

Financial Deregulation and Performance of Deposit Money Banks in Nigeria

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Certification

This thesis entitled “Financial Deregulation and Performance of Deposit Money Banks in Nigeria” was carried out by Adetoro Maroof Dare with Matric No: LCU/PG/000603 in the Department of Management and Accounting, Faculty of Environment, Management and Social Sciences, Lead City University, Ibadan under the supervision.

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Dedication

This thesis is fully dedicated to almighty God, Alpha and Omega of my academic success, the giver of life and initial of all things.

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Abstract

Banking in African like Nigeria has been undergoing gradual but stable since the turn of the 1990s, following the widespread introduction of financial reforms aimed at improving competition and efficiency. One of the most complex issues facing government is identifying the appropriate level and form of intervention in banking sector when these failures occur. In the light of this, the study examined financial deregulation and performance of deposit money banks in Nigeria. Simple random sampling technique was adopted for this study. Also, expo factor research design is adopted for this study since is a secondary data and both descriptive and inferential statistical tools were also employed with this study. This study also employed multiple regression model and Pearson Product Moment Correlation Coefficient (PPMCC) was used to analyze the nature of the variables. Given a P- value of 0.0261, R^2 of 0.8526 and admitted R^2 of 0.7346. Results from the analysis revealed that the combined effect of financial deregulation indicators on economic development is significant given a P- value of 0.0073, R^2 of 0.9132 and adjusted R^2 of 0.8526 and adjusted R^2 of 0.7346. Also, the analysis revealed that the combined effect of financial deregulation indicators on economic development is significant given a P- value of 0.0073, R^2 of 0.9132 and adjusted R^2 of 0.8438. The study further shows that financial deregulation indicators exhibited a centered significant effect on the performance of Nigerian deposit money banks following the joint significant value of $P = 0.0036$, $R = 0.8001$, adjusted $R^2 = 0.6401$. In view of the findings, the study thereby recommended that there is need to strengthen the surprising abilities of the regulation bodies. This will go a long way in building confidence in the financial sector and enables the sector to discharge its financial intermediation role efficiently.

Keywords: Deposit Money Banks, Financial Deregulation, Financial Performance, Deregularisation

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Chapter One

Introduction

1.1 Background to the Study

The introduction of banks was to provide a platform for smooth interaction between Surplus Economic Unit (SEU) and Deficit Economic Unit (DEU). This relationship was contingent upon the need to solve the problem of double-coincidence of wants experienced during the moneyless economy and reduces search cost between the duo¹. The Deposit money banks (DMBs) plays an intermediation role between the two economic units and this role of intermediation was built on the understanding that all parties in this intermediation process achieve its motive². The motive of SEU is from the supply – side which implies provision of capital or funds to the DEU in return for interest, which is the price for postponing its present consumption into foreseeable future while the DEU is from the demand – side which requires funds for its business transaction in return for profit³. The intermediation role provided by the DMBs between these two economic units is a lubricant to economic activities.

The liquidity transformation role of DMBs is quite challenging such that they are expected to gather funds from small savers and lend in chunk to borrowers for fostering investment. This is referred to as funds mobilization and this is expected to facilitate commerce⁴. The fund mobilization responsibility of DMBs has great impact on economic growth of any nation. It is noted that greater investment can be attained, provided there is adequate funds mobilization from SEU of the economy, by DMBs. One of the key determinants in funds mobilization is interest rate and that is why submitted that interest rates drive the supply and demand for loanable funds. Fund mobilization of DMBs revolves around capital

accumulation from small savers for investment purposes². It is a great task which must be pursued with vigor to meet capital-demanding economy to promote investment which can spur economic growth. Funds mobilization is identifying the sources of and gathering of idle funds from Deficit Economic Unit (DEU) for the use of business enterprises³.

The economic importance of such role becomes highly necessary for businesses to thrive and to enhance commerce which will snow-ball into economic growth⁴. This role show-cased the importance of financial institutions as managers of funds in any economy and this promotes economic activities of any nation. That is why concluded that the nation's financial system is determined by its economic size but the process of development of any economy lies in the efficient repackaging of funds from short – term savers to long – term borrowers⁵. In the 1970s, deposit money banks in the developing countries faced restrictions on interest rates, both on the deposit and lending sides of their business. They were restricted for the most part to classic financial intermediation deposit taking and lending to the exclusion, for example, of underwriting many corporate securities and insurance products. And banks were limited in the geographical scope of their operations³. No state permitted banks headquartered in other states either to open branches or to buy their banks, and many states prohibited or restricted intrastate branching³.

Today, almost all of these restrictions have been lifted: Interest rate ceilings on deposits were phased out in the early 1980s; state usury laws have been weakened because banks may now lend anywhere; and limits to banks' ability to engage in other financial activities have been almost completely eliminated, as have restrictions on the geographical scope of banking². Banking in Africa has been undergoing gradual but notable changes since the turn of the 1990s, following the widespread introduction of financial reforms aimed at improving competition and efficiency⁶. These reforms seem, however, to have had a limited impact.

Competition and efficiency in banking are key drivers of financial and economic development as they are expected to lower the cost of financial intermediation, improve access to banking services, facilitate innovation and contribute to the growth of the wider economy¹. In the case of Africa, banking competition and efficiency assume greater significance due not only to the dominance of the sector in the overall financial system, but also to its relatively low development even by developing economies' standards⁷. Financial services are provided by the finance industry which includes various organizations such as banks, mutual fund companies, insurance companies, financing firms, investment houses, stock brokerages and many more. The sole purpose of these institutes is to manage and regulate the fund hence a sound regulatory framework is required for the safety and soundness of community investment and consumer protection. The recent global financial turmoil has revealed the fact that the proper and prudential functioning of banking system is very essential for the sound financial health and the growth of the economy. Central bank being the financial regulator authority of the nation is responsible for the financial stability of the nation hence directly or indirectly regulates the money creation activity of the banks through financial regulation tools². Every country desire to enhance its economic growth so as to improve the standard of living of its populace. In reality, growth process does not follow a definite pattern. Whereas some might emphasize taxation as a trajectory, others may emphasize surpluses of public enterprises, borrowing, trading, and export of minerals etc⁶.

For a developing country like Nigeria, where most of its financial institutions are not finally matured, government regulates some financial activities. At other times, government might decide to play a passive role, in the management and administration of the banks or the financial sector. When this happens, we say there is a deregulation of the financial sector. The

banking institutions are crucial to any government, and play key role in the development of the economy⁷. The effectiveness and efficiency of performing these roles depends largely on its development and management, thus the need for reforms. Almost two decades after independence in 1960, Nigeria enjoyed fairly a stable economic growth to the extent that it was an era referred to as oil-boom. The country became a victim to ostentatious way of life, such that by early eighties when there was a global oil glut, her revenue earning was adversely affected, and she became vulnerable to debt crises and macroeconomic disequilibrium³.

From that time, Nigeria began to tinker with an economic reform programme as a pre-condition for not only rescheduling its \$30 billion external debt, but the management of the Naira. Subsequently, structural adjustment programme (SAP) was introduced, mainly due to the persistent and destabilizing economic crises that followed. Some macroeconomic indicators explain the pressure the country was passing through then- balance of payment problem, debt service burden, rising unemployment and foreign exchange crises etc⁸. It will be recalled that the financial sector applied diverse monetary control instrument to manage the economy. At the end, it appears that the Central Bank of Nigeria (CBN) and other banks were not coordinating their activities in the overall interest of the economy. The existing structures were ineffective making the demand for reform (deregulation) imperative. While reporting on the works of various authors on financial intermediation, posited that the economic development of any nation greatly depends on financial intermediation banks' play in facilitating technological innovation through their intermediation roles.

The stagnant growth in output of any country, especially the less developed ones, is often blamed on shallow finance⁹. However, in a financial repression hypothesis, argue that the performance of banks in the growth process is affected by the regulation of the system.

Financial deregulation describes the eliminations of credit control, regulating interest rate and removal of entry barriers into the financial services industry, development of capital markets and liberalization of international capital flows. Financial deregulation is therefore a government programme of moving the economy towards a free market economy. It is a policy in which market forces determine the allocation of credit rather than government controls. This normally includes the elimination of direct control on both internal and international transactions and a move toward relying on the price mechanism to coordinate economic activities¹⁰. Financial deregulation is a process of reduction or elimination of laws and regulation that hinders free competition in supply of goods and services, thus allowing market forces to drive the economy⁵.

The deregulation policy of government can be traced to the structural adjustment programme (SAP) of the 1986. The distortions in the economy and inadequate funds for financing government projects necessitated seeking for external finance from international financial organisations like the World Bank and International monetary fund (IMF) in which structural adjustment programme (SAP) was one of the conditions for such financial aids³. The main objective of the structural adjustment programme (SAP) was the adoption of appropriate pricing policies in all sectors of the economy, improve foreign investment, boost foreign exchange inflows, encourage savings and general economic deregulation through the elimination of some regulations to create free market economy. The major policies of Nigerian financial system deregulation include the deregulation of interest rate (lending and deposit rate), deregulation of exchange rate and entry deregulation for banks which brought many banks into existence⁷. These, generally was to enhance effective financial intermediation in the economy.

Other policies of deregulation includes the introduction of second-tier foreign exchange

market (SFEM), abrogation of sectorial credit allocation, creation of deposit Insurance scheme (NDIC), Review of minimum paid-up capital for commercial banks, reform of regulatory bodies by introducing Banks and other financial institution Act (BOFID) No. 25 of 1991, introduction of prudential guidelines, removal of credit ceiling, the Bank consolidation programme and the introduction of Asset management corporation of Nigeria¹¹. The economic justification of financial deregulation assumes that deregulation fosters bank competition due to increased number of commercial banks in the country which in turn may engender banks efficiency¹¹. In Nigeria, the policy was designed among other things to restructure and diversify the productivity of the economy to stimulate domestic production for economic growth and profitability of commercial banks. Deregulations is also aimed at increasing competitive efficiency, improve allocation efficiency, reduce cost of financial intermediation, and improves financial services and to rationalize the use of scarce resources³.

Among the several policies of deregulation stated above, interest rate deregulation performs outstanding function by allocating limited supply of credit in the economy and savings mobilization. Interest rate regulates the flow of business and industrial behavior in an economy by influencing the supply of and demand for loanable fund. Interest rate is the rental payment for the use of credit by borrowers and return for parting with liquidity by lenders and depositors. Interest rate deregulation involves the establishment of interest rate that equates the demand for supply of savings and lending. Commercial banks being the major instruments through which government executes financial policies need to be appropriately repositioned to cope with the gains and challenges of deregulation. The ability of commercial banks to cope with these challenges which will come in form of competitive lending rate, liquidity management, effective management of credit risk, adequate money supply, level of expertise in investment banking and corporate finance activities will all be the important determinants of the performance of commercial banks⁸.

Banks profitability plays a vital role at both micro and macro level in the economy. At the micro level, profitability is essential for the successful execution of banking business and facing the ever-growing competition in the financial markets. Whereas, at the macro level, a sound and profitable banking sector is better able to withstand negative shocks and contribute to the stability of the financial system. Financial regulation regulates the economic performance that could be replicated by the macroeconomic variables such inflation, GDP, and employment. It regulates the money supply by frequently targeting rate of interest to promote economic growth and stability². Monetary policy upholds the relationship between the rates of interest in an economy, which could be well understood as the price of money that one has to pay to borrow funds from the bank and the total money supply in an economy. RBI also facilitates external trade and payment and is responsible for the systematic development and maintenance of foreign exchange market in Nigeria.

Financial deregulation policy affects both real sector as well as the financial market. It affects the real sector with the long and variable lag whereas financial market bears the direct short run implications. Conduction of monetary policy is possible through strategies and tactics. Strategy seeks to achieve final objectives and short run operational procedures are regulated. Banks can hardly survive without a positive return on capital invested. Profitability is therefore the driven factor for activities of commercial banks. Consequently, banks engage in a variety of products and services for the achievement of this profit or to be profitable¹¹. The commonest and most important of these activities is the given out of loans to borrowers seeking financial accommodation. In doing this, it is expected that the borrower pays back the principal and interest. This interest in all bank services forms the bedrock of profitability in the banking sector. Banks are the intermediaries through which the surplus and deficit units in any economy interact to exchange financial value indirectly.

When the surplus units make deposits in the banks, they are given out to loan seeking customers or investors preparing to embark on viable projects with an interest charge on the loan. Consequent on the vital role of intermediation played by banks, the banking sector is highly regulated by the government. To carry out this regulation effectively, government employs monetary policies as the primary tool to regulate the banking sector. Embedded in these monetary policies are the different types of instruments that are used to regulate the operations of banks in the economy. Being an external factor to the banks, the tools could act as a militating or mitigating factor in boosting banks profitability⁶. The way and manner these factors are applied to banks vary from one country to the other and has traceable relationship to the state of the country's economy. In stable economies, these tools are spared of frequent manipulations and vice versa. Economic activities, to a large extent, depend on these tools especially in countries where the capital market is still in its primordial stages of development.

In Nigeria, financial regulation tools have been subjected to various forms of gyrations in keeping with the fluctuations in economic indices. Each time these policies change, bank operations are certainly affected. Zenith Bank within twenty-two years has demonstrated its resilience irrespective of the business/economic cycle and witnessed exponential growth in virtually all areas. Despite the monetary policies, this growth seems to be persistent. and other proponents of financial regression believes in the financial market driven by the forces of demand and supply hence with trend interest rate, depositors earn greater interest on their deposits and are encouraged to deposit. The study is considered as a review, no doubt the differences between those who favour deregulation and those who disfavor it have not been settled empirically. It is based on this divergence of opinion that we examine and appraise the impact of financial deregulation on the banking sector performance in Nigeria^{1,2}.

1.2 Statement of the Problem

Banking sector reforms in Nigeria are driven by the need to deepen the financial sector and reposition the Nigeria economy for growth; to become integrated into the global financial structural design and evolve a banking sector that is consistent with regional integration requirements and international best practices⁵. The economic justification of financial deregulation is based on the presumption that deregulation fosters bank competition, which in turn may engender bank productive efficiency. Bank competition is seen as a stimulus to exert downward pressure on costs, reduce managerial slacks and even incentivize innovation.

Furthermore, concern about the adverse impact of increased competition on bank risk taking behaviour has motivated the adoption of prudential re-regulation alongside deregulation. Although prudential re-regulation is designed to mitigate excessive risk taking and foster stability, it may impose higher regulatory costs and hamper competition⁹.

One of the most complex issues facing government is identifying the appropriate level and form of intervention in the banking sector. Its efficiency as a regulator is a significant determinant of the overall efficiency of the economy. The extent of regulatory intervention may also determine whether financial markets can develop to their full potential or not. Ultimately, any inefficiency must be funded by higher charges passed on to the community as cost arising from stringent regulation⁴. The more sophisticated the monetary policy, the greater its vulnerability to failure of banks to deliver against its promises. When these failures occur, investment which is an important factor in economic growth is kept low. Consequent upon this, trust and confidence in the financial system may go down and sourcing of funds from banks may face a downward trend due to increase in cost of loan². The increase in cost of capital often deters prospective investors from engaging in new

ventures as well as discourages customers of companies from optimal patronage of their products. It therefore, stands to reason that increase in cost of capital results in cyclical effects in the economy⁹.

In view of this, any review of monetary policy is often greeted with widespread apprehension, which cuts across various sectors of the economy. Critically examining the nature of Nigeria's financial sector challenges, arguments have been raised on the way and manners in which reforms are being carried out¹⁰. Of the major problems are lack of proper attention to the needs of the real sector of the economy, inadequate policy framework for financial development, weak regulatory supervision in a highly liberalized financial environment allowing banks to become overconfident, audacious, less transparent and less accountable in the handling of their diverse portfolios of services. There is undue preference by banks for financing general merchandise rather than manufacturing, agriculture, power, and the importation of finished goods rather than raw materials, plants and equipment⁶. The real sector is a vibrant part of the economy that needs special attention but due to lack of funds, it has since been in a poor state. The government has adopted policies aimed at achieving specified objectives, such as interest rate ceilings and selective sectorial policies¹¹.

Those policies were introduced with the intention of directing credit to priority sectors and securing "inexpensive" funding for their own activities. The ceiling on interest rate and quantity restriction on loanable funds for certain sectors ensures that a larger share of funds is made available for favored sectors hindering financial intermediation since the financial markets will only be accommodating the credit demand of the government plan and ignoring risks⁷. On the other hand, a decrease in the cost of capital tends to stimulate more aggressive investment in any economy. The higher the volume of investment, the greater the competition. Even though consumers of products from various companies stand to benefit

from this situation in the short run, it may portend serious danger in the economy if it is allowed to stretch to the extreme. As companies engage in stiff competition, weak ones (especially those that are disadvantaged technologically) may be driven out of business⁹.

This may result in monopolies with their obvious consequences in the economy. However, whether these changes in monetary policy instruments significantly affect profitability of banks remains a matter for investigation. Against this backdrop, this study seeks to examine the impact of financial deregulation on the banking sector performance in Nigeria¹².

1.3 Aim & Objectives of the Study

The aim of this study is to examine the financial deregulation on deposit money bank sector performance in Nigeria. The specific objectives of the study are to:

- i. examine the stability of financial sector reforms on deposit money bank of Nigeria.
- ii. determine the effect of the financial deregulation on the economy development of Nigerian deposit money bank.
- iii. ascertain the challenges of financial deregulation on the performance of the Nigerian deposit money bank.
- iv. assess the relationship between financial deregulation and the profitability of Nigerian deposit money bank.

1.4 Research Questions

Based on the problem, the following research questions have been generated:

- i. to what extent is the stability of financial sector reforms positively affect deposit money banks in Nigeria?

- ii. would financial deregulation positively affect the economy development of deposit money banks in Nigeria?
- iii. how would the challenges of financial deregulation positively affect the performance of deposit money banks in Nigeria?
- iv. what is the relationship between financial deregulation and the profitability of Nigerian deposit money banks in Nigeria?

1.5 Hypotheses

The hypotheses formulated for the study are:

- H₀1:** Financial sector reform has no significant relevance stability on deposit money banks in Nigeria.
- H₀2:** Financial deregulation has no significant relationship on the economy development of deposit money banks in Nigeria.
- H₀3:** Financial deregulation has no significant relationship on the performance of deposit money banks in Nigeria.
- H₀4:** Financial deregulation has no significant relationship on the profitability of deposit money banks in Nigeria.

1.6 Scope of the Study

The scope of this study is strictly the impact of financial deregulation on the banking sector performance in Nigeria. The study will only be restricted to Central Bank of Nigeria (CBN) polices to selected Nigerian deposit money bank between 2010 and 2020. It is also studied to make critical analysis of financial deregulation on the banking sector performance in Nigeria

and the most recent development that have occurred in the performance of Nigerian deposit money bank.

