Asian Economic and Financial Review, 2014, 4(8): 1123-1130

Asian Economic and Financial Review

journal homepage: http://aessweb.com/journal-detail.php?id=5002

FINANCING CAPITAL INVESTMENTS IN NIGERIA: THE ROLE OF THE BANKING INDUSTRY

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ABSTRACT

A developing nation like Nigeria needs huge capital outlay to finance the needed infrastructures and capital investments necessary to drive the economy. This study lays much emphasis on whether the banking industry is really financing capital investment thereby contributing immensely to the development of the economy. It also looks at the contribution of financial institutions in promoting the development of the stock market thereby mobilizing fund that will enhance manufacturing of goods. Data were collected from the CBN statistical bulletin spanning a period of 32 years (1981 – 2012). The data collected were analysed with regression using e-view software. It was discovered that the banks have contributed much in financing capital investments and stock market development in Nigeria. It was recommended that financial institutions should be encouraged to mobilize more deposit for lending that will aid capital investment. While the Central Bank on the other hand should reduce its minimum rediscounting rate.

Keywords: Financing, Capital, Investment, Banking industry, Nigeria.

1. INTRODUCTION

For any nation to develop her economy, she needs to mobilize adequate financial resources, which will aid such development. In order to sustain the rate of such economic development, the government should make a conscious effort to ensure that adequate funds are available to drive such development. This is necessary because the mobilization of financial resources will lead to capital formation and capital formation requires the release of domestic goods and services, which promote the real investment. Therefore, any economy that wants to increase its real capital formation must be able to provide a climate receptive to the resource from overseas and the encouragement of domestic savings. This requires an institutional arrangement that encourages savings, which will result into productive investment. An example of such an institutional arrangement is the establishment of banks that will serve as intermediaries in the financial market.

In Nigeria, there are about twenty-two licensed banks after the post consolidation era and even recently some banks were nationalised by the Central Bank of Nigeria (CBN) in order to save them from distress and ensure that they continue to perform their statutory functions. But the big question that needs an answer is that, to what extent has the banking industry contributed in ensuring that adequate finances are available for capital development and investment to drive the Nigerian economy?

This study therefore looks at the role of the banking industry in financing capital investments and infrastructures in Nigeria with a view to determining areas of improvement in banking industry.

2. LITERATURE REVIEW

The Nigerian Banking sector has a long and dynamic history, pre-dating the nation's political independence in 1960. The Nigerian Banking System is traceable to 1892, with the establishment of First Bank of Nigeria under the control of the British colonial administration. Subsequently, Nigerians and other Africans also established their own banks, which operated alongside expatriate foreign banks in Nigeria. Prior to the nation's independence, the nation's financial sector was a little organized, with few financial instruments in the market. Also, institutional mechanisms were weak, leading to many bank failures, particularly between 1953 and 1959. These negative developments prompted the Colonial government to establish the Central Bank of Nigeria in 1959 as the apex regulatory body charged with administrative responsibilities over the Nigerian Banking Sector. (Somoye, 2008).

In the next decade (1959 – 1969) the Nigerian banking sector witnessed a series of activities, culminating in the establishment of the money market in which commercial and merchant banks in Nigeria participated effectively. The major function of the money market is to facilitate the intermediation of short-term funds from the surplus to deficit units of the Nigerian economy. The deficit units, which include public or private sectors of the economy, sourced funds from the market through short-term financial instruments. The institutional players in the money market, which is the fulcrum of the financial sector, include deposit money banks and discount houses. The primary money market instruments comprise treasury bills, certificate of deposits, call money, commercial papers, investment funds, bankers' acceptances, and repurchase agreement.

The deposit money banks evolved from the adoption of the universal banking system in Nigeria in 2001. Until 2001, commercial and merchant banks dominated the money market. While the former engaged in the retail end of the market; the latter operated in the wholesale segment.

