth objectives is not one of the bank's immediate challenges and will not be in the foreseeable future. The new owners are committed to providing necessary support towards building a strong and resilient financial position to underwrite transactional activities of the Bank for sustainable value creation.

SAHEED: From my standpoint being in charge of stakeholder engagements, I observe that capital is one side of a liability flip coin; the other side is deposits. Given that low-cost deposits would improve Polaris Bank's net interest income (NII), and in other to avoid past mistakes, how does the bank hope to navigate this bend on its sustained recovery road?

SONOLA: There you go again with the recovery story (pause,) the bank has passed this phase. Business growth and development in the bank are based on customers' needs and value propositions. Leveraging digital banking platforms, retail reach, a value chain business model, customer acquisition, and increased transactional activities that would lead to improved Net interest income (NII) generation are gaining traction.

Again, let me restate that the bank has travelled past the recovery road years back, it is currently on the growth road leading to market dominance. Already, the Bank won the '*BusinessDay Newspaper Digital Bank of the Year Award*' back-to-back, 2021 and 2020, it was named the '*Most Improved SME Bank*' in 2022 in the KPMG's Annual Customer Experience Survey among other awards and recognitions. we have identified the need to grow our NII.

Our strategy is two-pronged: control the funding cost and grow earning assets at economic pricing. Our

funding costs have been very competitive in the industry and will remain so with our focus on low-cost deposits. Earning asset growth is one we are driving from both the investment and risk asset sides of our business. We have revamped our go-to-market structure, broadening our customer base, fine-tuning our product, and supporting service offerings, strengthening personnel sales capacities, and improving our loan onboarding processes. We are very confident our Net interest income and margin will witness considerable growth as our strategies mature.

OTTO: As a chaser to my colleague's question, Polaris Bank with its current asset-size would be seen as one of the smaller deposit money banks (DMBs), what are the challenges that this poses for the institution, and can 'small mean beautiful' in the present Nigerian banking context?

SONOLA: Firstly, we should not interpret the asset size to mean the bank is still in a recovery phase. Our size, relative to other Tier II players, can be best appreciated against the legacy challenges of the bank when a considerable part of the Balance Sheet was taken over by AMCON. Whilst we are not racing for size but for efficiency, we still consider size important as it affords more opportunities and possibilities. In terms of the challenges posed by our size, our corporate strategy took into consideration the current Balance Sheet size tailoring the business model after it and its projected growth. Since the business and operating strategy identifies with our size, there are no challenges at all.

The bank has consistently been growing its assets base year-on-year (Y-o-Y). The bank's recently developed strategic plan will guide the bank to a position of being a major challenger of Tier I banks and to be the leader among Tier II banks along all the key performance parameters. Furthermore, the bank's focus is to be one of the most efficient deposit money institutions in the industry, delivering superior value to its stakeholders, our competition is not of size, but value creation.

ABDULQUDUS: You have explained that size is important but not a severe constraint to your operations, but does a rising interest and inflation rate environment play to the favour of the bank by way of a larger net interest margin (NIM)? How vulnerable is the bank to a lower interest rate situation given its relative size?

SONOLA: Size is Prince but not King. The balance sheet structure of the bank is regularly reviewed to its resilience and protect the net interest margin. Given the volatility of our operating environment, the bank

plays mainly in the short end of the market to dynamically respond to market changes and ride the yield curve without adverse impact on its financial position.

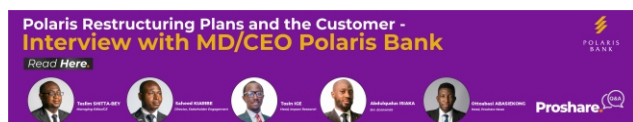
TOSIN: Maybe size is not a serious concern, but what about portfolio concentration? Proshare research has noted that several banks have a large exposure to the Oil and Gas sector, and this creates concerns about industry-specific downside risks, how does Polaris rank with regards to its loan asset concentration?

SONOLA: The observation about loan asset concentration is valid, and Polaris Bank is conscious of the problem, we come from a pain port that made us poster boys for concentration risk in a much earlier and bygone era. We have picked up institutional wisdom and currently operate a tight portfolio management framework that ensures that loan concentration risk is improbable. Our risk management process and risk assessment framework are deliberately more rigorous than the statutory guidelines require, thereby helping us to identify concentration tendencies early and nipping them in the bud.

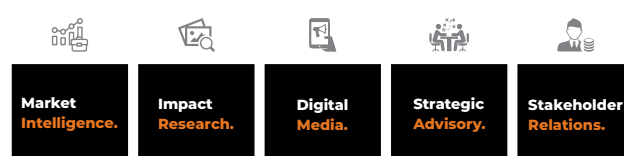
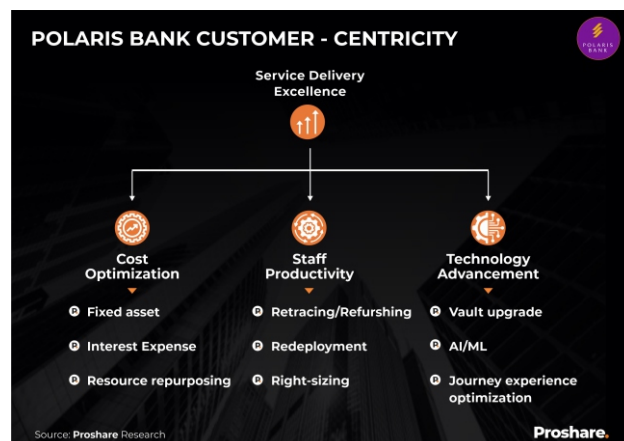
TESLIM: On a final note, in Proshare's Bank Relative Strength Index (PBSI) Polaris was categorized as a tier 3 bank in 2021, recent results suggest an improvement to borderline tier 2, based on CAR, CoR, CIR, NPLR, Asset Size, and sustained profitability, are there plans to further strengthen the bank's tier 1 and 2 capitals soon?

SONOLA: As I said earlier, one of the key initiatives to position the bank for competitiveness in the market is the boosting of the capital base of the Bank even though the current capital is adequate to support the business in the short term and equally above the regulatory minimum. Specifically, there is an on-going arrangement to shore up the capital with Tier 2 capital in the current year while Tier 2 capital is planned for 2024.

TESLIM: Kunle Sonola, thank you for the generous time spent with us.



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Director, Stakeholders Engagement

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