1.7 Significance of the Study

Several studies have sprung up in terms of the relationship between financial reforms and economic development of Nigeria such as the study provided evidence that Bank reforms are predicated upon the need for reorientation and reposition of existing status quo to attain an effective and efficient state, and fast track and consolidate specified sector of the economy to achieve desired objectives. None of them talked about financial deregulation and the banking sector performance, thus, creating a gap which the present study attempts to fill. This study will be of great benefit to bankers, investment analysts, government agencies, academics, private and public sectors more so, it will be useful to policymakers in the attempt to fashion out dynamic and reliable financial deregulation measure for controlling commercial banks' ability to create money and thereby influence the effective development of the economy.

This research provides insight into financial deregulation on the banking sector performance and will therefore be of valuable use to the following set of people.

- i. To student, it will provide a compliment to the fair existing text on monetary policy and economic stabilization.
- ii. To bankers, it will also find a valuable tool toward analyzing the effect of government action on their activities whether it is valuable or not.
- iii. To investors, it will serve as a guideline on the effect of financial deregulation on various sectors of the economy in which their fund can be invested.

- iv. To the ordinary reader, this work will serve as an open eye and a valuable store of knowledge.

1.8 Limitations of the Study

This researcher encountered some constraints in several ways in the course of writing this research. There were difficulties in accessing relevant data, some important documents, and articles to the field of study for proper studying were not easy to access. Where they are available, they could not be borrowed or taken away to study. Most of these documents were thus, used at the premises and searched for online.

However, the above limitations did not in any way affect the integrity and completion of this study, and the resources available were sufficient in arriving at the conclusion.

1.9 Operational Definition of Terms

Deficit: An excess of expenditure or liabilities over income or assets in a given period

Deregulation: the removal of regulations or restrictions especially in a particular industry

Development: An event of constituting a new stage in a changing situation

Exchange rate: The value of one currency for the purpose of conversion

Inflation rate: An exchange rate is the value of a country's currency vs. that of another country or economic zone.

Inflation: This is decline of purchasing power of a given currency over time

Intermediation: Channels of funds between third parties with surplus and those with a lack of funds

Investment: An investment is essentially an asset that is created with the intention of allowing money to grow

Liquidity: Availability of liquid assets

Loan: Money borrowed with the responsibility of repayment with interest

Macro-economic: The branch of economics that studies how an overall economy behaves or operate

Reserves: A company's profit added to capital

Turnover: The rate at which a businessman sells his goods

Underwriting: Process through which an individual or institution takes on financial risk for a fee

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Chapter Two

Literature Review

In this chapter the conceptual and theoretical issues relating to financial deregulation and performance of deposit money banks in Nigeria were discussed. These discussions is aimed at identifying the relevant issues that spurs the empirical investigation of this study.

2.1 Conceptual Review

2.1.1 Financial Deregulation

The financial system is described as the gaunt of financial instrument, financial institutions and financial markets. Due to the central position and the crucial role play by the financial sector, economists have provided evidence to show that there is growth and development of the economy¹. The financial sector in the opinion of experts can assist in breaking away from a depressed economic performance to an accelerated growth and performance. This is true if and only if the sector is not repressed and distorted with inappropriate and inflexible regulations. In any economy, there are two extreme policies which government can adopt in the process of achieving the goals and objectives of the nation².

On one hand, the government can adapt the policy of directly controlling and guiding the economy towards the desired path of growth. In this case the policy is regarded as policy of regulation. On the other hand, the government can allow the market the market forces (that is, demand and supply) to freely determine the path of growth of the economy³. Here the policy is known as the policy of deregulation. Financial sector deregulation mainly involved the removal of interest and exchange rate control by the government and liberalization of bank licensing⁴. It is the deliberate and systematic removal of the regulatory control, structures and operational guidelines which may be considered inhibitive of orderly growth, competition,

and efficient allocation of resources in the financial system⁵. It is not the complete removal of government control but the removal of some and strengthening others. Interest rates are the rental payments for the use of credit by borrowers and return for parting with liquidity by lender and depositors⁶. These are categorized as lending rate and deposit rates respectively. Like other prices, interest rates perform a rationing function by allocating limited supply of credit among the many competing demands for it³.

Interest rate regulates the flow of business and industrial behaviour in any economy by influencing the supply of and demand for loan able fund. A major strategy of the programme is to deregulate the financial sector⁷. Interest rate deregulation is the establishment of interest rate that equates the demand for supply of saving. They believe that financial sector deregulation is a prerequisite economic reform for economic development. This is because it encourages savings, investment innovations, adoption of technology and income equalization. Foreign exchange rate is the price of one currency expressed in terms of another currency⁸. In a deregulated foreign exchange market, the exchange rate is determined by the demand and supply of foreign currency. For example, if supply of foreign currency increases (because of increase in export income or capital inflow) in Nigeria, there will be sellers who cannot bid at the prevailing exchange rate. They will bid the price down (that is, the main will appreciate) until the required demand is forth coming⁹.

Government usually adopts the policy of deregulation to remove complex administrative control on economic activities. This is achieved by removing its direct involvement in many economic activities and by encouraging greater private sector participation and increased reliance on market for allocation of economic resources¹⁰. These among other things formed the introduction of the structural adjustment programme in Nigeria in July 1986. Deregulation of the financial system comes in because of financial depression in the

economy. Depression is said to be a period when there is severe and prolonged downturn in the economy, prices fall and constant reduction in purchasing power⁷. It also results in high unemployment, lower productivity, shrinking wages and generally low savings. Deregulation was adopted in 1987 against a crash in the international oil market and the reactant deteriorating economic condition in the country due to stringent policies in the financial sector making savings and investment unrealizable¹².

The savings/investment process in capitalist economies is organized around financial intermediation, making financial intermediaries a central institution of economic growth. Financial intermediaries are institutions usually banks or other similar firms that borrow money from consumer/savers and lend to companies that need resources for investment. Efficient financial intermediation in any economy confers two important benefits. One, it raises the level of investment and savings¹³. Two, it increases the efficiency in the allocation of financial funds in the economic system. The combine effect of these benefits is improvement in banks efficiency and hence economic growth. The basic concept in this study is that deregulation will foster competitiveness and efficiency in the banking industry which will lead reduction in operating costs of banks and enhance their total assets performance¹⁴. It is also expected that financial sector deregulation will narrow the spread between deposit and lending rates as a result of competition following the inflow of new entry and market determined interest rates. The contrast is the case in Nigeria since interest rate spread (lending-deposit rate margins) has been dramatically wide.

2.1.2 Development from the Deregulation of Bank and Other Reforms

The adoption of SAP the regulatory framework guiding the operations of banks changed. Steps were taken to liberalize interest and lending rates. Many more banks were allowed entry into the sector. Competition increased a great deal among banks and the face of the

industry changed within a few years. At different times ceilings on interest rates were removed, replaced and then removed again¹⁵. In 1994, the ceilings and floors on interest rates were again restored. Regulatory authorities took steps to correct some of the endemic afflictions of banks that were carrying poor quality assets and had little cushion for it. Capital adequacy, liquidity and credit restrictions were enhanced to forestall the possibility of continuous deterioration in the health of the critically affected banks. Meanwhile, the newer banks developed new products and created various opportunities for exploiting profit¹⁶.

They grew in profits by leaps and bounds, though industry watchers claim the bulk of their profits is accounted for by their undue emphasis on foreign exchange trade and the sharp practices in which they engaged. This coupled with the continued depreciation of the naira since the inception of SFEM has led to a seemingly unending search for the ideal market mechanism for allocating scarce foreign exchange¹⁷. Banking reforms have been an ongoing phenomenon in the world right from 1980s but has been more intensified in recent time because of the impact of globalization which is precipitated by continuous integration of the world market and economies. Banking reforms involve several elements that are unique to each country based on historical, economic and institutional imperatives.

In Nigeria, the reforms in the banking sector preceded against the backdrop of banking crisis due to highly undercapitalization deposit taking banks; weakness in regulatory and supervisory framework; weak management practices; and the tolerance of deficiencies in the corporate governance behaviour of banks¹⁸. Banking sector reforms and recapitalization have resulted from deliberate policy response to correct perceived or impending banking sector crises and subsequent failures. A banking crisis can be triggered by weakness in banking system characterized by persistent illiquidity, insolvency, undercapitalization, high level of non-performing loans and weak corporate governance among others. Similarly, highly open

economies like Nigeria, with weak financial infrastructure, can be vulnerable to banking crises emanating from other countries through infectivity. Banking crisis usually starts with inability of the bank to meet its financial obligations to its stakeholders¹⁹. This, in most cases, precipitates run on banks, the banks and their customers engage in massive credit recalls and withdrawals which sometimes necessitate Central Bank liquidity support to the affected banks.

Some terminal intervention mechanisms may occur in the form of consolidation (mergers and acquisitions), recapitalization, use of bridge banks, establishment of asset management companies to assume control and recovery of bank assets, and outright liquidation of non-redeemable banks. Bank consolidation, which is at the core of most banking system reform programmes, occurs, some of the time, independent of any banking crisis. Irrespective of the cause, however, bank consolidation is implemented to strengthen the banking system, embrace globalization, improve healthy competition, exploit economies of scale, adopt advanced technologies, raise efficiency and improve profitability²⁰. Ultimately, the goal is to strengthen the intermediation role of banks and to ensure that they are able to perform their developmental role of enhancing economic growth, which subsequently leads to improved overall economic performance and societal welfare. The proponents of Bank consolidation believe that increased size could potentially increase bank returns, through revenue and cost efficiency gains. It may also, reduce industry risks through the elimination of weak banks and create better diversification opportunities²¹.

On the other hand, the opponents argue that consolidation could increase banks' propensity toward risk taking through increases in leverage and off-balance sheet operations. In addition, scale economies are not unlimited as larger entities are usually more complex and costly to manage. The reforms in Nigeria are driven by the need to deepen the financial sector and

reposition the Nigeria economy for growth; to become integrated into the global financial structural design and evolve a banking sector that is consistent with regional integration requirements and international best practices. It also aimed at addressing issues such as governance, risk management and operational inefficiencies and at the centre of the reforms is about firming up capitalization²². The reforms are designed to enable the banking system to develop the required flexibility to support the economic development of the nation by efficiently performing its functions as the pivot of financial intermediation¹⁸.

Thus, the reforms were to ensure a diversified, strong, and reliable banking industry where there is safety of depositors' money and position banks to play active developmental roles in the Nigerian economy. Literature has shown that regulation and deregulation of the banking sector can have positive effect on bank performance provided the regulators and the operators are determined in their operation to make them work. There are two sides to this issue; some scholars opine that deregulation has positive effects while some find it detrimental on performance of banks. There are cases where regulation and deregulation have achieved their objectives and also situations where they have failed¹². The important aim of monetary stability in Nigeria has not been attained after deregulation. Monetary growth was far in excess of targets and resulted in large exchange rate depreciation and persistent inflationary pressures; Federal Government deficit kept rising; interest rates and inflation kept rising and there was excess of targets and resulted in large exchange rate depreciation and persistent inflationary pressures; Federal Government fiscal deficit. Interbank rates climbed to an alarming rate which in turn affected other rates¹⁹.

Because the expected monetary stability failed to materialize, government resorted to issuing stabilization securities in 1990 and transferred government accounts from the banks to the CBN. On the other hand, the massive sets of regulations introduced several introductions as

bank and other financial institution came out with several new products. These innovations have been largely responsible for the crashed financial institutions and banks. Some of the innovations which came with deregulation also turned out to be counterproductive. Hence, the need to answer the question as to whether deregulation affects bank performance positively or negatively²³. The financial system in any economy serves as financial intermediary between those with surplus fund and those with deficit in order to facilitate production, trade and capital formation, it serves as the “lubricant of the economy”. The fund in the financial system is expected to be managed in accordance with specified statutory requirements laid down by government or regulatory authorities²⁴.

The argument for regulation rests on the need for soundness of the financial system and sustenance of confidence of the public in the financial system¹⁸. Moreover, it is argued that the financial system is characterised by information asymmetry hence there is need for government regulation to prevent financial system instability¹¹. Information asymmetry in the financial system and the ensuing credit market failure can create inefficiency at both micro and the macro level, via underinvestment and overinvestment²⁵. The imperfections and externalities existing in the financial markets of developing countries are much more pronounced than those of the developed economies thus justifying regulation in the developing countries. Apart from the issue of asymmetry of information, other arguments put forward for the need for regulation of the financial system in developing countries include the need to redirect credit into sectors or sub-sectors deemed to have high social rates of return and low private/market rate of return; and the need to increase the flow of income towards identifiable “disadvantaged” groups in the population¹⁵.

However, what is observed in many developing countries is that the purpose of regulation is defeated as the performance of the economies has not justified these reasons. Rather, the

governments of many of these nations have used financial system regulations to keep interest rate at low level (sometimes negative real interest rate) to minimize the cost of government debt thus sustaining their unsustainably high budget deficits¹⁷. What are experienced in these countries are distortions like suppression of the equity market and inducement of present consumption at the expense of savings. The regulation of the financial system according to McKinnon and Shaw results in financial repression, which is characterized, in Nigeria by the policies of directed credit and interest rate ceiling. This is believed to cause some imperfections in the operations of the financial market¹¹.

A key component of the structural adjustment programme (SAP) is to liberalize the financial system so as to make the system operate on the basis of the market system and also to encourage competition in the system so as to attract foreign investors as well as local investors. It is believed that if the financial sector is liberalised it will be able to mobilise the necessary funds for development and also that liberalization will allow funds to be channeled into the most efficient use in line with the McKinnon and Shaw argument. Financial liberalization is recommended as a policy to overcome the problems of financial repression hence with the adoption of the structural adjustment programme, the adopted the policy of financial deregulation culminated into the policy of deregulation of interest rates in 1987, wherein the CBN ceased to prescribe interest rate chargeable on loans and advances or payable on deposits. Deregulation also led to the privatization of most of the federal government banks. The period of deregulation saw the establishment of many banks and other financial institutions as the policy made it lucrative to own and run a financial institution. Between 1986 and 1989, a total of 38 new banks opened their doors while 25 others were granted licences to start operation¹⁴.

Between 1987 and 1991 the licensing procedures for banks were relaxed, allowing politically connected people to obtain licenses and operate banks despite having no obvious qualifications or relevant experience. During this time 84 new banks were established. The increased number of banks overwhelmed the examining capacity of the CBN/NDIC hence many banks failed to comply with prudential guidelines. During this time the number of commercial banks and other financial institutions such as finance houses, loans and savings associations as well as community banks rose phenomenally. As at 1990 the number of banks in Nigeria was well over 100 with still over 20 licensed to begin operation at that time. The period of deregulation came with other strategic changes in the banking sector. Among such is the creation of the Nigerian Deposit Insurance Corporation (NDIC) by Decree No. 22 of 15th June 1988. The NDIC was charged with responsibility of insuring bank deposits, ensuring safe banking practices through effective supervision, and assisting the CBN to formulate banking policies with a view to ensuring the stability of the financial system²⁰. To strengthen the operations of banks the minimum paid up capital for banks were increased from September 1989 from N10 million to N20 million for commercial banks and from N6 million to N12 million. In 1990, the CBN introduced new capital adequacy requirement under which the bank's minimum required capital and reserves are based on risk weighted assets, as in the Basle accords, in addition to the previous requirement, under which banks' minimum adjusted capital were computed as a percentage of loans and advances²².

In 1991, the minimum paid up capital of commercial banks was raised from N20 million to N50 million while that of merchant banks was raised to N40 million. This was later raised to N5 billion for commercial banks. To enable Nigerian banks to compete effectively in international businesses, the capital base of banks was raised to N25 billion by the CBN in 2004. With this upward review of capital base, some banks have to merge while some were bought over in order to meet the requirement. However, the banks which could neither merge

nor bought over, but were unable to meet the new capital requirement were liquidated. The regulation on capital requirement greatly reduced the number of banks in Nigeria presently to less than forty²³.

The financial sector witnessed another reform with the ascendancy to office of the new CBN Governor, Sanusi Lamido Sanusi, who organised rescue programme for some banks who were about to collapse following allegation of corporate mis-governance and probably as a result of the global economic meltdown. Between 1980 and 1986 when SAP was introduced, the average deposit rate was 7.9% but this increased to 13.47% on the average between 1987 and 2003. Similarly, inflation rate, which was 16.0% on the average between 1980 and 1986 rose to 26.3% on the average between 1987 and 2003. Banking system credit to the private sector, which was N13,315.30 on the average between 1980 and 1986 rose to N340,357.23 between 1987 and 2003 while the credit to the public sector increased from N13,315.53 to N141,972.84 within the same period²⁴.

2.1.3 Financial Sector Reform in Nigeria

The Nigeria financial system policies at the pre reform period were characterized by intensive public sector intervention by way of direct credit, selective credit controls, sustained increase in paid-up capital of new banks, strict control of interest rates, preferential treatment to some sectors in terms of allocation of credit²¹. Such was the scenario when in 1983, the World Bank urged Nigeria to deregulate its financial system drawing on the financial repression hypothesis. The World Bank chided the government over the allocation of credit, public subsidies to financial institutions thereby fostering negative real interest rates, the inadequate number of banks and the complexity and rigidity of government regulation²⁴. The first in the series of reforms of the Nigerian banking sector was the liberalisation of credit allocation policy in 1986.

In 1987, the number of priority sectors for the purpose of allocation of bank credit was reduced to two, namely priority and other sectors. Another notable banking sector reform policy measure of this period was deregulation of banking licensing²⁵. There was also deregulation of interest rate which was embarked on in January 1987. Banks were allowed to fix their interest rate on both deposits and loans with a desired spread of 3% between the deposit and lending rates²⁷. The process of complete deregulation was achieved in August of the same year. Market determined interest rate ruled until 1991 when interest rate was capped. Market forces were once more permitted to prevail in 1992 and 1993 in interest rate determination²⁶.

In 1990 an auction system meant to make the treasury bill more attractive align the rate with other money market rates which had earlier been deregulated, reduce the inflationary effect of governments cheap borrowing and strengthen the use of treasury bill rates as an effective tool of monetary control was introduced. New financial institutions (quasi banks and non-banks) were licensed¹⁹. This gave rise to the establishment of community banks, peoples bank and finance houses. The essence was to make credit easily accessible to the members of the community and to serve the low-income earners operating small scale businesses²⁷.