However, as part of banking sector reforms, the dichotomy between commercial and merchant banks was abrogated in 2001, with the emergence of Universal Banks. Under the reform, the minimum capital requirement for each bank was raised to N25 billion. Apart from universal banks, discount houses were also established as part of market players in the banking sector. They are specialized non-bank financial institutions engaging in mobilizing funds from the surplus sectors and channelling resources to the deficit sector. They also mobilized funds for investment in securities through re-discounting facilities in government short-term securities.

Other players in the Nigerian banking sector include the Development Finance Institutions (DFIs). These are specialized banks established primarily to address the slow pace of development and the nation's challenges of economic under performance. Currently, the banks include, Bank of Industry (BOI); Urban Development Bank (UDB); The Federal Mortgage Bank of Nigeria (FMBN); The National Economic Reconstruction Fund (NERFUND); and Nigerian Agricultural and cooperative Bank (NACB).

However, it appears that the commercial banks are presently dominating the banking sector of the economy. This may be due to the enormous responsibilities placed on their shoulders by the reforms. Ademola (1996) and Perry (1996) are of the opinion that commercial banks' primary function is to facilitate the flow of savings from those of the economy with surplus funds to other sectors with insufficient funds by accepting deposit and giving out advance as well performing other services to their customers.

Heffernan (2005) views the functions of commercial banks as follows;

1. Provision of international trade services**:** offering various services to their customers who are exporters or importers. For instance, a Nigeria exporter can receive payment from abroad through his commercial bank by drawing a bill of exchange on the importer. Commercial banks also discount bill of exchange that is; buy the bills of exchange at a price less, by the amount of discount, than the face value of the bill. This will enable the exporter to collect payments on the goods exported before the importer makes payment.

2. Provision of brokerage services: Commercial banks in Nigeria act as share distribution agents engaging in buying and selling of securities in buying and selling of securities for their customers. That is why they act as intermediaries between their Client and stock brokers (or merchant banks) to acquire or sell stock in the capital market (Securities and Exchange Commission and the Nigeria Stock Exchange)

3. Provision of foreign exchange services: Commercial banks act as intermediaries between the Central Bank of Nigeria or authorized foreign exchange dealers (bureau de change) and their clients-mostly manufacturing companies, in processing applications for foreign exchange allocation. They also provide travellers with traveller's cheques and foreign currency notes to enable them carry out minor transactions on getting to their countries.

4. Safekeeping of valuable assets: The commercials banks have strong rooms where valuables can be kept. Customers usually keep their government stocks, share certificates of occupancy, wills and jewellery's with banks for safety.

5. Debt factorising: Debt factorising is a debt recovery strategy in which a commercial bank acting as the third party or a factor buys a debt at a discount and gets the face value of the debt at maturity.

6. Accepting deposits of money: Commercial banks are deposit taking financial intermediaries. They accept deposits act as financial intermediaries. They accept deposits from households, Firms, and governments (State and Local Government) in the form of demand deposits.

7. Granting of loan and advances**: -** this is the profitable function of the commercial banks. They make profit by lending to creditworthy customers that is, that's having collateral securities, at a higher rate of interest than the rate they pay on deposits. In order to protect depositors, commercial banks provide mostly short-term loans that is, loans repayable within a period of one year. The bulk of the loans and advance often go to the priority sectors manufacturing and agricultural, in compliance with the central banks guidelines.

8. Acting as agents for transfer of funds**:** Commercial banks act as agents of payments of transfer funds on behalf of their customers through collection of cheques, standing orders, direct debiting and so on.

9. Creating demand-deposit money: Commercial banks create demand-deposit money by lending out the money that they received from some other customers.

2.1. Challenges of the Banking Sector in Nigeria

The post consolidation era of the banking sector according to Nnanna (2004) came with some emergent issues and challenges. These challenges relate to the stakeholders in the industry, particularly the operators, regulatory authorities and governments at various levels. Some of these challenges are:

I. Increased Customer Orientation and Focus: Customer expectations for improved banking services have increased as banking no longer involve providing standard products to customers, but needs to be sensitive to customer's needs for greater efficiency and convenience.

