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A THEORETICAL STUDY ON THE FAILURE OF LEHMAN BROTHERS AND MERRIL LYNCH: A LESSON FOR BANKING INSTITUTIONS IN NIGERIA

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ABSTRACT

The bankruptcy of Lehman Brothers and Merril Lynch is conceptually examined as a lesson for the banking institutions in Nigeria. Therefore, institutional failure was the cause of the current financial system instability in Nigeria, particularly in the banking sector. Nigerian financial experts believed that the demise of the two banks served as a strong enough warning to the country's banking sector. Thus, the study shows that the two banks' ability to predict their future depended solely on their size and age rather than on the effectiveness and efficient management of risky assets. As a result, normal lending practices are not used; instead, subprime mortgage arrangements that lack collateral security are used. Refinancing has become more challenging due to the falling home prices and insufficient securitization technologies. This advises the regulatory authorities to use more unconventional techniques of gathering classified information in addition to the traditional tools of bank monitoring. To adapt to the local situation, financial institutions should retrain and train their staff. It is preferable to implement conventional lending practices than to rely on subprime mortgage management that lacked collateral security. To maintain efficient oversight and sound risk management practices, the Central Bank of Nigeria (CBN) should take the initiative.

Keywords: Failure, Lehman Brothers, Merril Lynch, Lesson, Nigerian, Banking Industry.

INTRODUCTION

According to the research done by Andabai (2017), a bank's future is dependent on how well its risky assets are managed, in addition to factors like size and age. Lehman Brothers, however, was established in 1850 as a broker and trader of commodities and switched to investment banking in 1899. The institution employed 26,189 people and had a $639 billion capital base. The organization was specialized in investment banking, equities, fixed income sales, research, trading, investment, management, private equity, and private banking, according to Ogoun, Ogiriki, and Andabai's (2016) work. The bank later served as a major player in the United States of America's government securities market; Merrill Lynch was established in 1914. The institution has a $32 billion capital basis and $1.6 trillion in total assets. According to a theoretical analysis by Nzotta (2014), with offices in over 98 cities and membership in 28 stock exchanges, the bank is claimed to be the largest securities firm in the world. The company employs over 60,000 people worldwide. To be more explicit, on September 14 and 15, 2008, the two banking giants were destroyed, giving the financial crisis that was raging in the United States of America at the time an unanticipated dimension.

Andabai's (2018) did observe in his study; that effective and "efficient management of risky assets must remain focused and professional" in order to prevent a bank from failing. Age and size alone cannot do this. According to the research done by Ogiriki and Andabai (2017), various people have diverse interpretations of what bank failure signifies. Some people

believe that a bank only fails when it stops operating, regardless of whether it has been formally declared liquidated. As a result, several research including Dauladi (2017), Akomolate (2018), and Ajiboye (2018) claimed that a bank collapses when its original goal is not met. Aniekan and Babalola's (2018) study confirmed that a bank only fails when it stops operating, even if it hasn't been declared insolvent. Others, however, believe that a bank has failed if it cannot accomplish the goals for which it was founded. Based on the topic, Ezelueli's (2018) work proposed that a bank failure occurs when a bank ceases to exist and is unable to fulfill its obligations to depositors. Emene (2017) went on to emphasize that these duties extend to the company's clients, stockholders, and the neighborhood where it is based. According to Olagunju (2018), a bank failure occurs when there is irreparable bank distress, the bank's license is removed, and the bank is then liquidated. Anosike (2018) concurred that when a bank is liquidated due to its inability to pay its debts, it has failed.