Two decrees, CBN decree No. 24 of 1991 and the Banks and other Financial Institutions Decree No. 29 of 1991 gave CBN the impetus to a higher degree of autonomy in the conduct of monetary policy, regulatory and supervisory powers over the deposit money banks and such other financial intermediaries like finance companies.²⁸ Then came the re-introduction of pre-reform policy of regulations²⁶. The return of regulation started with embargo placed on bank licensing. By the second quarter of 1996, there was a liberalizing of savings deposit rates, a prescription of maximum spread of 7.5% and thus a ceiling on lending rates²⁸.

In August 1996, the government liberalized interest rates yet again but maintained MRR at 13.5%. The banks maintained the maximum lending rate equally but reduced the interest rate on savings deposit. The reason for deregulating interest rates was part of the process of freeing the banking system and allowing the market forces to prevail, guaranteeing efficient allocation of scarce resources and enabling mobilization of idle funds by the banks. This policy however witnessed reversals when lending rates became intractable²⁹. The assertions that the banking system was inefficient, characterized by structural and operational weaknesses and thus unable to play the catalytic role of promoting private sector led growth, led to a 13 point agenda of banking sector reforms focused on further liberalization of banking businesses that will ensure competition, safety of the system and proactively position the industry to perform the role of intermediation and catalyst economic development was put in place³⁰. Unfortunately, what would have been the gains from this exercise was short lived following the negative impact of the global financial crisis which affected a section of the banking industry that by 2007 some banks were already having liquidity problems³¹.

2.1.4 Financial Sector Reforms and Banks

The Nigeria Government undertook a comprehensive market-oriented reforms program in 1991. It is vital to recognize that the most significant difference in the pre- and post-liberalization period was that in the former investment were not market driven while in the latter period investment are market driven³². The industrial licensing system insured that investment was consistent with plan targets and the financial plans ensured that the planned investment (in terms of sectoral targets) was realized. The entire financial system, including banks worked to realize planned investment targets in various sectors³³.

In this period, the screening and monitoring functions of banks were substantially de-emphasized as the government directed a large part of bank lending³⁴. The post liberalization period witnessed a substantial deregulation of the financial sector along with radical reforms of trade and industrial policies, which has led investment to be completely market driven³⁵. Prior to onset of reforms the banking sector, in Nigeria was dominated by 28 state owned commercial banks who accounted for 90 percent of deposits and advances. Private sector banks and foreign banks did exist, but their operations, expansion, and possible new entry were severely restrained by the policy environment²⁸. In this period there were severe restrictions placed on the banks with regard to pricing and allocation of credit. Moreover, the sources of funds for banks too were highly restricted and regulated. Banks were not free to raise new equity and their participation in the money market was inhibited by government-imposed ceilings on the interest rates in this market³⁶. It was only in 1989 that certificate of deposits (CD) were introduced but their market was again subjected to substantial restrictions. In fact, the government through a detailed and a complicated administrative system determined all interest rates in the financial system³⁷.

On the balance of payment front even the current account was not convertible let alone the capital account²⁵. The RBI was forced to bring about changes in the monetary stance mainly through the Cash Reserve Ratio (CRR) as the low level of development of the government securities market ruled out the use of open market operations. In such a scenario, any withdrawal of reserves leads to an almost immediate curtailment of bank lending. But this would have nothing to do with the capital market imperfection³⁸. As a part of ongoing reforms program in Jan 1993, the CBN set up detailed guidelines regarding the entry of new banks. Under the new guidelines entry by both private sector and foreign banks were allowed and this had an impact on the market structure of the banking sector³⁹. The share of government owned banks in total deposits and advances has fallen to below 80 percent in

2000. Financial liberalization has given much greater freedom to banks on both the assets and liabilities side of operations. Between 1991 and 1994, interest rates on banks loans were deregulated in a phased manner.

In October 1994, interest rates on loans above 0.2 million were completely deregulated. Deposits rates were also substantially freed from controls⁴⁰. All new banks were required to be incorporated under the Company's Act 1996, and their shares are required to be listed on stock markets³². This has opened up a new source of funds hither to unavailable to banks (in the form of new equity issues) and in fact much government owned banks too have raised money. The market for CD has also been improved, through the removal of the bank specific limits on their issue in 1993. This has led to substantial activity in the primary market for CD's, but the secondary market remains thin⁴¹. The reform in the financial sector has led to creation of a well-regulated and deep market for government securities. Open market operations have become the predominant instrument through which the RBI implements monetary policy changes. In 1994, a separate supervisory body "Board of Financial Supervision" (BIFS) was established as an independent supervisory and monitoring body. This body exercises its powers of inspection and supervision with respect to all financial intermediaries including banks, development banks, and non- banking financial companies⁴².

2.1.5 Financial Deregulation Challenges and the Performance Nigerian Deposit Money Bank

There is no doubt that the prior existence of an unstable macroeconomic environment and weakness in the economics structure of Nigeria led to the introduction of the deregulation policy⁴³. The introduction of the deregulation policy is aimed at eliminating the inadequacies and distortion of the old system. Deregulatory policy which deals with the removal of selected regulation in business by government were aimed at attaining a realistic naira exchange rate⁴⁴. These deregulatory rationalization of traffic to estimate and diversify

domestic production, dismantling of administrative controls production and specialization of procedures, liberalization and increased reliance upon market forces for the determination of the pattern of resources allocation⁴⁵. These deregulatory measures were designed to re-orient the economy towards free market in the area where the financial and intermediary role of banks becomes more crucial to the economy⁴⁶. The practical application of the deregulatory policy has been focused on. institutional deregulation, interest rate deregulation, and price and trade deregulation

Deregulatory policy was childbirth of structural adjustment programme introduced in July 1986. Before the inception of deregulation, the interest rate was highly regulated and there was frequent adjustment of interest rate which was aimed at achieving the monetary objective of the period. With the introduction of the deregulatory policies the interest rate has been gradually deregulated. On 1st October 1987, all controls on interest rate were removed in line with the prophesies on the deregulation of the economy⁴⁷. Deregulation of interest rate makes the allocation of credit by price possible. Institutional deregulation saw the period of discontinue government interference in the various institutions for example the deregulations of the oil industry gave market the freedom to airport and determine the prices of product without NNPC assistance⁴⁸. This policy was equally applicable to different institutions that make up the economy. Given this positive development and need to realism interest rate determination with the policy of financial deregulation, the cap on interest rate which have been imposed since 1994 removed effectively in October 1st 1996⁴⁹.

2.1.6 Effects of the Financial Deregulation on the Development of Banks in Nigeria

Economic growth entails an increase in a country's total output of goods and services continuously over a period. As a result, there are more available commodities and services for everybody in the economy such as the increase in per capital income⁵⁰. A high rate of

economic growth is a major policy objective of most governments. This is because it provides an opportunity for a higher standard of living, reduces poverty, and allows redistribution of income to reduce the gap between the rich and the poor. Therefore, part of the hurdles before any nation, especially underdeveloped and emerging economies, is to attain a high rate of economic growth. Financial sector plays crucial roles towards the attainment of economic growth of a country⁵¹. Any reform formulated to reposition the sector will have multiplier effects on other parts of the economy. This is expected to herald a new era of economic growth and more opportunities for the citizen⁵². Formulation and implementation of financial reforms in the country started in 1952. It was when the colonial government enacted the first banking ordinance. For over 20 years after independence, Nigeria financial system was under strict control of the government. This was evident in the ceiling of deposit and lending rates, the direction of credit to preferred sectors, high reserve requirements for banks, and lack of free entry and exit into the banking sub-sector⁵³.

Unfortunately, these policies produced unintended consequences during the period. The failure of monetary and exchange rate policies to achieve the desired economic objectives under the control regime led to the implementation of the World Bank and International Monetary Fund economic policies in Nigeria. They suggested financial reform measures known as Structural Adjustment Programme (SAP) in 1985/1986. Since then, reforms that cut across all strata of Nigeria financial system had been initiated and implemented. Taking a critical look at the country's financial sector, many issues and opposing views have been expressed in the ways and manner series of reforms have been implemented over the years⁵⁴. Some of the major problems are seen in the activities of Nigeria financial system. These include inadequate attention to the needs of the productive sector of the economy, inadequate policy reforms to stimulate financial sector development, and weak regulatory administration in a deregulated financial environment. Thus, these make financial institutions not to comply

with rules and guidelines from regulatory agencies⁵⁵. They are less transparent and ethical in the handling of their portfolios of assets.

Moreover, there is excessive penchant by banks on granting credits for general merchandise instead of growth-enhancing sectors like power, agriculture, manufacturing, and others. There is overconcentration on the financing of imported finished goods, instead of raw materials and capital goods. A considerable number of literatures are available on the nexus between financial reforms and economic growth⁵⁶. These literatures cover both theoretical and empirical aspects in developed, emerging, and third world economies. Some of the reasons for the necessity of financial reforms also abound in literatures. The idea that financial reforms and development promoting economic growth was first put forth by⁵⁷. He stated that theories relevant to this postulation included Shaw financial deepening hypothesis, financial market theory, and efficient market hypothesis. Then, some of the theoretical arguments concerning the link between financial reforms and economic growth. They argued that if the financial sector was deregulated, it could be the key stimuli for economic growth and development. Therefore, they opined that a well-developed financial system through reforms would improve the efficiency of financial intermediation by reducing monitoring and transaction costs⁵⁹. This will eventually lead to economic growth and development both in the short and long run respectively. Those were pooled into panel data set by adopting linear regression model technique. It examined the effect of financial reforms on economic growth in Nigeria. They found out that credit claims of deposit money banks affected economic growth in positive ways⁶⁰. Meanwhile, interest rate charged by banks on lending had negative relationship with economic growth. Therefore, they recommended that management of banks in Nigeria should enhance their capacity in credit analysis and loan administration, so that financial reforms would be more effective⁶¹.

2.1.7 The challenges of Financial Deregulation on the Nigerian Economy

Deregulation of the economy comes in because of depression. Depression is said to be a period when there is severe and prolonged downturn in the economy, prices fall, and reducing purchasing power. It also resulted into high unemployment, lower productivity, shrinking wages and general economic pessimism. In essence financial depression refers to the distribution of domestic financial market through measured such as calling on interest rate and credit expansion, selective allocation of credit and high reserve requirement⁶¹. It is believed that misguided policies have damaged the economy of Nigeria by reducing saving activities. In essence, the standard recommendation put in place to resuscitate the economy is proper deregulation of the economy which will affect the financial sector.

The deregulation policy was adopted in 1987 against a crash in the international oil market and the reactant deteriorating economic condition in the country due to stringent policies in the financial sector⁶². The policy was adopted to achieve fiscal balance and balance of payment availability as well as liberation of the financial system by altering and restructuring the production and consumption pattern of the economy, eliminating price distortions, reducing the heavy dependency on crude oil export and consumer goods importation, enhancing the non-exports base and achieving sustainable growth. The banking sector by its nature of activities is the most heavily regulated sector in most economics. It is based on these criteria that the success of Nigeria's experiment with economic deregulations must inevitably be assessed⁶⁴. The efficient functioning of an economy is to a great extent the responsibility of the banking industry. In this respect the rapid development of the Nigeria economy depends mainly on the depth of involvement of the Banking Industry following from the need for efficient functioning of the economy, the Central Bank decided to deregulate the financial system particularly banking is therefore an attempt to bring out the

much-desired development. This will broaden the monetary base and encourage competition in the industry. This will also bring about encouraging banking habit among the populace⁶⁵.

Deregulation policy and its impacts on the Nigerian Banking Industry, deregulating the economy through the banking sector will go a long way in developing and efficient money market thereby improving the payment system in the economy. Infact, the deregulation policy has improved the level of awareness of activities of banks among Nigerians⁶⁶. In the light of this, deregulation measures have continued to pose profound environment challenged to the banking industry⁶⁷. The liberalization of the financial system has led to the massive protuberating of banks with its attendant consequences of tight computation for fair market share of the public fund, competitive interest rates as well as executive reliance on economic rather than prudential regulation which should focus on bank solvency and credit risk⁶⁸.

2.1.8 Monetary Policy

Monetary policy is defined by the Central Bank of Nigeria (CBN) as combination of measures designed to regulate value supply and cost of money in an economy, in consonance with the level of economic activities. Defined monetary policy as the combination of measures taken by monetary authorities (e.g. the CBN and the ministry of finance) to influence directly or indirectly both the supply of money and credit to the economy and the structure of interest rate for economic growth, price stability and balance of payment equilibrium⁶⁹. He added that the CBN is empowered by decree 25 of 1991 Act, to formulate and implement monetary policy in Nigeria, in consultation with the ministry of finance subject to the approval of the President. Sums it up when he said that monetary policy is therefore applied to influence the availability and cost of credit to control the money supply policy. He generally described the action taking by the Central Bank as using tools /

instrument at its disposal to influence monetary conditions in particular, the quantity and supply of money in the macro-economic goods⁷⁰.

These goals would normally include price stability, full employment, high economic growth rate and balance of payments equilibrium. The attainment of these goals will result into the country achieving both internal and external balance of trade and payment. The practice of monetary policy using tools instruments to regulate the quantity of money supply to achieve stability in the economy is based on the premise that there is a stable relationship between the quantity of money supplied in an economy and economic activities⁷¹. Even though, the way and manner with which the central bank regulates its money supply vary from place to place the approach can be divided into two main groups. The first group advocates that monetary policy should target price stability as its single important objectives. The other macro-economic goal agitates for due regulation of money supply and in extension in the control of persistent price increase to ensure sustainable and balance development in the economy⁷².

2.1.9 Evolution of the Monetary Policy Framework in Nigeria

Generally, central bankers and economists are less divided in their perceptions of the objectives of monetary policy than in their views about what role the central bank should play in accomplishing these objectives⁷³. Consistent with its legal mandates, the objectives of monetary policy of the CBN since its inception have been the followings:

- i. Achieving domestic price and exchange rate stability.
- ii. Maintaining of a favorable balance of payment.
- iii. Development of sound financial system.
- iv. Promotion of rapid and sustainable rate of economic growth and development.

The Exchange Rate Targeting Regime

The conduct of monetary policy in Nigeria under the colonial government was largely by the prevailing conditions in Britain. The instrument of monetary policy at that time was the exchange rate, which was fixed at par between the Nigerian naira and the British pound. This was very convenient, as fixing the exchange rate provided a more effective mechanism for the maintenance of balance of payment viability and for control over inflation in the Nigerian economy. This fixed parity lasted until when the British pound was devalued⁷⁴. Owing to the civil unrest in the later part of this period, the monetary authorities did not consider it expedient to devalue the Nigeria naira in sympathy with the British pound. Two major reasons accounted for this; first, a considerable proportion of the Nigerian naira would only raise the domestic price of imports without any appreciable impact on exports, which were largely the primary products⁷⁵. Rather than devalue, the monetary authorities decided to peg the Nigerian currency to the US-dollars but imposed severe restrictions on imports via strict administrative controls on foreign exchange. Following the international financial crisis, which led to the devaluation of the US dollar in relation to Nigerian currency, Nigeria abandoned the dollar peg and once again kept faith with the pound until, when the Nigerian currency was once again pegged to the US dollar. With those developments, the severe drawbacks in pegging the Nigerian naira to a single currency became obvious. A clear case was that the naira had to undergo a “de facto” devaluation in sympathy with the dollar when the economic fundamentals dictated otherwise⁷⁶. It was against this backdrop that the need to independently manage the exchange rate of the naira became very imperative and was firmly established. Hence, Nigeria pegged her currency to a basket of 12 currencies of her major trading partners⁷⁷.

Monetary Targeting Regime till Date

The economy witnessed a major structural change that affected the conduct of monetary policy. Oil dominated the export and over 96 percent. While non-oil export (mostly agriculture) declined rapidly from 42.4 percent to 16.9 percent as a result of the increased revenue accessing to the government from oil, the imbalance in the balance of payments and low external reserves became things of the past. Indeed, Nigeria's external reserves rose rapidly by over 1,000 percent in 1975 from about ₦100 million in the late sixties approximately ₦3.4 billion. The need to finance post-war developments also led to a considerable growth in public expenditure, thus intensifying inflationary pressures⁷⁹. Under the circumstances, the monetary authorities adopted a new monetary policy framework. This development marked the beginning of monetary targeting in Nigeria, which involved the use of market (indirect) and non-market (direct) instruments. Consequently, the major focus of monetary policy was predicted on controlling the monetary aggregates, a policy stance which was largely based on the belief that inflation is essentially a monetary phenomenon⁸⁰.

Direct Control

The major objective of monetary policy during this period was to promote rapid and sustainable economic growth. Consequently, the monetary authority imposed quantitative interest rate and presented sectoral credit allocation to the various sectors of the economy. Overall, the "preferred" sectors, such as agriculture, manufacturing and construction were singled out for the most favored treatment, in terms of generous credit allocation and a below market lending rate⁸¹. The most important instrument of monetary control the CBN relied upon was the setting of targets for aggregate credit to the domestic economy and the prescription of low interest rates. With these instruments, the monetary authority hoped to direct the flow of loanable funds with a view to promoting rapid development through the provision of finance to the preferred sectors of the economy. The level and structure of

interest rates were administratively determined by the CBN. Both deposit and lending rates were fixed in order to achieve social optimum in resource allocation, promote the orderly growth of the financial market, curtail inflation and lessen the burdens of internal and international debt servicing of the government⁸².

In implementing the policy, the sectors were classified into three categories: (1) “preferred” agriculture, manufacturing, and residential housing, (2) “less preferred” imports and general commerce; and (3) “others”. This classification enabled the monetary authorities to direct financial resources at concessionary rates to sectors considered as priority areas. These rates were typically below the CBN. Determined minimum rediscount rate (MRR) which itself was low and not determined by market forces. Empirical evidence during the control regime era revealed that the flow of credit to the prior sectors did not meet the prescribed targets and failed to impact positively on investment, output and domestic price level⁸³. Overall, banks tended to practice adverse selection in their credit allocation. The major factor which impaired the major objective of monetary policy during this period was to promote rapid and sustainable economic growth. Consequently, the monetary authority imposed quantitative interest rate and presented sectoral credit allocation to the various sectors of the economy. Overall, the “preferred” sectors, such as agriculture, manufacturing and construction were singled out for the most favored treatment, in terms of generous credit allocation and a below market lending rate⁸⁴.

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This led to severe external sector imbalance. The emerging economic development made Nigeria adopt the Structural Adjustment Programme (SAP) under General Ibrahim Babangida as the Military Head of State, as a policy option to put the economy back on the path of sustainable growth. In a broad term, the SAP strategy involved both structural and sectoral policy reforms. The reforms included the deregulation of the financial system to accomplish a market-oriented financial system that would support efficient financial intermediation. The programme, thus, entailed reforming and dismantling the control regime

which was characterized by a system of fixed credit allocations, a subsidized and regulated interest rate regime, exchange controls and import licensing⁸⁷. The emergence of SAP ushered-in a regime of financial sector reforms characterized by the free entry and free exit and the use of indirect instruments for monetary controls⁸⁸.