II. Dearth of Qualified Manpower: Most banks lack the required manpower to drive the new process in view of the emergence of the big ticket transactions occasioned by consolidation.

III. Improved Regulatory Framework: The regulatory authorities decided to strengthen their supervisory capacity to ensure smooth operations by adopting appropriate supervision strategies like

- Adoption of Risk-based supervision
- Need for greater capacity for supervision
- Necessary supervision tools/software (Ogunleye, 2005).
- Adoption of consolidated supervision

IV. Legal Reforms: Though a number of legislative initiatives had been taken during the early reform years to address the banking sector problem, the authorities discovered the need for further improvement in order to complement efforts of the regulatory authorities in realizing a sound and stable banking system.

V. Expansion of Investment Infrastructure: Nigeria's dearth of infrastructure implies that additional investment is needed generally in the medium term to engender reduced cost of operation for banks and translate to lower cost of funds for economic agents.

3. METHODOLOGY

In order to achieve the results of the study, the following hypotheses were formulated;

1. H_0: Bank credit does not have any impact on capital investments in Nigeria.
2. H_0: Bank Credit does not have any impact on Stock Market Development in Nigeria.

To carry out an effective analysis on the study, a model was specified which would aid the regression analysis. The model is given as:

$TBCt = \beta 0 + \beta_1 GFCt + \beta_2 SMDt + \varepsilon t$

Where,

TBC (Total Bank Credit to the Economy) represent the aggregate credit of financial institutions available for capital investment;

GFC (Gross Fixed Capital Formation) represents the additions to capital investments in the economy;

SMD (Stock Market Development) is used in this sense to represent stock market development and it is a measure of investment in the capital market. The value of transactions in The Nigerian Stock Market was used as a proxy for the SMD.

εt stands for the error term in the model specified.

It is expected that the elasticity parameters (β_1, β_2,) > 0.

Data representing the various variables were extracted from CBN statistical bulletin for the period of thirty-two years spanning from 1981 – 2012. The figures are shown in appendix 1.

The data were analysed using e-view software and the result of the regression is presented below:

$TBC = -93638.11 + 1.660109GFCt + 2.453617SMDt + \varepsilon t$

T- Ratio (-0.777506) (12.11914) (5.940378)

R-squared = 0.964194 R -square adjusted = 0.961725

F-Stat = 390.4602 D.W. Stat = 1.989723

From the results so far, it is observed that TBC assumes a value of -93638.11 when all the relevant explanatory variables in the model assume zero value. Gross Fixed Capital (GFC) Formation and Stock Market Development (SMD) have positive co-efficient of 1.660109 and 2.453617 respectively.

From the T-ratio, we find that both the GFC and SMD variables are significant. This is due to the fact that its t-value is above the "rule of thumb" of 2.

Both the R^2 and adjusted R^2 are robust, explaining the fact that variations in the TBC are caused by the repressors' up to 96% respectively. This shows the goodness of fit of the model and also explains the dependent variable in relation to the independent variable in 96 ways. The 4% left is known as the error term. The F-statistic 390.4602 is also highly significant.

From the above, there is no conclusive evidence of serial or autocorrelation since the D.W. calculated of 1.989723 is in the neighbourhood of "2".

3.1. Test of Hypotheses

From the t-values, we discovered that the T-value for GFC is more than 2. i.e. T- Cal > T tabulated. We therefore accept the alternate hypothesis, which states that: Bank credit has made an impact on capital investments in Nigeria.

To test for hypothesis two, we discover that the T- value for SMD is higher than the tabulated. i.e. T-Calculated > T tabulated. We therefore reject the null hypothesis and accept the alternate, which state that: there is a positive relationship between Bank credit has made an impact on Stock Market Development in Nigeria.