Theoretical Issues

Andabai (2018) conducted research and found "that bank failures in emerging financial systems had a significant impact on their economies". Even when the crisis was resolved, there was still a significant cost associated with resource allocation distortion. Therefore, the bank restructuring and recapitalization caused by the crisis burdens these economies for many years. However, Imoughele and Ismaila's (2017) research defined bank failure as the whole or partial "loss of shareholders' funds along with the stoppage of independent operation or as a result of the liquidation of the financial system". A bank is regarded to have failed, according to Emiaso (2016), if it hasn't succeeded in reaching even one of its original goals. Therefore, these research defined a bank failure as not only when it stops operating but also when it is unable to pay its debts. Ikeora (2016) emphasized that these duties are owed to the company's clients, shareholders, and even the neighborhood in which it works. The crucial role that banks play in the formation and expansion of the economy explains why every economy looks for ways to prevent such failures.

Therefore, Ezelueli (2018) said "that despite preventive measures, most economies" have at least one instance of bank failure of varying degrees, such as Nigeria. While the closure of a bank is always regarded as serious, serious can also refer to the bank's failure to fulfill maturing obligations by the due date. Since the beginning of banking in Nigeria, a bank failure also refers to the failure of the bank to pay maturing commitments. Some banks violate these commitments because Nigerians cannot use banking systems, and because such services are provided inefficiently and with delays, leading many Nigerians to utilize the unregulated financial sector and undermining trust in banks. In this sense, it may be stated that the banks failed to live up to the standards set forth by their establishment. However, banks' inability to fulfill commitments, such as those related to meeting depositors' withdrawal requests, ongoing losses, and complete liquidation, has led to these outcomes.

According to Ogoun, Ogiriki, and Andabai's (2016) research, another risk "posed by bank distress is the threat to an effective payment mechanism and the settlement of transactions that are primarily cash-based, along with the hazards in the economy that go along with them". Furthermore, as a result of the volatility that characterizes the demand for money, the adequacy of monetary policy had decreased in direct proportion to the degree of loss of trust in the banking system. Due to banks' diminished role as a secure steward of money, the amount of money in circulation outside of the banking system appears to have

increased. In spite of the worldwide trend toward credit-based economies and the expansion of this culture in most emerging markets, it is perplexing that most economic transactions in Nigeria are still conducted on a cash-and-carry basis. This phenomenon is responsible for a sizable amount of the total money supply, which could have been successfully used in the productive sector if the banking system was stable, secure, and sound.

According to a theoretical study by Nzotta (2014), "a cash-based economy" increases distortions in the money supply and macroeconomic management in addition to having an impact on the growth of financial institutions. As a result, the economy would have to spend money to address the problem of distress, which invariably resulted in taxing all taxpayers. The implications would be considerably more dire for a downtrodden economy already headed for slowing growth. In addition to the theoretical ramifications of bank failure on credit, economic agents' spending is limited by the amount of credit made available to them. As a result, this development will limit overall credit availability or disrupt bank activities as intermediaries, which will have an impact on the overall health of the economy. In reality, there will be a detrimental impact on financial intermediation, including bank credit-granting activities and overall economic activity (Anosike, 2018).

According to Babajide's (2008) research, Lehman Brother declared bankruptcy on September 15, 2008, "following a string of losses brought on by exposure to the troubled" US subprime market. According to Andabai (2018), "Bank of America also purchased Merrill Lynch on September 14, 2008, for $50 billion in all-stock transactions". The collapse of the two established financial organizations as a result caused the New York Exchange to drop by 504 points, shaking the whole global financial system. Opara (2017) came "to the conclusion that the two organizations were also regarded as the oldest in order to be among the top investment banks" According to Aliyu (2017), "the failure of the two banks proved his point that banks are supported by the caliber of their assets and the prudent management of their risky assets, not by the amount of capita"l. Because poor asset quality will eventually cause a bank to fail, regardless of how much capital it has. In fact, he noted that the two banks were larger than all 22 banks in Nigeria.