2.1.10 Monetary Policy Review of the Operation of Instruments

2.1.10.1 Bank Rate

Bank rate is the rate at which the central bank of the country is prepared to buy or rediscount the eligible bills of exchange. It operates on the cost of credit directly by altering the cost at which the central bank's credit is available to the commercial banks⁸⁹. In practice, it may, however, be extremely difficult to predict the effect of change in the bank rate on public sector banks borrowings and money supply as it banks borrowings depend on the degree of dependence on borrowed reserves and the sensitivity of banks demand for borrowed reserves to the difference between their lending and borrowing rates³². Since 1997 the Bank Rate has been reactivated as the principal signaling device of the monetary policy stance across the interest rate structure in consonance with inflationary expectations and the liquidity situation. The Bank Rate was reduced in stages to 6.25 percent in October 2002, the lowest rate since May 1973, and by a further 25 basis points in April 2003. The Bank Rate has been reduced by 500 basis points in the last five years. Banks have the freedom to fix interest rates on term deposits, with flexibility in offering as approved by their boards⁹⁰. The only regulated rate is on the saving accounts with cheque facility. The reduction in the administered interest rates on small saving announced in the Union Budget 2003-04 and moderate inflation enabled a 50-basis point reduction in the saving deposit rate to 3.5 percent per annum from March 1, 2003¹⁹.

2.1.10.2 Lending Rates

The downward rigidity in lending rates is reflected in spreads over the prime lending rates (PLR). Unconscionably wide spreads are unwarranted in a period of low inflation. Moreover, the adversely impact the overall credit portfolio of Banks and obscure the appropriate pricing of loans. In this context, banks are required to announce the maximum spread over the PLR for all advances except consumer credit⁹³. Structural impediments to flexibility in the interest rate structure include the high carrying cost of long term deposits mobilised in the past by banks at fixed interest rates and non- performing assets. Long term deposits (over 1 year) contracted at fixed rates constitute around 70 percent of the aggregate deposits of the banking system. Advances in the form of short-term credit at fixed rate constitute around 40 percent of the total loan portfolio⁹⁴. There is also a lack of depositor interest in flexible deposit schemes in an environment of low inflation and falling nominal interest rates. The carrying cost of NPA and the tendency to load additional risk premium against possibilities of further accumulation of NPAs forces up lending rates. Besides NPAs, persistence of high operating costs also results in a significant drag on commercial bank's ability to lower lending rates⁹⁵.

2.1.10.3 Reserve Requirements

With the help of this technique the Central bank can affect the credit creating capacity of the banks The Central Bank exercises direct control over the liquidity of the banks through two complementary methods⁹⁶.

2.1.10.4 Cash Reserve Ratio (CRR)

Under section 42(i) of the Central Bank of Nigeria (CBN) Act, scheduled banks are required to keep a certain percentage of their demand and time liabilities with the CBN. An increase in the CRR is an indicator of restrictive monetary policy⁹⁷. The policy of varying CRR may take the form of rise in CRR against the total demand and time liabilities. Or, the CBN may instruct the banks to maintain with it additional cash reserves computed with reference to the

excess of their total demand and time liabilities over the level of such liabilities on a base data by the CBN, subject to the condition that incremental do not exceed 100 percent of the excess and that the total reserve do not exceed 15 percent of their demand and time liabilities³⁷. This has changed thereafter. The medium term objective is, however to reduce the CRR to the statutory minimum level of 3.0 percent on a review of the developments in the international and domestic financial markets, a 75 basis point reduction in the CRR during June to November, 2002 was followed by a further 25 basis point cut from June 14, 2003 taking the level of the CRR down to 4.5 percent⁹⁸. The minimum daily maintenance of CRR was raised to 80 percent of the average daily requirement for all the days of the reporting fortnight with effect from the fortnight beginning November 16, 2002. This was subsequently lowered to 70 percent with effect from the fortnight beginning December 28, 2002. The payment of interest on eligible CRR balances maintained by the banks was changed from quarterly basis to monthly basis from April 2003⁹⁹.

2.1.10.5 Statutory Liquidity Ratio (SLR)

The Banks in Nigeria are required statutorily to maintain a prescribed minimum proportion of their total demand and time liabilities (L) in the form of liquid assets¹⁸. These liquid assets consist of excess reserves (ER), unencumbered government and other approved securities (I) and other current account balances with other banks (CB).

$$\text{Thus, SLR} = \frac{\text{ER} + \text{I} + \text{CB}}{\text{L}}$$

SLR operates as an instrument of monetary control by affecting the freedom of the banks to sell government securities and borrow against these from CBN. This ratio has remained unchanged at a minimum of 25 percent of net demand and time liabilities (NDTL) since October 1997. From 1 2003, all scheduled urban co-operative banks have to maintain the

entire SLR holdings of 25 percent of NDTL in government and other approved securities only¹⁰⁰.

2.1.10.6 Open Market Operations (OMO)

This refers to the purchase and sale of government securities by the Central Bank to alter the reserve base of the banks and hence to check their capacity to expand credit. Every open market purchase of securities by the Central Bank increases the currency held by the public and cash reserves of the banks and every sale reduces it³⁹. Prior to liberalization in India, the open market operations of the Reserve Bank have not been very powerful instrument of monetary control because of the underdeveloped nature of money and capital markets²². In order to ensure that a sufficient stock of marketable securities would be available in the portfolio of the Central Bank for conducting OMO from time to time, the government of India converted Rs. 40,000 crore of 4.6 percent Special securities issued earlier to the Reserve bank into marketable securities at various maturities at the prevailing yields⁴⁰.

Between 1987 and 1991 the licensing procedures for banks were relaxed, allowing politically connected people to obtain licenses and operate banks despite having no obvious qualifications or relevant experience. During this time 84 new banks were established. The increased number of banks overwhelmed the examining capacity of the CBN/NDIC hence many banks failed to comply with prudential guidelines¹². During this time the number of commercial banks and other financial institutions such as finance houses, loans and savings associations as well as community banks rose phenomenally. As at 1990 the number of banks in Nigeria was well over 100 with still over 20 licensed to begin operation at that time. The period of deregulation came with other strategic changes in the banking sector²⁶. Among such is the creation of the Nigerian Deposit Insurance Corporation (NDIC) by Decree No. 22 of 15th June, 1988. The NDIC was charged with responsibility of insuring bank deposits,

ensuring safe banking practices through effective supervision, and assisting the CBN to formulate banking policies with a view to ensuring the stability of the financial system (NDIC, 1989)⁴¹.

To strengthen the operations of banks the minimum paid up capital for banks were increased from September 1989 from N10 million to N20 million for commercial banks and from N6 million to N12 million²⁸. In 1990, the CBN introduced new capital adequacy requirement under which the bank's minimum required capital and reserves are based on risk weighted assets, as in the Basle accords, in addition to the previous requirement, under which banks' minimum adjusted capital were computed as a percentage of loans and advances. In 1991, the minimum paid up capital of commercial banks was raised from N20 million to N50 million while that of merchant banks was raised to N40 million³². This was later raised to N5 billion for commercial banks. To enable Nigerian banks to compete effectively in international businesses, the capital base of banks was raised to N25 billion by the CBN in 2004. With this upward review of capital base, some banks must merge while some were bought over to meet the requirement. However, the banks which could neither merge nor bought over, but were unable to meet the new capital requirement were liquidated⁴².

The regulation on capital requirement greatly reduced the number of banks in Nigeria presently to less than forty³⁶. The financial sector witnessed another reform with the ascendancy to office of the new CBN Governor, Sanusi Lamido Sanusi, who organised rescue programme for some banks who were about to collapse following allegation of corporate mis-governance and probably because of the global economic meltdown. Between 1980 and 1986 when SAP was introduced, the average deposit rate was 7.9% but this increased to 13.47% on the average between 1987 and 2003. Similarly, inflation rate, which was 16.0% on the average between 1980 and 1986 rose to 26.3% on the average between

1987 and 2003.³⁸ Banking system credit to the private sector, which was N13,315.30 on the average between 1980 and 1986 rose to N340,357.23 between 1987 and 2003 while the credit to the public sector increased from N13,315.53 to N141,972.84 within the same period. However, when this is deflated by the size of the economy, another picture is displayed⁴².

The financial repression in the form of usury restrictions on interest rates, heavy reserve requirements on bank deposits, and compulsory credit allocations, interact with ongoing price inflation to reduce the attractiveness of holding claims on the domestic banking system⁴¹. It was postulated that the fragmentation of the capital market resulting from financial repression also has adverse consequences for the quality and quantity of capital formation. Financial sector development in, which is the ratio of private credit to domestic credit, is meant to capture the aspect of domestic asset distribution of an economy²⁷. A rise in this ratio is expected to be an indication of improvement in financial development. The four measures used above were also used. In many studies, interest rate spread has been used as a measure of financial sector many empirical works is measured using the ratio of money/liquid liabilities to GDP or deposit to GDP⁴⁰. A higher ratio is usually associated with greater financial liquidity and depth. This may however be misleading because the ratio may decline rather than rise as financial system develops because people have more alternatives to invest in longer-term or less-liquid financial instruments⁴³.

Moreover, this measure only focuses on the size of the financial sector without consideration for the efficiency of the sector in allocating the society's resources or the issue of accessibility. Hence in this study, we shall use four measures of financial sector development⁴². The first of these measures is the ratio of broad money to GDP (M2Y). The ratio of broad money to GDP is designed to capture the financial depth or the real size of the financial sector in a growing economy and it is expected to be rising over time if the financial

sector develops faster than the real sector economy³⁶. The second measure is the ratio of domestic credit to GDP. This represents the domestic assets of the financial sector. It is expected to increase in response to improved price signaling. The third measure, which is the ratio of private credit to GDP, isolates the credits issued to the private sector as opposed to credits to the government and excludes credit by the central bank⁴⁰. Although this measure is the most preferable measure of financial development in the literature, it does not directly measure the amelioration of financial and transaction costs³².

Higher level of this variable can be interpreted as depicting higher levels of financial services and therefore greater financial intermediary development⁴⁴. This is so because with financial sector deregulation, interest is allowed to be dictated by market forces rather than being fixed by the authority⁴⁵. This is obvious in the Nigeria case. Between 1980 and 1986, prior to the deregulation of the financial sector, maximum lending rate was 9.5% in 1980, this was adjusted to 10% in 1981 and was 12% in 1986. However, by 1987, with deregulation, it jumped up to 19.2% and fluctuated widely thereafter, increasing and decreasing at some other times as dictated by market forces⁴⁶. Similar trend is observed with the interest rate on saving. This was fixed at 6.5% in 1980 and 1981. It was adjusted to 8% in 1982 and 1983 and increased to 10% in 1984 to 1986. But immediately after deregulation, it went up to 15.8% in 1987 and continued to move thereafter in line with market forces⁴⁶.

2.1.11 Bank Failures and Financial Innovations as a Constraint on Monetary Policy

The fear that restrictive monetary policies could lead to bank failures and financial instability, and that this can create a constraint on 'admissible' monetary policies, is sometimes used as an argument in favour of regulations aimed at reducing or eliminating the danger of bank failures (e.g., the view of deposit rate ceilings as a 'compensation' helping banks to survive these dangers). However, these arguments are not convincing¹⁰¹. If monetary policy is neutral

in its long-run effects on the real economy, as might be expected to a first approximation, then it is difficult to see why variations in the money supply could create serious permanent problems for basically sound banks.

With flexible wages and commodity prices, monetary policy would have no real effects in the short run. With sluggish, slowly adjusting wages and commodity prices, there would be some real effects, but of a temporary nature only. While this could, indeed, lead to liquidity shortages, it would force bankers to incorporate this risk into their management strategies through appropriate liquidity and capital ratios, and to adjust the maturity structure of their assets and liabilities (the extent to which this is necessary depends on the degree of accommodating behaviour which can be expected from the central bank)¹⁰². Of course, bank failures are bound to occur and it is the responsibility of the monetary authorities to guarantee the stability of the financial system through creating an appropriate legal and institutional framework.

They have the duty of guaranteeing that bank failures do not lead to a systemic bank run or to undesired variations (shrinkages) of the money stock (the lender-of-last-resort function). In such a framework, there would be no constraint on the active use of monetary policy. This issue should not be confused with the (real) problems which may arise from changes in the regulatory framework, and which may then arise particularly severely when a restrictive monetary policy is pursued at the same time. Abolishing or relaxing a regulation which has previously served to protect the survival of certain groups of banks which would not have survived otherwise (in the same form) will likely, lead to difficulties for these banks. While this may be exacerbated by a tight monetary policy, it is not really caused by the latter¹⁰³.

A related, and frequently voiced, concern is that financial innovation and deregulation lead to more financial instability, as market participants and the authorities now face more

unexpected developments and shifts ('disturbances') in financial markets. But is it true that deregulation can be said to lead to more financial instability? Admittedly, in a transitional stage this may be so, as changes in regulation (in both directions) involve a certain amount of uncertainty about their effect on market participants and their responses. In the long run, however, it is not clear why this should be the case to the extent that financial innovation is itself the result of existing regulations, and as more stringent and numerous regulations create an incentive for finding innovative ways around these regulations, deregulation may actually lead to a decline in financial innovation and, in this sense, increase the stability of financial markets. In this connection, it is interesting to note that in explaining the comparatively low degree of innovative activity apparently taking place in Germany and in Switzerland, their central bankers have pointed to the comparatively low levels of financial regulation (prudential controls excluded)¹⁰⁴.

2.1.12 Banking Deregulation and Financial Stability: A Microeconomic View

In this part, we analyse first the potential market failures calling for bank regulation. We start with a brief review of the role of banks, followed by a discussion of the potential sources of instability and of the need for public intervention. The current system of banking regulation is analysed and we discuss three proposals to improve the current regulatory framework¹⁰⁴. The role of banks and the source of market failure A bank or a financial intermediary is a firm whose assets include primary financial claims issued by borrowers such as individuals, governments, firms (or other financial intermediaries) and whose liabilities are sold as secondary claims to capital surplus units in various forms such as demand deposits, savings deposits, term deposits, subordinated debt (loan capital) or equity shares. (To keep pace with recent financial innovations, we include in our definition all the insurance-related activities such as letter of credit and note-issuance facilities - the so-called

'off-balance-sheet' items). Therefore, the inclusiveness of commercial banks (public or private), savings banks, finance and leasing companies and mutual funds. The first step in an analysis of bank regulation is to understand the nature of the services provided by banks and the sources of market failure calling for public intervention¹⁰⁵. Although the services provided by banks are interrelated, it is convenient to distinguish three categories of increasing complexity: portfolio management, payment (transmission) services, and monitoring and risk-sharing mechanisms.

Portfolio Management

The first service offered by banks is a 'portfolio management' service. Financial intermediaries help savers to acquire at low cost a diversified portfolio of financial liabilities issued by capital deficit units. The purest example is the mutual fund which allows the holder of its shares to have access to a diversified portfolio of claims. Mutual funds' shares are valued at market prices every day and, in essence, this financial intermediary is a channel between deficit and surplus units which reduces transaction costs¹⁰⁶.

Payment Mechanism

The second role of banks in the economy is to manage the payment system, that is, to facilitate and keep track of transfers of wealth among individuals. This is the bookkeeping activity of banks realized by debiting and crediting accounts. By keeping a record of the amount of funds invested by each party in the pooled portfolio, the bank can organize the exchange of claims among individuals that can be initiated by cheques, money orders or, with the coming new technology, by home banking or EFTPOS (electronic funds transfers and point-of-sale terminal) facilities. If a bank were to offer only these two services - the issue of shares to finance a diversified pool of assets and the management of payment services - its shares would be marked at market every day and shareholders would earn the

market rate of return, adjusted for risk, less a fee retained by the intermediary for managing the investment pool and the payment mechanism¹⁰⁸. However, this new school takes too simple a view of the economic function of banks by ignoring a third important series of services, the risk sharing (insurance) and monitoring facilities. These services create the need for public intervention.

Risk-Sharing and Monitoring Services

An essential function of banks is to transform the risk faced by the parties or, to put it in modern terminology, to supply risk-sharing contracts. The risk-sharing service is an integral part of the portfolio and payment services and is presented here as an additional service for convenience only. There are many such risk-sharing facilities¹⁰⁹. The first one is that banks not only provide a diversified pool of assets, but also organize efficiently the distribution of the risky income earned on the asset pool. The debt holders (the depositors) usually receive a fixed payment (the interest) while the shareholders of the banks assume the risk in receiving the residual income. Other risk-sharing or insurance activities will include liquidity insurance (options for debt holders to withdraw the funds quickly at face value), interest rate insurance (floating-rate lending with ceilings on interest rates) and, in principle, any type of risk such as income variability. A standard insurance market will not emerge because the information about liquidity needs is private so that the insurer could not distinguish the cash-constrained consumers from the others¹¹⁰. However, a liquid deposit contract is a perfect instrument because cash-constrained consumers can withdraw their deposits early while the other consumers have an incentive to keep their deposits in the bank to benefit from a higher return¹¹¹.

Banks Act as Insurance Companies

Although difficult to measure, the risk-sharing function is of great value because it permits the financing of risky projects with an appropriate distribution of returns among individuals. In addition to risk-sharing services, banks perform a very useful function in reducing the costs of screening and monitoring borrowers. In many cases, private information held by borrowers result in financial contracting problems and in costly monitoring. Diamond has shown why banks can reduce these costs. Instead of monitoring borrowers themselves, depositors delegate this activity to a financial intermediary. Depositors will of course need to evaluate the financial intermediary itself, but by diversifying its loan portfolio across many borrowers, the intermediary reduces substantially the aggregate risk so that the cost of monitoring by depositors is substantially reduced¹¹².

A major result is that optimal financial contracting takes the form of loans and deposits and that it results in financial intermediaries holding an illiquid loan portfolio: the potential for market failure lies in these risk-sharing and monitoring functions. Two independent explanations have been advanced: the public good character of information gathering and monitoring, and the liquidity of par value deposits which can create a bank run¹¹².