The economic implication of this result is that Bank credit available has contributed to a large extent to the growth of capital investment in the Nigerian economy as reflected by the positive relationship between Total Bank Credit (TBC) and Gross Capital Formation (GFC). The study also shows that Bank Credit available to the economy has contributed to the development of the Stock Market. This is reflected by the significant positive relationship between Bank Credit (TBC) and Stock Market Development (SMD).

4. CONCLUSION AND RECOMMENDATIONS

The banking sector in Nigeria has gone through series of reforms. Some critics are of the opinion that these reforms have not been beneficial to the economy. However this study has been able to demonstrate to a large extent that these reforms have been beneficial to the growth of capital investment and the development of the stock market in Nigeria. Despite these successes achieved, the following recommendations may be deemed necessary;

1. Commercial banks or rather the banking system should be encouraged through the right policies to mobilize more demand deposit and extend enough credit to the domestic economy through moderate interest rates.
2. Deepen Bank Reform: It is expedient to continue and deepen the banking reforms which will help to reposition Nigeria's banking sector for better performance. The reform should help create an enabling environment for banks to operate and offer a variety of financial products and services, which can promote business organizations and the economy in general. The reforms should create a liberal environment allowing free competition amongst banks and the delivery of services across that spectrum of the economy (Adam, 2005).
3. The Central Bank of Nigeria should lower its minimum rediscount rate (MRR), which serves as a benchmark from which lending and borrowing rates take their cue.

Conclusively, efforts should be geared towards reducing the banking system's over-all investments in securities. This singular action will leave adequate loanable funds for direct loans to the domestic economy.

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APPENDICES

APPENDIX 1

VARIABLES EXTRACTED FOR THE DATA ANALYSIS

YEAR	TBC	GFC	SMD
1981	8582.9	18220.59	304.8
1982	10275.3	17145.82	215
1983	11093.9	13335.33	397.9
1984	11503.6	9149.76	256.5
1985	12170.2	8799.48	316.6
1986	15701.6	11351.46	497.9
1987	17531.9	15228.58	382.4
1988	19561.2	17562.21	850.3
1989	22008	26825.51	610.3
1990	26000.1	40121.31	225.4
1991	31306.2	45190.23	242.1
1992	42736.8	70809.16	491.7
1993	65665.3	96915.51	804.4
1994	94183.9	105575.49	985.9
1995	144569.6	141920.24	1838.8
1996	169437.1	204047.61	6979.6
1997	385550.5	242899.79	10330.5
1998	272895.5	242256.26	13571.1

Continue

1999	322764.9	231661.69	14072
2000	508302.2	331056.73	28153.1
2001	796164.8	372135.65	57683.8
2002	954628.8	499681.53	59406.7
2003	1210033.1	865876.46	120402.6
2004	1519242.7	863072.62	225820
2005	1976711.2	804400.82	262935.8
2006	2524297.9	1546525.65	470253.4
2007	4813488.8	1936958.21	1076020.4
2008	7799400.1	2053005.95	1679143.7
2009	8912143.1	3050575.92	685717.3
2010	7706430.4	4012918.65	799910.9
2011	7312726	3908280.32	638925.7
2012	8150030.3	3357397.77	808994.3

Source: CBN (2013)

APPENDIX 11

E-VIEW REGRESSION PRINT OUT

Dependent Variable: TBC

Method: Least Squares

Date: 10/10/13 Time: 03:34

Sample: 1981 2012

Included observations: 32

Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C	-93638.11	120433.9	-0.777506	0.4432
GFC	1.660109	0.136982	12.11914	0.0000
SMD	2.453617	0.413041	5.940378	0.0000
R-squared	0.964194	Mean dependent var		1745848.
Adjusted R-squared	0.961725	S.D. dependent var		2904002.
S.E. of regression	568141.5	Akaike info criterion		29.42719
Sum squared resid	9.36E+12	Schwarz criterion		29.56460
Log likelihood	-467.8350	F-statistic		390.4602
Durbin-Watson stat	1.989723	Prob(F-statistic)		0.000000

Source: E-View software