According to a study by Ezelueli (2018), "the bankruptcy of Lehman Brothers and Merrill Lynch did not cause a panic among Nigerian banks". Because, other from when there are direct financial transactions, it won't have any impact on our economy or on Nigerian banks. According to Chiwendu (2018), "Nigerian banks should exercise caution while making consumer credit loans, particularly at this time when liquidity is scarce". The global financial crisis first appeared to have stayed outside Nigeria's borders, but in the final few weeks of that year (2008), the stock market caused ruins here. No one paid attention to the "underlying stock market transactions, balance sheets, or foreign fixed income flows when they were moving slowly and the domestic market was experiencing limited liquidity" (Andabai, 2018).

According to Babajide's (2008) research, "the subprime mortgage crisis that destroyed the two banks began in 2006 with the collapse of the US housing bubble, a high rate of default on "subprime" and other adjustable rate mortgages (ARM), and a higher default rate on borrowers with less credit history or lower income than "prime" borrowers". Sanusi (2016) emphasized ""that the practice of offering loans to borrowers who do not qualify for market interest rates due to different risk factors, such as income level, amount of down payment made, credit history, and employment status, is referred to as subprime lending. According to Balogun (2018), "a variety of other variables, such as home owners' failure to make their

mortgage payments and lenders' or borrowers' prior prejudging of a situation, can also be blamed for the crisis". According to Kayode (2018), further "dropping property values had also made refinancing more challenging due to securitization innovations and risk associated to home owners' failure "to make mortgage payments that had been disseminated widely, with a number of subsequent repercussions.
According to Ahime's (2018) research, borrowers were attracted to take out mortgages because of lending "incentives and a long-term pattern" of growing house prices because they thought they would be able to refinance at a better rate in the future. Refinancing, however, changed more as a result of the sharp decline in house prices that occurred in several regions of America between 2006 and 2007. According to Ezelueli (2018), as "ARM interest rates rise, there is a significant increase in default and foreclosure activity. As a result, approximately 1.3 million American homes saw foreclosure activity in 2008, an increase of 79% from 2006". The opinion of Babajide (2008), "was that the mortgage lenders who took on the credit risk were the first to be impacted when borrowers found themselves unable or unable to make payments on time". Major Banks and other financial institutions reported losses of about $435 billion in July 2008 as a result. In conclusion, compromise with the management of risky assets was the primary cause of failure.
Andabai (2018) emphasized that t"he failure of Merrill Lynch and Lehman Brothers had further demonstrated that no bank or financial organization is too large to collapse". According to Khacances (2018), "two well-known examples in this regard are Bank of Credit and Commerce International (BCCI), which failed in 1991, and Barings Bank, which also failed in 1995". In fact, they found it hard to imagine that Lehman Brothers and Merrill Lynch were affected by the raging financial crisis given that both had weathered past crises, including the great Wall Street crash of the 1920s. But he also emphasized that the lesson for Nigerian banks is that both banks failed as a result of having too much credit exposure to the subprime mortgage market through mortgage backed securities. In other words, rather than a bank's size or age, its future rests on how well it manages its risky assets. In light of the two naming agents' experiences, Ekpenyong (2010) underlined that Nigerian banks should not skimp on the management of risky assets.

CONCLUSION AND RECOMMENDATIONS

The study came to the conclusion that a bank's future depends on how well risky assets are managed, not only how big and old it is. Refinancing had become more challenging due to insufficient securitization advances brought on by the decline in housing prices. The report consequently advises the regulatory authorities to use more unconventional techniques of gathering classified information in addition to the traditional tools of bank monitoring. To adapt to the local situation, financial institutions should retrain and train their staff. It is preferable to implement conventional lending practices than to rely on subprime mortgage management that lacked collateral security. To maintain efficient oversight and sound risk management practices, the Central Bank of Nigeria (CBN) should take the initiative.

Contribution to Knowledge

The study was able to add to the body of recent writing, making it more useful for researchers and academics to employ in their work. Thus, the study added information by

showing that a bank's future depends on how effectively and efficiently it manages its risky assets rather than just its size and age.

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