The evaluation of the solvency of a bank and the monitoring of its activities is a costly activity which has the nature of a public good. As such, it may be supplied more efficiently by the public sector rather than by the private sector (rating agencies). And if large numbers of small scale depositors find it costly to undertake the fixed cost of processing and understanding bank ratings, however supplied, it may be more efficient for the government to remove this requirement by providing deposit insurance. Monitoring would then be conducted by the public sector and regulation would be the vehicle for making those assessments bite. It must be stressed that these arguments are not specific to the banking industry, though that may be the industry in which the interaction of small scale and the fixed

cost of understanding the ratings is highest¹¹³. The second source of failure is specific to banking. The par value and liquid deposit features of the deposit contract result in incentives to withdraw deposits and run at the onset of problems. Because of asymmetric information, banks are unable to distinguish liquidity driven withdrawals and prudential ones. There is a market failure because a bank run is an inefficient way of solving bank defaults. The reason is that bank assets include loans which cannot be realized easily in a short time. In the case of a bank run, these illiquid assets must be realized with heavy transaction costs, or else profitable production has to be interrupted if the loans are called in. Therefore, a bank run will reduce the efficiency of the risk-sharing contract¹¹⁴.

An alternative explanation of market failure stresses the 'contagious' nature of a run. Because of imperfect information on the solvency of other banks, a bank failure can trigger a run on other, solvent banks. As Bagehot put it long ago; "the peculiar essence of our banking system is an unprecedented trust between man and man". And when that trust is much weakened by hidden causes, a small accident can greatly hurt it¹¹⁵. A large bank run can happen when one bank fails, because people will follow the crowd assuming that the value of banks' assets are highly correlated with one another. Whatever the source of the contagious runs (panic or a signaling effect), it creates an externality because the failure of solvent banks will impair customer relationships and raise the future cost of credit¹¹⁶. Appropriate disclosure of information should reduce the risk of a large run-on solvent bank, but it remains likely that some depositors will still withdraw: it only takes a few seconds for the careful treasurer of a firm to transfer funds. The financing of illiquid assets with volatile short-term deposits always creates the possibility of a costly and inefficient bank run. No one should dare to guess the likelihood of a bank run in Europe, but it is possible that some accidents and failures may occur as the financial markets adapt to deregulation, financial and technological innovations and to the volatile economic environment¹¹⁶. In particular, the developments of

'off-balance-sheet' instruments (such as options, futures, swaps and loan commitments) raise some concern while the accounting, risk management and supervisory systems are still in their infancy¹¹⁷. These innovations further reduce the transparency of balance sheets, with the result that market participants will find it harder to evaluate the solvency of banks. Another worrying development is that, as part of their liability management strategy, banks have relied increasingly on (non-insured) money market funding¹¹⁸.

2.2 Theoretical Framework

2.2.1 The Keynesian Theory

In the Keynesian analysis, monetary policy plays a crucial role in affecting economic activity. It contends that a change in the supply of money can permanently change such variables as the rate of interest, the aggregate demand and the level of employment, output and income. In the existence of unemployment equilibrium, this implies that an increase in money supply can bring about permanent increase in the level of output. This rise in supply of money, its first effect is in the rate of interest which tends to fall. Given the marginal efficiency of capital, a fall in the rate of interest will increase investment³². The increased investment will raise effective demand through the multiplier effect thereby, increasing income, output, and employment. The analysis what causes the rate of interest to change in his monetary policy. In the Keynesian analysis, the rate of interest is determined by demand for the supply of money. If either the demand for money or supply of money changes, the equilibrium rate of interest would change. The supply of money is determined by the monetary authority which is normally fixed in the short run in other words, money is the desire to hold cash for transaction, precautionary and speculation purposes⁴⁰.

The speculative and transactionary demand for money depends on the rate of interest or bond prices. "it was also alleged that the theory's framework was too rigid for analyzing the effect

of changes in the money supply in expenditures and the price level”⁴⁴. The proceeds to question the efficiency of his monetary policy under certain conditions and this was argued that a very low interest rate, the demand for money becomes perfectly elastic³⁵. This liquidity trap portion of the demand for money curve which is completely flat⁵⁰. This means that for any further interest in supply of money by the monetary authority cannot reduce the rate interest. This implies that there will be no effect on investment income, the monetary policy does not influence economic activity, given the interest inelastic investment functions, and monetary policy will be effective in the Keynesian view on monetary policy²¹. They believed on the basis of his experiences that monetary policy operates under some certain limitations upon which its impact depends on first, if the increase in supply of money reduces the rate of interest provided the demand for money does not become infinite (i.e. perfectly elastic)²⁸.

The reduction in the rate of interest increases investment demand provided it is not inelastic to the rate of interest becomes effective. “If you are tempted to assert that money is a link which stimulates the system of activity, we must remind ourselves that there may be several steps between cup and the lips”⁴². This limitation becomes more serious during depression and this monetary policy becomes ineffective. Change in money stock using monetary policy tools with investment demand through interest rate i.e. (if interest rate increases, investment will decrease and vice versa)³⁹. The demand for money refers to the total amount of money balances that people want to hold for certain purposes. For any fall in interest rate for instance, investor would be encouraged to borrow more fund for investment since there is enough saving to cover the desired investment. Higher investment demand will stimulate aggregate demand and national product through the multiplier process⁴⁷.

In Keynesian framework, an open economy is given by

$$Y = C + I + G + X_n.$$

Where Y = Aggregate demand.

C = Consumption expenditure.

I = Investment expenditure.

G = Government expenditure.

X_n = Net export ($X-M$).

X = Export.

In this framework of Keynesian in an open economy leads to an open market purchase of securities, for instance, the CBN which is an expansionary monetary policy increases banking sector liquidity and attempt to dispense with it, pushed the interest rate downward and this in turn will encourage investment and aggregate demand will increase, then gross national product (GNP) will increase which leads to economic growth²⁸. “Since resources can be less than fully employed for sustained period, the level of real output can be influenced by aggregate demand”. This theory assumes equilibrium with less than full employment where both employment and income are fluctuating⁴². The theory views interest as reward for parting with liquidity. It provides that interest rate is determined by the demand and supply of money. The theory opined that supply of money is usually determined by monetary authorities while the demand for money is a function of income and interest rate. The theory further explained that transactionary and precautionary motive of liquidity is dependent on income while speculative motive is dependent on interest rate, it is interest elastic³⁹. The Keynesian theory implies that low interest rate as a component of cost administered is detrimental to increase savings and hence investment demand. Proponents of this theory argue that increase in the real interest rate will have strong positive effects on savings which can be utilized in investment, because those with excess liquidity will be encouraged to save

because of the high interest rate, thus banks will have excess money to lend to investors for investment purpose thereby raising the volume of productive investment³². Keynes also emphasized that the rate of interest is purely a monetary phenomenon. This theory introduced the concept of liquidity trap, a situation where low interest rates discourage savings and consequently reduces investments due to lack of investable fund⁴⁵. The study observed that the Keynesian liquidity preference theory interest rate is a stock theory. It is a stock analysis because it takes the supply of money as given during the short run and determines the interest rate by liquidity preference or demand for money⁵².

This theory alludes to the Nigerian situation under the regulated interest era, where the monetary interest rate set by government authorities was low and the real interest rate was even lower because of inflation¹³. The low interest rate encouraged inefficiency in the use of capital and resultant negative growth trend in investment. The negative trend was also because of lack of investable fund as people preferred to hold liquid cash as there was no adequate inducement to part with liquidity. Keynes theory is regarded as an improvement over classical theory as it considers interest as a monetary phenomenon that links the present and the future⁴⁵. This theory abandoned the assumption of full employment, introduced the concept of unemployment therefore, it considered the change in the income level and its relationship with savings and investment. Thus, in Keynesian analysis more investment leads to more consumption, or in other words, investment and consumption go together³⁸. Keynesian analysis is more realistic in the context of unemployment of re-sources prevailing in the economy. Opponents of this theory insist that it is an indeterminate, incomplete, inadequate, and unrealistic theory of interest rate⁵¹.

2.2.2 The Monetarist Theory

Monetarist believes that fluctuations in the money supply are responsible for most large fluctuation in the economy. They argues that show and steady growth in the money supply would yield stable output, employment and prices. The “monetary revolution” refers to the new and importance contribution that the monetary theory and policy by profession Melton Friedman and his colleagues at the university of Chicago, it was assert of revolution against the views of Keynesians who held the view that “money does not matter”¹⁶. The Keynesian regarded to the money supply as passive factors in the economic system whose economic effects were highly unpredictable. On the other hand, in the monetary revolution “only money matters from three reasons.

- i. The quantity of money is capable of being controllable fairly accurately by deliberate policy.
- ii. Changes in the quantity of money can produce substantial changes in the flow of income, prices and others.
- iii. That the relationship between the stock of money and other asserts are relatively stable and dependable.

The monetarist revolution possesses the following characteristics. Money supply being crucial determinant of economic activity in the short run. It is the money that determines total spending and therefore output, employment, and price lead. Thus, there is a direct link between the money supply and the natural income⁵⁰. If the content velocity of money which is expressed as Y/M , because of the stability of monetary velocity change total spending and national income by predictable amount⁵⁵. The demand for money is a transaction demand for money and it is determined by the level of income. If the central banks (CBN) increase the money supply by purchasing securities, people will find their holdings of money have increased. They will, therefore, spend their excess holding of money party in assets and

partly on consumer goods and services. This spending will reduce their money balance and at the same time raise the national income¹⁶.

On the contrary, a reduction in this supply of money by selling securities on the part of the central bank will reduce money holdings of the buyers of securities. Therefore, increase their money holding partly by selling their assets and partly by reducing their consumption expenditure on goods and services. This will reduce the national income but the demand for money remains the same⁵². A change in the money supply causes a proportionate change in the prices level of income. Given the demand for money, if the economy is operating at less than full employment level, an increase in the money supply will raise output and employment with a rise in total expenditure in the short run. An increase in money supply causes national income to rise because with excess money supply, people start spending more until the demand for money and supply of money is equal⁵⁷. Thus, an increase in the money supply in the short run raises output, employment, and income. Not a rise in the money supply in the long run, with a further increase in the demand, prices and wages will increase in the expectation of inflation due to an appropriate increase in money supply¹⁹.

Therefore, the monetarist regards the point of revolutionary as against the Keynesians view in monetary policy because the rate of interest plays no part in influencing either the demand for money or supply of money⁴⁹. Moreover, changes in money supply influence economic activities. It could be directly or indirectly through changes in the rate of interest like Keynesians. The transmission mechanism of monetary policy influences on economics activity involves reshuffling of both financial and real assets in the portfolio of economic units. Keynes considers only two types of assets, bonds, and speculative cash balances in his transmission⁵⁸. According to the monetarist, when the central bank increases the money supply by purchasing securities in the open market, their prices rise but yield fall due to fall

in market rate interest. People will therefore sell securities and their holding of money will rise, this will raise the demand for financial and real assets. In the monetarist system, central bank cannot influence interest rate through changes money supply²³.

If it tries to reduce the interest rate by releasing large amount of money, this will only cause inflation since the economy is already at near or full employment level. In fact, this will reduce the real money supply and increase the interest rate¹¹. In the long run, the level of real national income is determined by the forces of demand and supply. This is based on the on the consumption that prices and wages in all markets are inherently flexible. This view is in marked contrast to the Keynesian view that there is always under employment equilibrium in the economy and unemployment is involuntary⁴³. The monetarist hold that the economy is stable subjected to wide or sudden in fluctuations due to changes in the economy account of monetary and fiscal policies adopted by the government¹⁹. These policies destabilize the economy. Friedman does not favor even counter radical monetary policy might have a destabilizing effect on the economy. However, to stabilize the economy and avoid inflation, the rate of output and the nation grows without inflation²².

Expectation plays an important role in the monetarist view. The -monetarist hold that expectation are rationed. “Decisions taken in the basis of expectations will cause the anticipated future result to occur ever more quickly if not at once¹⁹. Thus, intelligent expectations are self-reinforcing and stabilizing so long as the government does not create false signals by erratic and irrational interventions”. They have revolutionized economic thinking through the rational expectations of hypothesis. For examples, the rational trade-off even in the monetarist as revolutionary⁵⁴.

2.2.3 Equilibrium Theory

As noted earlier, the origin of deregulation in Nigeria is imbedded in mending domestic imbalances and macroeconomic disequilibrium in the early 1980s which led to economic distortions and slowed growth³³. The theoretical foundation of deregulation is largely taken from the general equilibrium theory, which postulates the relevance of the society's limited resources for efficient production of the needs of the society and efficient distribution of commodities and services among various consumers. The rationale for the deregulation of the banking industry is anchored on the idea to revitalize the Nigerian economy so as to strengthen the naira and make the value more realistic and exports more competitive³¹. Operators of the Nigerian economy were advised by the international monetary fund (IMF) to allow "market forces" determine the true value of the naira. Deregulation is often accompanied by increased market competition. It compels banks to compete with one another for core deposits; their level of exposure to risk may increase as the spread between the cost of funds and the return of funds narrows¹².

They have also identified several ways by which financial reform could increase uncertainties of both the financial and iron financial sector which includes relaxed freedom to entry into the financial sector and freedom to bid for funds through interest rates and new investment, which could lead to excessive risk-taking²². It could also lead to: - Excessive reliance on economic rather than prudential regulations, which should focus on bank solvency and credit risk. -Mismatch of investments; the deregulation of interest rate could affect financial institutions that have large exposure to long-term assets funded by short-term liabilities, which carry fixed interest rates. -Inadequacy of instrument of monetary control or insensitivity to the need for the control of interest rate during deregulation³¹. Financial repression gives rise to inadequate amount of mobilized savings which has to be rationed in an inefficient manner to a small group of favoured borrowers⁴⁵.

Interventions by the authorities in the money and capital markets have the effects of distorting the flow of credits as well as indirectly sustaining the apparent excessive risk aversion of financial intermediaries in developing countries. The banks play important role in economic development²⁹. “The services provided by financial intermediaries mobilizing savings, evaluating projects, managing risks, monitoring managers, facilitating transactions are essential for technological innovations and economic development”. In view of the important role financial institutions plays in a period of reform and deregulation, the structural adjustment programme was conceived to achieve fiscal balance of payments viability, adoption for a realistic exchange rate policy through the establishment of a second tier foreign exchange market (SFEM), reduction of complex administrative controls and fostering reliance on market forces, deregulations, rationalization, commercialization and privatization of the public sector enterprises etc⁴⁰.

The banking sector’s development is correlated with economic growth and a source for long term growth. Several empirical studies have been conducted on consolidation, recapitalization, and banking sector reforms in Nigeria¹¹⁷. They lend credence to the impact of reforms in the banking sector on economic growth. Although, some proponents of the deregulation of the economy argue that the reform have brought about real and relatively greater improvements with regard to deficits, inflation rates and foreign trade, others are quick to castigate it for having woefully failed to redress the basic structural deformities of the Nigerian economy and in particular it brought about devaluation of the currency that raised the cost of service external debts and led to deflationary policies that depressed economic activity¹¹⁸.

2.3 Review of Empirical Studies

2.3.1 Empirical Review on Financial Deregulation

Some studies are specifically looked at how bank business lending responds to monetary policy tightening. They found that banks' lending does not decline when policy is tightened³⁵. They concluded that the entire decline in total lending comes from a reduction in consumer and real estate loans. They found evidence that banks' lending may respond to a tightening of monetary policy⁵⁶. The study found that when policy is tightened, both total loans and business loans at small banks fall, while loans at large banks are unaffected. The differential in the response of small banks may indicate they have less access to alternative funding sources than large banks and so are less able to avoid the loss of core deposits when policy is tightened³⁸. The monetary variables were banks rate, lending rates, cash reserve system and statutory ratio, and each was regressed on banks profitability independently. Lending rate was found to exact positive and significant influence on banks' profitability, which indicates a fall in lending rates will reduce the profitability of the banks. Also, bank rate, cash reserve system and statutory ratio were found to have negative and significant effect on the profitability of banks⁴⁵. Their findings were the same when lending rate, bank rate, cash reserve system and statutory ratio were pooled to explain the relationship between banks profitability and monetary policy instruments in the private sector.

The bank interest rates (lending, deposit, and inter-bank) to monetary policy changes from 1985-2002 using an Auto-regressive Vector Correction Model (AVECM) that allows for different behaviours in both the short-run and longrun.³⁶ The study shows that the speed of adjustment of bank interest rate to monetary policy changes increased significantly after the introduction of the 1993 Banking Law, interest rate adjustment in response to positive and negative shocks is asymmetric in the short run, with the idea that in the long- run the equilibrium is restored. They also found that banks adjust their loan (deposit) prices at a faster rate during period of monetary tightening in Italy. The implication of monetary policy on bank lending in Ghana between 1998 and 2004 study revealed that Ghanaian banks'

lending behaviour is affected significantly by the country's economic support and change in money supply⁵². Their findings also support the finding of previous studies that the Central Bank prime rate and inflation rate negatively affect bank lending. Prime rate was found statistically significant while inflation was insignificant⁵². Based on the firm level characteristics, their study revealed that bank size and liquidity significantly influence bank's ability to extend credit when demanded.

A study was carried on the significance of Statutory Liquidity Requirement (SLR) as a monetary policy instrument in Bangladesh. Using descriptive analysis techniques, they found that statutory liquidity requirement has experienced infrequent changes and past evidence showed that reduction in SLR produced positive impact on bank credit and investment especially prior to the 1990s¹⁵. SLR and Cash Reserve Requirement (CRR) were found to be significant tools of reducing inflation and both are used only in situation of drastic imbalance resulting from major shocks. They posited that Bangladesh Bank has used open market operations (OMO) more frequently rather than changes in the Bank Rate and SLR as instruments of monetary policy in line with its market oriented approach²⁹.

A study was carried out on the impact of bank lending rate on the performance of Nigerian Deposit Money Banks between 2000 and 2010²⁷. It specifically determined the effects of lending rate and monetary policy rate on the performance of Nigerian Deposit Money Banks and analyzed how bank lending rate policy affects the performance of Nigerian deposit money banks. The result confirmed that the lending rate and monetary policy rate have significant and positive effects on the performance of Nigerian deposit money banks²⁶. The implication of this is that lending rate and monetary policy rate are true parameter of measuring bank performance. The effect of monetary policy instruments on banks performance with a view to determining the existence of long-run relation for the period

1980-2008. The Engle-granger two step cointegration approaches were adopted. The empirical estimates indicated that bank rate, inflation rate and interest rate are credit enhancing, while liquidity ratio and cash reserves ratio exerted negative effect on banks total credit¹⁰. Although, it was only cash reserve system and interest rate that were found to be significant at 5% critical value, main conclusion drawn was that monetary policy instruments are not effective to stimulate credit in the long run, while banks total credit is more responsive to cash reserve system. Moreover, it was suggested that the monetary authorities should moderate the minimum policy rate as a tool for regulating commercial banks operations and facilitating investment in the economy.

The relationship between inflation and output, in the data and in standard models reporting that empirical cross-country studies generally find a nonlinear, negative relationship between inflation and output”; the relationship cannot be effectively reproduced by standard models due to their standard narrow assumption²⁴. He further concludes in his study that banking and financial regulations are significant enough than any other measure to gauge the impact of Monetary policy on growth⁵². The heterogeneous response of banks to the changes in the monetary policy plays a very crucial role in the transmission process of the policy³⁷. The banks response to the monetary policy stance related to the risk taking and lending issues depends on the internal factors for instance, liquidity with the bank, capitalization, and the market power. The empirical analysis was based on the panel datasets of US and euro area, which reveals the difference in the responses of individual banks to the changes in the policy interest rates. “It is argued that the extensive heterogeneity in banks response identifies overlooked consequences of bank behavior and highlights potential monetary sources of the current financial distress”³⁰.

The comparative study on Private and Public in Bangladesh commercial banks (BCBs), they focused their study on “asset and liability management” and concluded that private BCB’s are far better in asset management than liability management when compared with public banks⁵⁴. It was revealed that the banks’ profitability in Sub-Saharan Africa (SSA) are comparatively high than the other regions¹⁵. Banks profitability study was conducted on the sample size of 389 banks in SSA and the findings revealed that the size of the banks, diversified banks activities and the private ownership plays a significant role in determining the higher returns on assets. “Bank returns are affected by macroeconomic variables, suggesting that macroeconomic policies that promote low inflation and stable output growth do boost credit expansion. The results also indicate moderate persistence in profitability¹⁴. The paper gives some support to a policy of imposing higher capital requirements in the region to strengthen financial stability”.

The impact of monetary policy shocks on output and prices in Nigeria, using structural vector auto regression (SVAR) model and assumed that the unexpected changes in output and price within that period remained untraced by the central bank²⁵. The study conducted with the three major alternative policy instruments, broad money (M2), Minimum Rediscount Rate (MRR) and the real effective exchange rate (REER) revealed their effects on output and prices⁴⁹. “The quantity-based nominal anchor (M2) has modest effects on output and prices with a very fast speed of adjustment. While innovations on the price-based nominal anchors (MRR and REER) have neutral and fleeting effects on output, they finally concluded that (M2) is the most influential instrument with the central bankers for the monetary policy implementation and suggested that quantity based nominal anchor should be given more weight age compared to price based nominal anchor. Hence, it is imperative to correctly identify the impact of monetary policy changes to facilitate superior policy making¹¹⁹.”

Due to frequent changes in the banking industry the scope of banks has been strengthened in the monetary transmission mechanism, However; Monetary policy to a great extent regulates the borrower's dependency on banks credit and lending operations and the stance of restrictive monetary policy on economy may be well influenced by the banks credit channel⁵². Banks undergo structural changes by altering their credit channels to enforce the monetary policy stance⁵¹. The research paper analyzed that the constrained monetary policy had little significance on the bank lending. "Some borrowers are dependent on bank credit and sudden disruptions in bank lending could alter their spending decision and affect the level of economic activity"¹¹⁷. In some research paper attempt to test the "hypothesis that in the context of a relatively developed banking system and effective monetary policy framework the speed of adjustment of the deposit rates would be faster than that of the lending rates in response to a change in monetary policy instrument such as the discount rates. This knowledge of the speed of adjustment is crucial for an effective transmission and implementation of a change in monetary policy instrument¹²⁰.

The test of hypothesis on a set of industrial and developing countries based on the 'Auto-Regressive Distributed Lag' (ARDL) methodology tends to suggest that the deposit rates adjust faster than the lending rates in most of the industrial countries as well as in those developing countries in which the banking system appears to be relatively more developed³³. The findings are plausible and have strong policy implications for both the industrial and developing countries." However, the overall monetary and macroeconomic condition in India were found to be satisfactory and in line with the monetary policy expectations⁵⁶. However, some need was felt for the advancement in the financial sector reforms with the ongoing watch on domestic and external situation by the RBI. Monetary policy supports the provision of adequate liquidity to facilitate credit growth and investment demand in the economy with cautiously watching the fluctuations in the price level that specifically looked at how bank

business lending responds to monetary policy tightening. They found that banks' lending does not decline when policy is tightened⁴⁰. They concluded that the entire decline in total lending comes from a reduction in consumer and real estate loans. The banks' lending may respond to a tightening of monetary policy. They found that when policy is tightened, both total loans and business loans at small banks fall, while loans at large banks are unaffected. The differential in the response of small banks may indicate they have less access to alternative funding sources than large banks and so are less able to avoid the loss of core deposits when policy is tightened¹²¹.

The impact of monetary policy on the profitability of banks in India between 1995 and 2000, the monetary variables were banks rate, lending rates, cash reserve system and statutory ratio, and each was regressed on banks profitability independently. Lending rate was found to exact positive and significant influence on banks' profitability, which indicates a fall in lending rates will reduce the profitability of the banks. Also, bank rate, cash reserve system and statutory ratio were found to have negative and significant effect on the profitability of banks. Their findings were the same when lending rate, bank rate, cash reserve system and statutory ratio were pooled to explain the relationship between banks profitability and monetary policy instruments in the private sector¹⁶.

A study was carried out on the velocity and asymmetry in response of bank interest rates (lending, deposit, and inter-bank) to monetary policy changes from 1985-2002 using an Auto-regressive Vector Correction Model (AVECM) that allows for different behaviours in both the short-run and longrun⁵⁵. The study shows that the speed of adjustment of bank interest rate to monetary policy changes increased significantly after the introduction of the 1993 Banking Law, interest rate adjustment in response to positive and negative shocks is asymmetric in the short run, with the idea that in the long- run the equilibrium is restored.

They also found that banks adjust their loan (deposit) prices at a faster rate during period of monetary tightening in Italy⁴⁹. The constrained implication of monetary policy on bank lending in Ghana between 1998 and 2004, their study revealed that Ghanaian banks' lending behaviour is affected significantly by the country's economic support and change in money supply⁴⁵. Their findings also support the finding of previous studies that the Central Bank prime rate and inflation rate negatively affect bank lending. Prime rate was found statistically significant while inflation was insignificant. Based on the firm level characteristics, their study revealed that bank size and liquidity significantly influence bank's ability to extend credit when demanded⁵⁸.

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rate and monetary policy rate are true parameter of measuring bank performance⁴⁰. The effect of monetary policy instruments on banks performance with a view to determining the existence of long-run relation for the period 1980-2008. The Engle-granger two step cointegration approaches were adopted. The empirical estimates indicated that bank rate, inflation rate and interest rate are credit enhancing, while liquidity ratio and cash reserves ratio exerted negative effect on banks total credit¹¹.

Although, it was only cash reserve system and interest rate that were found to be significant at 5% critical value, main conclusion drawn was that monetary policy instruments are not effective to stimulate credit in the long-run, while banks total credit is more responsive to cash reserve system¹⁸. Moreover, it was suggested that the monetary authorities should moderate the minimum policy rate as a tool for regulating commercial banks operations and facilitating investment in the economy, the relationship between inflation and output, in the data and in standard models reporting that empirical cross-country studies generally find a nonlinear, negative relationship between inflation and output”; the relationship cannot be effectively reproduced by standard models due to their standard narrow assumption. He further concludes in his study that banking and financial regulations are significant enough than any other measure to gauge the impact of Monetary policy on growth³⁰.

The heterogeneous response of banks to the changes in the monetary policy plays a very crucial role in the transmission process of the policy²⁰. The banks response to the monetary policy stance related to the risk taking and lending issues depends on the internal factors for instance, liquidity with the bank, capitalization and the market power. The empirical analysis was based on the panel datasets of US and euro area, which reveals the difference in the responses of individual banks to the changes in the policy interest rates⁴⁵. “It is argued that the extensive heterogeneity in banks” response identifies overlooked consequences of bank

behavior and highlights potential monetary sources of the current financial distress.” In a comparative study on Private and Public Bangladesh commercial banks (BCBs). They focused their study on “asset and liability management and concluded that private BCB”s are far better in asset management than liability management when compared with public banks²⁹.

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compared to price based nominal anchor. Hence, it is imperative to correctly identify the impact of monetary policy changes to facilitate superior policy making¹⁰. The frequent changes in the banking industry the scope of banks have been strengthened in the monetary transmission mechanism. Monetary policy to a great extent regulates the borrower's dependency on banks credit and lending operations and the stance of restrictive monetary policy on economy may be well influenced by the banks credit channel. Banks undergo structural changes by altering their credit channels to enforce the monetary policy stance. The research paper analyzed that the constrained monetary policy had little significance on the bank lending⁵⁰.

Some borrowers are dependent on bank credit and sudden disruptions in bank lending could alter their spending decision and affect the level of economic activity.” In the context of a relatively developed banking system and effective monetary policy framework the speed of adjustment of the deposit rates would be faster than that of the lending rates in response to a change in monetary policy instrument such as the discount rates⁶. This knowledge of the speed of adjustment is crucial for an effective transmission and implementation of a change in monetary policy instrument. The test of hypothesis on a set of industrial and developing countries based on the 'Auto-Regressive Distributed Lag' (ARDL) methodology, tends to suggest that the deposit rates adjust faster than the lending rates in most of the industrial countries as well as in those developing countries in which the banking system appears to be relatively more developed⁵⁹. The findings are plausible and have strong policy implications for both the industrial and developing countries.” However, the overall monetary and macroeconomic condition in India were found to be satisfactory and in line with the monetary policy expectations⁴⁴.

However, some need was felt for the advancement in the financial sector reforms with the ongoing watch on domestic and external situation by the RBI. Monetary policy supports the provision of adequate liquidity to facilitate credit growth and investment demand in the economy with cautiously watching the fluctuations in the price level³. Varied results had been found on the effect of financial system deregulation on the performance of banking sector in Nigeria. Some studies found a positive effect of financial system deregulation on the performance of banking sector, while some studies show no effect and others found a negative effect².

The impact of deregulation of the economy on Nigeria commercial banks” they have it that deregulation was designed to restructure and diversify the productivity of the economy in order to reduce dependency on the oil sector and also to achieve fiscal and balance of payment viability. Deregulating the economy through the banking sector will go a long way in developing an efficient money market thereby improving the payment system in the economy¹³. The deregulation policy has improved the level of awareness of activities of banks among Nigerians. The Nigerian banking industry experienced tremendous growth during the period of deregulation in Nigeria economy from 1986. The important aim of monetary stability in Nigeria has not been attained after deregulation⁵⁸. Monetary growth was far more than targets and persistent inflationary pressures. Federal Government fiscal deficit, interbank rates climbed to an alarming rate which in turn affected other rates. Because the expected monetary stability failed to materialize, government resorted to issuing stabilization securities in 1990 and transferred government account from the banks to Central Bank of Nigeria²⁹.

On the other hand, the massive sets of regulations introduced by the regulatory bodies led to several introductions as bank and other financial institution came out with several new

products. These innovations have been largely responsible for the crashed financial institutions and banks⁶⁰. The effect of deposit money bank credit on the Nigeria economy growth, using gross domestic product (GDP) as an indicator of economic growth; while bank credit to private sector, interest and inflation rates as the independent variables¹⁷. They reported that commercial banks performance and healthy financial sector affects the growth of the entire economy. That the major function of commercial banks as financial intermediation involves channeling funds from the surplus units to the deficit unit of the economy, thus transforming deposit into loans or credits²⁸. The role of commercial bank credit in economic development has been recognized as credits are obtained by the various economic agents to enable them meet investment operating expenses⁴¹. The commercial banks also help to make these credits available by mobilizing surplus funds from savers who have no immediate needs for such funds and channel such funds in form of credit to investors who have brilliant ideas on how to create additional wealth in the economy but lack the necessary capital to execute the ideas⁵¹. The Nigerian Financial Sector Reforms Using Behavioural Models. This study supports the view that financial system deregulation promotes the efficiency of the financial intermediation process. The study found that the adoption of financial deregulation has triggered a significant realignment of financial depth, width, and savings mobilization. That financial liberalization promotes the efficiency of the intermediation process³⁹.

A study was carried out on impact of monetary policy instruments on profitability of commercial banks in Nigeria using the Zenith Bank Plc experience. The paper used descriptive research design. It utilized time series data collected from published financial statements of Zenith Bank Plc as well as Central Bank of Nigeria Bulletin from 2005 to 2012. Four research questions and four hypotheses were raised for the study. Pearson Product moment correlation technique was used to analyze the data collected while t-test statistic was

employed in testing the hypotheses. The study discovered that cash reserve ratio, liquidity ratio and interest rate did not have significant impact on the profit before tax of Zenith Bank Plc. However, minimum rediscount rate was found to have significant effect on the profit before tax of the bank. The paper concluded that a good number of monetary policy instruments do not impact significantly on profitability of commercial banks in Nigeria. The paper recommended that management of commercial banks in Nigeria should look beyond monetary policy instruments to enhance their profits⁴¹.

The impact of monetary policy changes on inflation and banking sector interest profitability in India. The banking system is the most dominant segment of the financial sector. Indian banks are well regulated and have emerged stronger under the regulator's watchful eye. Their unassailability could be well gauged by the health of an economy. The paper focuses to find out that whether the monetary policy instruments act as an important driver to regulate Inflation or recession in subsequent years and further to assess the extent to which it impacts the profitability status of the banks. The results suggest that there has been a significant impact of policy changes on the commercial banks interest profitability and the inflation. But when the policy tightens its stance, commercial banks have enough flexibility to re-adjust their lending rates and deposit rates to narrow down the impact on its profitability due to the hike in policy rates. Banks work in tandem to the monetary policies stance to bring out the desired result in the economy²⁶.

Effect of monetary policy instruments on banks performance was examined in this paper with the view to determine the existence of long-run relation between 1978 and 2008. The Engle-granger two-step cointegration approach was adopted based on the regression model that regress banks total loan and advances on minimum policy rate, cash reserves ratio, liquidity ratio, inflation and exchange rate. The empirical estimates indicated that bank rate,

inflation rate and exchange rate are total credit enhancing, while liquidity ratio and cash reserves ratio exert negative effect on banks total credit. Although, it is only cash reserve ratio and exchange rate found to be significant at 5% critical value. However, the cointegration test indicated that the null hypothesis of no cointegration was accepted. The main conclusion drawn is that monetary policy instruments are not effective to stimulate credit in the long run, while banks total credit is more responsive to cash reserve ratio. Then, it is proffered that the monetary authority should moderate the minimum policy rate as a tool for regulating commercial banks operations and facilitating investment in the economy³⁷.

The CAPM model was used to examine the property-liability insurance industry, and subsequently found a significant relationship between the expected return and systematic risk and unsystematic risk. Dependent variables are used reserve to liability ratio and equity ratio and independent variables are profit margin and returns on assets (ROA) as well as Structural formula modeling that involve factor-analysis as well as path-analysis. The research proposed 4 crucial results. Very first, based on the empirical outcome, the study design offers superb goodness-of-fit. In other words, utilizing several monetary indices superbly steps the particular monetary elements. 2nd, the administrative center framework exerts an adverse as well as substantial impact on functional danger. 3rd, there isn't any reciprocal relationship however the one-way impact in between funds framework as well as functional danger. 4th, the actual functional danger exerts an adverse as well as substantial impact on success³¹.

The capital structure and performance of firms, basically the aim was to check the relationship between debt level and financial performance of companies (listed at Egyptian stock exchange during the period of 1997 to 2005). By using the three-accounting based measure of performance (ROA) return on assets (ROE) return on equity and gross profit margin. He found that there is negative significant influence of short-term debt (STD) and

the Total debt (TD) on the financial performance measured by the return on asset (ROA) but no significant relationship was found between long term debt (LTD) and this measure of financial performance. He also proposed that there is not significant influence of the debt (TD, STD and LTD) on financial performance measured by both gross profit margin and return on equity. The results also indicated that control variable firm size has no significant effect on the firm's performance. In this research paper least squares regression model was used to check the performance of the firms³³.

A study was conducted on the relationship of capital structure and corporate performance of firms before and during 2007 crisis. All 49 construction companies are taken from Malaysia which were listed in Main board of Bursa Malaysia from 2005 to 2008. These forty-nine companies are divided in three units like small, medium and large or big size. Always financial crisis are occurred by the poor corporate performance, in the Malaysia construction industries and construction activities are the major source of growth and development in Malaysia, in this research (capital structure) independent variables are used Long term debt to capital (LDC), debt to capital (DC), debt to asset (DA), debt to equity market value (DEMV), debt to common equity (DCE), long term debt to common equity (LDCE) and (Corporate performance) dependent variables are return on capital (ROC), return on equity (ROE), return on asset (ROA), earnings per share (EPS), operating margin (OM) and net margin (NM). The pooling regression model is employed to test the influence of capital structure on the company's performance⁴³.

Capital structure (CS) and its impact on financial performance during 2005 to 2009 of business organizations in Sri Lanka. The result of research validated a negative relationship between capital structure (CS) and financial performances of the Sri Lankan companies. It was suggested that intellectual capital (IC) performance of Indian pharmaceutical and textile

industry. The data was gathered from the 105 pharmaceutical companies and 102 textile companies. Dependent variables used in this study includes MB (market to book value), ROA (return on Asset), ATO (asset turnover ratio) and ROE (return on equity), independent variables are PC, DER, VAIC and sales. Correlation and regression analysis were conducted to find the results. The use of MB as the market valuation is also debatable because the market sentiments of the stakeholders may not always consider financial statements of the company³⁰.

A study was conducted and a sample of French firms from low to high growth industries to investigate the relationship between efficiency, leverage, and ownership structure. The study reveals that higher leverage is associated with improved efficiency over the entire range of observed data. Strong positive correlation is evident from the empirical study when stratified by industry. This can be an important policy suggestion for finance director because they can use debt to form optimal capital structure to maximize wealth of shareholders. It was shown in the studies of Ahmad, *et al*, that only short-term debt and total debt have significant relationship with ROA while all capital structure indicators have significant relationship with ROE⁴⁴.

Specifically, a study was conducted on twenty-eight companies listed on the Palestinian Stock Exchange between 2006 to 2010 using accounting and market performance measures (ROE, ROA, EPS, Market value to book value of equity and Tobin's Q) and four capital structure measures (STD, LTD, Total debt to total assets and Total debt to total equity)¹⁵. The results showed a positive significant relationship between firm's capital structure and their performance. This result is at variance with a study on firms operating in Nigerian petroleum industry and find a positive relationship between EPS, DPS and leverage ratio and finds leverage ratio having significant impact on both EPS and DPS. Alternatively, evaluates the

impact of capital structure choice on firm performance using a sample of non-financial companies listed on Egyptian Stock Exchange Market from 1997 to 2005 using three accounting-based measures of financial performance (ROE, ROA, and Gross profit margin). His finding showed an insignificant relationship between all measures of capital structure and return on equity, as well as gross profit margin. The results were consistent with those of Mahira²¹.

A research on 30 non-financial firms listed on the Nigerian Stock Exchange over a period of eight years (2001-2007). With the use of return on assets (ROA) and return on equity (ROE) as performance measures, and debt ratio as capital structure measure, they found a significant negative impact of debt ratio (DR) on ROA and ROE. The result was in support of the agency cost theory⁶.

A study was conducted and a sample of French firms from low to high growth industries to investigate the relationship between efficiency, leverage, and ownership structure. The study reveals that higher leverage is associated with improved efficiency over the entire range of observed data¹⁹. Strong positive correlation is evident from the empirical study when stratified by industry. This can be an important policy suggestion for finance director because they can use debt to form optimal capital structure to maximize wealth of shareholders. It was shown in the studies of only short-term debt and total debt have significant relationship with ROA while all capital structure indicators have significant relationship with ROE⁷.

A study on 30 non-financial firms listed on Nigerian Stock Exchange from 2004-2010. The result of their research showed that capital structure represented by debt ratio had a significant negative impact on firms' financial performance¹⁸. Examined 240 non-financial firms listed on the Karachi Stock Exchange (KSE) Pakistan over a span of six years from 2004-2009. The performance measures used by them were accounting based (ROA, Total

debt ratio, Long and Short-term debt ratio) and market-based measure (market-to- book value ratio). Empirical outcomes show that all measures of capital structure (total debt ratio, long and short-term debt ratio) are negatively related to return on assets. Additionally, total debt ratio and long-term debt ratio are negatively related to market-to- book ratio⁴⁵.

A study was conducted on the relationship between capital structure and performance of listed banks in Ghana from 2000 to 2010. The results revealed that banks listed on the Ghana Stock Exchange are highly geared and this is negatively related to the banks' performance. The regression results also revealed that capital structure is inversely related to performance of the listed banks in term of ROE and Tobin's Q32. Another study by Pratheepkanth business companies in Sri Lanka from 2005 to 2009 using regression analysis finds that return on investment (ROI) and return on asset (ROA) have negative relationships with capital structure²³. This finding is also similar to that of 43 evaluates the effects of debt and equity financing on corporate performance revealing that capital structure have significantly negative consequence on corporate performance. Henceforth, the study shows that it is risky for companies to depend entirely on either debt or equity for raising capital, but it is far better to raise capital by both methods, with each employed together, at the same time. This method is better as it affords the benefit of one method offsetting the problems of the other and vice versa. On the other side, some empirical studies have shown no significant relationship or mixed evidence between capital structure and firm performance. For instance, thirteen (13) respondents were examined on the impact of capital structure on the value of firm using seventy-seven (77) nonfinancial firms from four different key sectors of Bangladesh capital market. The study concludes that the best use of wealth of shareholders needs a perfect mixture of debt and equity, while cost of capital has a negative correlation in this decision and it has to be as minimum as possible. It was further seen that by changing the capital structure composition a firm can increase its value in the market.

Since the establishment of the link between finance and economic growth, several studies had been conducted in the area. The outcome showed how the banking reforms benefitted the populace by reverting the unbecoming economic indices. Few among the extant empirical literature are reviewed in this work. The financial liberalisation, debt mismatch, allocated efficiency, and growth in the United States (US) using a two-sector model. The model comprises elements of credit market game with a two-sector endogenous growth model. The study found that financial liberalisation increases growth but leads to more crises and costly bailouts. The study further asserts that liberalisation preserves financial discipline and may increase allocative efficiency, growth, and consumption possibilities⁴³.

The capital investments financing in Nigeria was conducted using annualised data of 32 years from 1981. The study employed regression model as the analysis tool. It found that banks have contributed much in financing capital investment and stock market development in Nigeria. It recommends that financial institutions should be encouraged to mobilise more deposit for lending that will aid capital investment and that the apex bank should reduce its minimum rediscounting rate¹²².

Also, the impact of financial liberalisation on banking sectors performance was conducted in Central and Eastern European countries using a two-stage empirical model with data covering the period of 2004 – 2008. The study used Ordinary Least Square (OLS) as a feeder model. It measures banks performance using cost efficiency and total productivity growth index –through the Malmquist index. The Chinn- Ito index was used to assess the level of financial openness. It made use of return on assets and ratio of equity to assets to compute bank stability using Z-score as a popular method in the financial literature. The study found that the financial liberalisation improves cost efficiency of banks and openness is able to increase cost efficiency and finally, the institutions will be able to offer cheaper services to

clients. It concludes that the level of banking reform and interest liberalisation indicator has a positive impact on the total productivity growth of banks¹²³. Further, it asserts that the important factors shaping the total productivity are merely the banking system characteristics and bank-specific variables, and the only macroeconomic variable with impact is the GDP growth rate¹²⁴.

The relationship between financial development and economic growth in a panel was conducted in 52 middle-income countries over the period of 1980 – 2008. The study used pooled mean group estimator in a dynamic heterogeneous panel setting. The study found that financial development does not have a linear positive long-run impact on economic growth, and in a non-linear relationship between financial development and economic growth, it found an inverted U-shaped relationship between finance and growth in the long run but an insignificant relationship between the two in the short run. The study concludes that middle-income countries face a threshold point after which financial development no longer contributes to economic growth¹²⁵.

The financial intermediation and economic growth was conducted in Nigeria using annual data from 1970 to 2010. The study adopted Ordinary Least Square and Error Correction Model using Engle-Granger technique for data analysis. The study found that only broad money supply by promoting economic growth through the efficient allocation of resources¹²⁶. Also, the effect of banking sector reforms on economic growth was conducted in Nigeria using annualised data over the period of 1999 – 2009. The study adopted OLS regression technique. The study found that interest rate margins, parallel market premiums, total banking sector credit to the private sector, inflation rate, size of the banking sector, capital and cash reserve ratios account for a very high proportion of the variation in economic growth in the country¹²⁷. The study reviewed empirical studies on financial intermediation by

banks on economic growth gives attention to the issues of causality, non-linearity, time perspective, financial intermediation proxies, and interaction terms. The study concludes that there are still quite a few unresolved issues in the link between financial intermediation by banks and economic growth¹²⁸. However, the study recommends a careful study on the relationship between government and banks, to unravel why finance spurs growth in one country and not in others. The study concludes that financial intermediation positively impacts economic growth in the country. Thus, it recommends component analysis for the real sector because between the years 2004 to 2007, the sector received more loans but recorded the worst average annual growth rate in the manufacturing capacity utilisation rate¹²⁹.

Another study was carried out on extensive review of the empirical studies as it relates to financial development and economic growth at global level. A larger percentage of the empirical works buttress the existence of a positive relationship between financial development and economic growth. Even though, some argue that the relationship is finance-led growth, while some argue otherwise, that is growth-led finance. The study concludes that the development of the domestic financial sector is significant in affecting the pattern of economic growth¹³⁰.

Also, a study was conducted and the emphasis of the significance of financial sector reforms on funds intermediation, accumulation of capital, and economic growth. They posited that it was deregulation of financial segments of the economy in many emerging economies in South America, Southeast Asia, and Eastern Europe that led to the quantum leap in their economic growth and development¹³¹. The nature and extent of the impact of financial sector reforms on economic growth in Cameroon. Data were gathered from 1980 to 2015. The researcher adopted Vector Autoregressive (VAR) technique. It was discovered that more than

70% of variations in real GDP was accounted for lagged financial sector development indicators. The research concluded that there was a strong positive long run relationship between financial sector development and economic growth in Cameroon¹³². The significance of financial segment deregulation for investible funds mobilization, efficient allocation of resources to the real sector, and economic growth. They stated that the need to eliminate restrictions from the financial segment of many countries was well deserved. Such courses of actions led to growth of the economy in the long run. Therefore, this was the motivating force behind financial deregulation policies in many countries across the world especially in Asia, Africa, and South America¹³⁴.

The view that the ability of the financial system to enhance the liquidity of securities and stimulate savers to hold their wealth in productive assets (debentures, stocks, and preferential stock) would be greatly enhanced. It led to increase in productive capacity and investment with a resultant increase in economic growth¹³⁵. The effectiveness of financial reforms towards economic growth was conducted in Nigeria They used Error Correction model approach. The findings showed that continuous fall in real deposit rate led to low mobilization of credit in the economy. This resulted in not too impressive performance of GDP. Therefore, it was recommended that reforming of interest rates stimulated savings, credit, and investment level¹³⁵.

The relationship between financial development and economic growth was conducted in Ghana. The research adopted Autoregressive Distributed Lag (ARDL) bound testing approach. They used GDP per capita as a growth indicator. They discovered that there was a long run relationship between economic growth and financial reforms. They suggested that financial sector policy makers should focus on reforms. It would stimulate credit expansion

and investment level and increase productive capacity of the economy and per capita income¹³⁶.

Moreover, used data that covered the period between 1960-2005 for Latin America countries¹³⁷. Using cross-section econometric model, they highlighted the leading roles played by financial institutions and policy reforms on economic growth. The study found out that despite of reform initiatives taken by governments of these countries, the economic performance of South America countries during the 1990s was not impressive. However, Chile economy grew almost 7% per year during the period. The better performance achieved by Chile in comparison to other Latin America countries during the period could be explained by the formulation of growth-enhancing policies and more efficient financial institutions. They consequently suggested that other countries in the region should emulate Chile's model by strengthening their financial institutions. If this were done, it would increase the investment level and boost economic growth and development.

The empirical study conducted in Zambia used a two-step procedure to investigate the impact of financial sector deregulation on banks performance and economic growth. They revealed that banking system cost efficiency was generally increased over time. However, the overall performance of banks was not encouraging. Their findings showed conflicting results that were not in compliance with theoretical expectations. There have been conflicting results from different studies, especially developing economies on the relationship between financial reforms and economic growth. However, from most studies, there is a causal link between financial sector reforms and economic growth. Most of the previous researchers focus on the relationship between financial reforms and economic growth in Nigeria using single variable for the period they covered¹³⁸.

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2.4 Conceptual Model

This framework established the relationship between financial deregulation and the performance of selected Nigerian Deposit money banks, indications of the parameters shows that financial deregulation is Independent variable which the dependent variable relies on the variables to determine the banking sector performance in Nigerian selected Nigerian Deposit money banks.

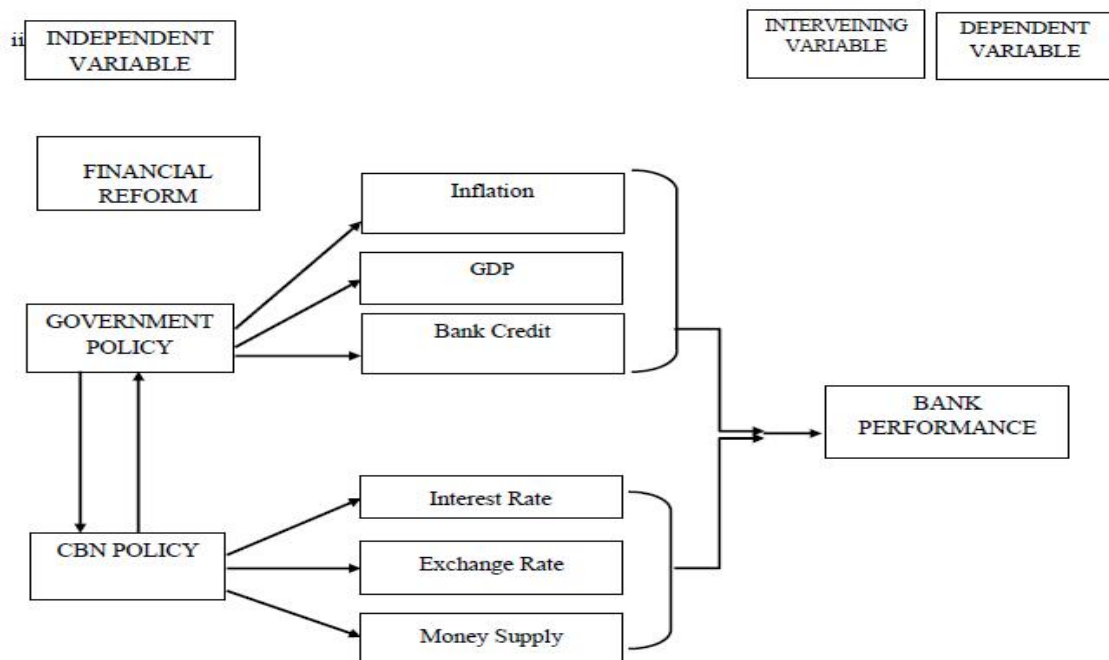


Figure 2.1: Framework for the study (Researcher, 2022)

2.5 Summary of Literature Reviewed

In literature public policy paradigm on banking regulation has shifted from economic regulation to deregulation and prudential re-regulation. On one hand the economic justification of financial deregulation is based on the presumption that deregulation fosters bank competition, which in turn may engender bank productive efficiency. Bank

competition is seen as a stimulus to exert downward pressure on costs, reduce managerial slacks and even incentivize innovation¹⁰⁷. On the other hand, concern about the adverse impact of increased competition on bank risk taking behavior has motivated the adoption of prudential re-regulation alongside deregulation. Although prudential re-regulation is designed to mitigate excessive risk taking and foster stability, it may impose higher regulatory costs and hamper competition. Therefore, such a mixed process of deregulation and prudential re-regulation may have opposite effects on bank performance.

It is curious that there is hardly any clear-cut evidence on what in theory, are opposite effects of policy reforms on these key aspects of bank performance. That is to say that the evidence is inconclusive. The deregulation described as the period of deregulation ended up with so many regulations aimed at correcting the distortions caused by regulatory controls. This is understandable because in order to change the old “ rules of the game “ new ones have to be put in place and this requires new regulations. The period generally referred to as the SAP period in Nigeria was designed to alter the structure and operational mechanism of the financial system among other objectives. The foreign exchange market and interest rate structure became important targets. In 1982 the country returned to stricter exchange control practices as a budgetary instrument to limit the country’s foreign exchange expenditure, in line with the declining foreign exchange earnings worsened by the civil war. The foreign exchange control measures were complemented by the various trade restrictions and by 1983 there were as many as 182 commodities added to the lists of imports requiring licenses¹¹⁸. While there have been claims that Nigerian banks have performed better since deregulation, some others have maintained that this applies only to private rather than public banks, the call for government divestment in the interest of Nigerian banks has been made in line with the policy thrust of SAP. From another perspective, it has been argued that continued government involvement in the ownership and operations of banks, especially the

larger ones (which by their age account for about 40% of the total assets of all banks), hindered their effective supervision thereby increasing the risk of failure and erosion of public confidence in the banking system. Hence, bank performance, its determinants and trends over the transition from a regulated to a deregulated economy, as well as the demands the transition makes on the supervisory authorities, requires greater attention. More than ever before, the preparedness and ability of the CBN to effectively supervise and conduct monetary policy in the resultant unprecedented expansion form the thrust of this study.

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Chapter Three

Methodology

3.1 Research Design

A correlational and expo facto research design is adopted for the study. The design is considered appropriate because the interest of the researcher is to examine the stability of financial reform on deposit money bank, and to check the effect of the financial deregulation on the economy development of Nigeria deposit money bank, also to ascertain the challenges of financial deregulation of the performance of the Nigeria deposit money bank and also asses the relationship between financial deregulation and profitability of Nigeria deposit money bank. It also suits the paradigm of the study which has positivist approach thus requiring a qualitative data to test the hypotheses. Panel data design is chosen because of the nature of the data to be used for this study, which is simply the audited annual report and accounts of selected NDMBs. Justifiably; it is not only being considered as a powerful and strong research instrument, but also most recent and efficient analytical methods in handling econometric data of this nature¹.

3.2 Population of the Study

Population of the study consisted of twenty-one (21) NDMBs registered and licensed by the CBN quoted and on the floor of the Nigerian Stock Exchange (NSE) as specified on its official website as at November, 2020. Most of these banks have also been in existence over the entire ten (11) year study period (2010-2020).

Table 3.3 List of Quoted NDMBs on the Floor of NSE

S/N	Nigerian Deposit Money Banks	Quoted/ Unquoted
1	Access Bank Plc	Quoted
2	Citibank Nigeria Limited	Unquoted
3	EcoBank Nigeria Plc	Quoted
4	Enterprise Bank	Unquoted
5	Fidelity Bank Plc	Quoted
6	First Bank Nigeria Limited	Quoted
7	First City Monument Bank Plc	Quoted
8	Guaranty Trust Bank Plc	Quoted
9	Heritage Banking Company Limited	Unquoted
10	KeyStone Bank	Unquoted
11	Mainstreet Bank	Unquoted
12	Polaris bank	Quoted
13	Stanbic IBTC Bank Limited	Quoted
14	Standard Chartered Bank Nigeria Limited	Unquoted
15	Sterling Bank Plc	Quoted
16	SunTrust Bank Nigeria Limited	Unquoted
17	Union Bank of Nigeria Plc	Quoted

18	United Bank for Africa	Quoted
19	Unity Bank of Nigeria Plc	Quoted
20	Wema Bank Plc	Quoted
21	Zenith Bank Plc	Quoted
22	Tajbank Limited	Unquoted
23	Jaizbank bank	Unquoted
24	Titantrust bank	Unquoted
25	Globus bank	Unquoted
26	Providus bank	Unquoted
27	Coronation bank	Unquoted
28	FBNQuest Merchant bank	Unquoted
29	Rand bank	Unquoted
30	FSDH bank	Unquoted
31	Nova bank	Unquoted

Source: CBN (2020).

3.3 Sampling and Sample Techniques

In arriving at the sample size for this study, a simple random sampling technique was employed after segregating banks into either “old or new” generation criteria based on their year of existence. A simple random sampling technique is the one that allows all the members of the entire population have equal chances of being selected since they all possess factually the same characteristics. The sample size for this study will be twenty (21) banks selected randomly using initial segregation into “old and new” generation banks

categorization. Banks that have been in existence before the 2004 CBN consolidation exercise and still survived it are categorized as “old generation” while those that came up after the exercise are categorized as “new generation”. Seven (7) banks will be randomly selected from each category to make up the fourteen (14) banks. Some other criteria which will be used to arrive at the sample size will be for those banks which have their annual report and accounts readily accessible for the study period (2010 - 2020) and to have been quoted on the floor of the NSE.

3.4 Instrument for Data Collection

Data collecting entails obtaining relevant and essential information for a certain study project. It is the foundation for data collection. Primary data and secondary data are the two types of data that may be gathered. This study will use panel data mainly from secondary sources of data, which will be extracted from audited annual financial reports of selected Nigerian Deposit Money Banks on Nigerian Stock Exchange for the period 2010-2020 for the independent variables. Secondary data will be considered more appropriate, since the variables of the study can be best measured using financial information available in the financial report of the selected Nigerian Deposit Money Banks.

3.5 Pilot Study

It's a good idea to do pilot studies before moving on with a larger, more comprehensive research, such as a randomized controlled trial (RCT). Using them, for example, may help forecast the right sample size for the entire project and/or enhance the research design in numerous ways. Therefore, a pilot study is being performed to test the hypothesis (s) to determine whether the full-scale research can be carried out as planned.

3.6 Model Specification

Models for this study were adapted, with little modifications, from findings in prior studies on the relationship between financial deregulation and banking sector performance in Nigeria. These studies emphasized all the major dimensions that describe the relationship between the identified study variables. Hence, the study employed the following models in relation to each of the research objectives.

In order to examine the relevance of financial sector reforms on economic development of Nigeria in objective one of the study, the following model-equation was designed;

$$GDP_{it} = \beta_0 + \beta_1 EXR_{it} + \beta_2 INR_{it} + \beta_3 ITR_{it} + \beta_4 BC_{it} + \epsilon_{it} \dots \dots Eq (3.1)$$

An examination to ascertain the effects of financial deregulation on the performance of the Nigerian deposit money bank in objective three adopt the following model (2)

$$INR_{it} = \beta_0 + \beta_1 ITR_{it} + \beta_2 EXR_{it} + \beta_3 BC_{it} + \beta_4 PROF_{it} + \epsilon_{it} \dots \dots Eq (3.2)$$

An assessment of the significance of financial deregulation on the profitability of Nigerian deposit money bank will be the focus of model (3).

$$ITR_{it} = \alpha_0 + \eta_1 INR_{it} + \eta_2 PROF_{it} + \eta_3 BC_{it} + \eta_4 EXR_{it} + \epsilon_{it} \dots \dots Eq (3.3)$$

Where:

GDP – Gross Domestic Product

INR – Inflation Rate

ITR – Interest Rate

BC – Bank Credit

EXR – Exchange Rate

PROF – Net Profit after Tax and Interest

LEV – Leverage

ϵ_{it} - Error Term

α - Intercept

β, η – Coefficient

Apriori Expectation $\beta_1 \beta_2 \dots \beta_n > 1$

3.7 Method of Data Analysis

Model shall be adopted in the study to make surmising on financial regularization in the NDMBs. ITR, EXR BC, PROF, MS and IR is the independent variable in the study while financial sector performance is the dependent variable. Specifically, Pearson Product Moment Correlation Coefficient (PPMCC) will be used to analyze the nature of the relationship between board size and performance of selected post consolidated NDMBs. General least square (GLS) multiple regression analyses will be utilized to dissect the panel data based on random effect model utilizing STATA 10. The random effect is shown up at from the result of Durbin-Wu-Hausman test which settled on it conceivable to settle on a decision between the fixed effects model and random effects model².

Apart from GLS, other supportive analyses will be carried out like descriptive statistics which provide information on mean, standard deviation and minimum and maximum values in the set of data analysed. Also, the correlation matrix results will be produced in order to understand the interrelationship between variables. Moreover, the Breusch-Pagan/Cook-Weisberg tests for heteroskedasticity and multi-collinearity test for auto correlation will be

carried out to ensure the fitness of the model.

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Endnotes

1. M.D., Alhassan, F.K., Anokye, & E.D., Gakpetor. *The Impact of Interest Rate Spread on Bank Profitability in Ghana*. **European Journal of Business, Economics and Accountancy**, 6(1), 2018, pp. 67-89.
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Chapter Four

Results and Discussion of Findings

4.1 Presentation of Data

Data obtained from secondary sources were analyzed in relation to the various objective of the study. This part of the study is divided into two; the first part gives the descriptive analysis while the second part gives the inferential statistical analysis of the data followed by discussion of findings.

4.1.1 To Assess the Stability of Financial Sector Reforms on Deposit Money Bank in Nigeria

This section present and analyze the descriptive and regression analysis of the variables relating to the relevance of financial sector reforms on economic development of Nigeria.

4.2 Data Analysis, Interpretation

4.2.1 Descriptive Statistics of the Variables

Presented in Table 4.1 is the descriptive statistics of the variables. The result shows that Gross Domestic Product (GDP) has a mean value of (N716.009billion), maximum and minimum value of (N950.11billion) and (N527.58billion) respectively. The standard deviation of (143.1997) shows there is significant deviation from the mean. Exchange rate (EXR) has a mean value of (1233.737), maximum value of (2078.31) and minimum value of (400.41). The standard deviation of (578.56) shows a significant dispersion from the mean. Inflation rate (INR) has a maximum value of (249798.2) and a minimum of (42802.99). The standard deviation of (76139.38) shows a significant dispersion from the mean value (120143.5). Interest rate (ITR) has maximum and minimum values of (57990.2) and (20730.6)

respectively with a mean value of (30629.69). The standard deviation of (11518.5) shows a significant deviation from the mean. Bank credit (BC) variable has mean value of (206.3), a maximum value of (215) and a minimum value of (192). The standard deviation of (8.628763) shows significant dispersion from the mean.

Table 4.1 Descriptive Analysis of Variables showing the relevance of financial sector reforms on Deposit Money Bank in Nigeria

Variable	Observation	Mean	Standard Deviation	Minimum	Maximum
Year	10	2008.5	3.02765	2004	2013
GDP	10	716.009	143.1997	527.58	950.11
EXR	10	1233.737	578.5552	400.41	2078.31
INR	10	120143.5	76139.38	42802.99	249798.2
ITR	10	30629.69	11518.5	20730.6	57990.2
BC	10	206.3	8.628763	192	215

Source: Researcher’s Computation, 2022

4.2.2 Regression Analysis of the Relevance of Financial Sector Reforms on Deposit Money Bank in Nigeria.

A multiple regression analysis whose equation is presented below found that the coefficient of determination (R-square) is 0.9132. This shows that the predictive power of the independent variable (financial sector reforms) as used to explain variation in the dependent variable (Deposit Money Bank proxied by GDP) is about 91% with a high adjusted R-square of (0.8438). The combined P value of 0.0073 and F-Value of 60.43 shows that financial sector reforms affect deposit money banks Nigeria by the variables examined. The regression equation is as shown below.

$$\text{GDP}=1468.087+0.2810\text{EXR}+0.00059\text{INR}-0.0104\text{ITR}-3.8632\text{BC} \dots\dots 4.3$$

The result shows that EXR shows a positive contribution of 28%, INR had a marginal positive contribution of about 0.059% to the variation in GDP. ITR indicated a negative but marginal contribution of 1.04% to changes in GDP while BC showed a negative contribution of about 3.863 to changes in GDP. The regression table is as shown below:

Table 4.2 Results of the Regression Analysis Showing the Stability of Financial Sector Reforms on Deposit Money Bank in Nigeria

Dependent variables	Independent variables	Coefficient	Standard Error	T	p> t	[95% interval]	conf.
GDP	EXR	.2899558	.0689144	4.21	0.008	.1128057	.467106
	INR	.0000599	.0003994	0.15	0.887	-	
						.0009667	.0010865
	ITR	-.0104484	.0025184	-4.15	0.009	-.0169223	-
						.0039746	
	BC	-.863164	2.643678	-1.46	0.204	-10.65895	
						2.932626	
	Constant	1468.087	551.2917	2.66	0.045	50.94668	2885.228
R-squared =0.9132 Adj. R-squared = 0.8438 P≤0.05 F (4,5)= 60.43							

Source: Researcher's Computation, 2022

4.2.3 Pairwise Correlation showing the Relevance of Financial Sector Reforms on Deposit Money Bank in Nigeria.

A pairwise correlation test between the variables indicates similar result given correlation between GDP and other explanatory variables. The coefficient of correlation (R) between EXR and GDP is (0.6604), an indication of significant and positive relationship. INR has a moderate positive correlation of (0.4038) with GDP and the variable ITR has a weak correlation coefficient of (0.0148) with GDP. BC shows a negative but moderate correlation coefficient of (0.5974) with GDP.

Table 4.3 Result of Pairwise Correlation showing the Relevance of Financial Sector Reforms on Deposit Money Banks Nigeria

GDP	EXR	INR	ITR	BC	GDP
GDP	1.0000				
EXR	0.6604*	1.0000			
INR	0.4038	0.7389*	1.0000		
ITR	0.0148	0.7184*	0.5791	1.0000	
BC	-0.5974	-0.2973	0.0301	0.0207	1.0000

Source: Researcher's Computation, 2022

4.3 Test of Hypotheses

Hypothesis One

Decision criteria: if $F_{calc} > F_{tab}$; reject Null hypothesis and accept alternative hypothesis.

If $F_{calc} < F_{tab}$; accept Null hypothesis and reject alternative hypothesis.

H₀1: Financial sector reforms has no significant relevance on deposit money bank of Nigeria

Decision Criteria:

With a calculated F-value of 60.43 as compared with a tabulated F-value of 5.19 (at 5% level of significance), the null hypothesis is rejected while the alternative hypothesis is accepted, with the conclusion that financial sector reforms have no significant relevance on deposit money bank of Nigeria

4.3.1 To Examine the Effects of Financial Deregulation of the Performance of the Nigerian Deposit Money Bank

To examine the effect of financial deregulation on the Nigerian deposit money bank performance

Descriptive Analysis of the Study Variable

Table 4.4 presents the descriptive statistics. As observed, Inflation rate (INR) has a mean value of (N9398.08billion), minimum value of (N2112.5billion) and maximum value of (N19077.4 billion). This shows that the value of INR has increased considerably within the study period. The standard deviation of (N5348.566billion) is considerably low and suggests a little deviation from the mean. Interest rate (ITR) has maximum and minimum values of (57990.2) and (20730.6) respectively with a mean value of (30629.69). The standard

deviation of (11518.5) shows a significant deviation from the mean. The variable Exchange rate (EXR) has maximum and minimum value of (249798.2) and (10689.7) respectively with a standard deviation of (80325.93) which shows a significant deviation from the mean value of (116932.2). Bank credit (BC) variable has mean value of (206.3), a maximum value of (215) and a minimum value of (192). The standard deviation of (8.628763) shows significant dispersion from the mean. The other variable Profitability (PROF) has a mean value of (1130975), maximum and minimum value of (4021780) and (973526) respectively. The standard deviation of (1130975) exhibited significant dispersion from the mean.

Table 4.4 Descriptive Analysis of Variables showing the Effect of Financial Deregulation on the Nigerian Deposit Money Bank Performance

Variable	Observation	Mean	Standard Deviation	Minimum	Maximum
Year	10	2008.5	3.02765	2011	2020
INR	10	9398.08	5348.566	2112.5	19077.4
ITR	10	30629.69	11518.5	20730.6	57990.2
EXR	10	116932.2	80325.93	10689.7	249798.2
BC	10	206.3	8.628763	192	215
PROF	10	2143988	1130975	973526	4021780

Source: Researcher's Computation, 2022

4.3.2 Regression Analysis showing Effect of Financial Deregulation on the Nigerian Deposit Money Bank Performance

Findings based on the result obtained indicate that R-square= 0.8526, which implies that approximately 85% of the variation in the dependent variable (cashless policy) is caused by the explanatory variables included in the model and remained robust at 0.7346 after adjusting for degree of freedom. Moreover, the explanatory variables are jointly significant at 5% level

as captured by F-statics (70.73) with a corresponding P-value of the 0.0261. The general model of the equation is presented in equation 4.2 below:

$$\text{INR} = -64093.36 + 0.1188681\text{ITR} + 0.0578191\text{EXR} - 294.3442\text{IBC} - 0.0020401\text{PROF} \dots (4.2)$$

The result implies that two of the four explanatory variables are significant in explaining variation in INR. These are EXR and BC with a t and p values of (3.48 and 0.018) and (-2.76 and 0.040) respectively. Moreso, two of the variables (ITR and EXR) shows positive effect on MCAP, while the other two variables (BC and PRO) exhibit positive effect. A unit increase in EXR and IFR will lead to (0.1189) and (0.0578) increase in INR respectively. Furthermore, BC and PROF were found to have negative coefficient of -294.34 and 0.00204 respectively. However the combined statistics shows that there is a significant relationship between financial deregulation AND the Nigerian deposit money bank performance given $F(4, 5) = 70.23$ and P-value of 0.0261.

Table 4.5 Result of Regression Analysis showing the Effect of Financial Deregulation on the Nigerian Deposit Money Bank Performance

Dependent variables	Independent variables	Coefficient	Standard Error	T	p> t 	[95% conf. interval]
INR	ITR	.1188681	.1002932	1.19	0.289	- .1389438 .3766799
	EXR	.0578191	.0166172	3.48	0.018	.0151031 .100535
	BC	-294.3442	106.5641	-2.76	0.040	-568.276 -20.4125
	PROF	-.0020401	.0011419	-1.79	0.134	- .0049753 .0008952
	Constant	64093.36	22071.47	2.90	0.034	7356.837 120829.9
R-squared = 0.8526 Adj. R-squared = 0.7346 P ≤ 0.05 F (4,5) = 70.23						

Source: Researcher's Computation, 2022

4.3.3 Pairwise Correlation showing the Effect of Financial Deregulation on the Nigerian Deposit Money Bank Performance

Moreover, the pairwise correlation test between the study variables further affirms the relationship between international trade and economic growth in Nigeria. The correlation coefficient (R) between INR and ITR was found to be 0.5157, an indication of moderate positive relationship between the two variables. EXR shows a significant positive correlation coefficient of 0.7100 with INR. BC shows negative coefficient of -0.4680, while PROF and INR exhibit a positive but insignificant correlation with a coefficient of 0.2741 as shown in table 4.6 below:

Table 4.6 Result of a Pairwise Correlation showing the Effect of Financial Deregulation on the Nigerian Deposit Money Bank Performance

INR	ITR	EXR	BC	PROF	INR
GDP	1.0000				
EXR	0.5157	1.0000			
INR	0.7100*	0.5750	1.0000		
ITR	-0.4680	0.0207	0.0250	1.0000	
BC	0.2741	0.5328	0.6808*	0.0467	1.0000

Source: Researcher’s Computation, 2022

Test of Hypothesis Two

Decision criteria: if $F_{calc} > F_{tab}$; reject Null hypothesis and accept alternative hypothesis.

If $F_{calc} < F_{tab}$; accept Null hypothesis and reject alternative hypothesis.

H₀₂: Financial deregulation in Nigerian deposit money bank does not affect the trends of Nigerian Deposit Money Banks

Decision Criteria

With a calculated F-value of 60.43 as compared with a tabulated F-value of 5.19 (at 5% level of significance), the null hypothesis is rejected while the alternative hypothesis is accepted, with the conclusion that financial deregulation in Nigerian deposit money bank affect the trends of Nigerian Deposit Money Banks

4.3.4 Significance of Financial Deregulation on the Profitability of Nigerian Deposit Money Bank

Presented in this section are the descriptive and regression analysis of the significance of financial deregulation on the profitability of Nigerian deposit money bank.

4.3.4.1 Descriptive Analysis of the Study Variables

In the descriptive statistics as shown in table 4.7 below, Interest rate (ITR) which serves as proxy environmental sustainability has a mean value of (35373.36), maximum and minimum value of (80092.56) and (11411.07). The standard deviation of (25684.8) shows there is significant deviation from the mean. Inflation rate (INR) has a maximum value of (343.70) and a minimum of (48.6). The standard deviation of the variable is (108.013) showing that there is considerable dispersion from the mean value of (160.11). Profitability (Prof) has a mean of (783.26) with a maximum and minimum value of (1179.7) and (332.1) respectively. The standard deviation of (293.1935) is considerably low and suggests a significant deviation from the mean. Bank credit (BC) has a mean value of (1754.733), maximum value of (2082) and minimum value of (1244.7) with a standard deviation of (293.1935) which shows a significant deviation from the mean. The mean value of Exchange rate (EXR) is (2296.55), maximum value of (3619.1), minimum value of (957) and a standard deviation of (858.2045) which implies a little dispersion from the mean.

Table 4.7 Descriptive Analysis of Variables showing the Significance of Financial Deregulation on the Profitability of Nigerian Deposit Money Bank

Variable	Observation	Mean	Standard Deviation	Minimum	Maximum
YEAR	10	2008.5	3.02765	2011	2020
ITR	10	35373.36	25684.8	11411.07	80092.56
INR	10	160.11	108.013	48.6	343.7
PROF	10	783.26	335.0659	332.1	1179.7
BC	10	1754.733	293.1935	1244.7	2082
EXR	10	2296.55	858.2045	957	3619.1

Source: Researcher’s Computation, 2022

4.3.5 Regression Analysis of the Significance of Financial Deregulation on the Profitability of Nigerian Deposit Money Bank.

A multiple regression analysis whose equation is presented below found that the coefficient of determination (R²)= 0.9888, which shows that the predictive power of the independent variables as used to explain variation in the dependent variable (ITR) is only about 99% with a high adjusted R² of (0.9441). The combined P value of 0.0018 and F-value of 22.2 shows there is significant relationship and effect between the variables examined. The regression equation is as shown below.

$$ITR = - 350.48 + 350.48INR - 109.54PROF + 11.72BC - 1.66EXR.....4.2$$

The result shows that a unit increase in INR Shows negative contribution of 350.48 to ITR, a unit increase in PROF contributed 109.54 decrease to ITR. BC indicated a positive

contribution of 11.72 and EXR shows a positive contribution of 1.66 to changes in ITR. More so, two of the four explanatory variables were significant at 5% in explaining variation in NO. These are INR with (t=0.018 and P=0.004) and EXR with (T = -0.28 and P=0.0000).

Table 4.8 Result of Regression Analysis showing the Significance of Financial Deregulation on the Profitability of Nigerian Deposit Money Bank

Dependent variables	Independent variables	Coefficient	Standard Error	T	p> t	[95% conf. interval]
ITR	INR	350.4833	170.5178	2.06	0.018	-1816.15 2517.117
	PROF	-109.5416	182.9432	-0.60	0.657	-2434.056 2214.972
	BC	11.71945	23.81048	0.49	0.709	-290.8214 314.2603
	EXR	-1.658809	5.917415	-0.28	0.026	-76.8467 73.53908
	Constant	70103.6	126383.7	0.55	0.678	-1535754 1675961

R-squared = 0.9888 Adj. R-squared = 0.9441 P<0.05 F (4,4)= 22.12

Source: Researcher's Computation, 2022

4.3.6 Significance of Financial Deregulation on the Profitability of Nigerian Deposit Money Bank

Furthermore, the correlation matrices (Pearson correlation coefficient) of the variables included in equation 4.2 are shown in table 4.9 below to identify the possible multicollinearity of the variables in the models. It can be seen in the table that the variable INR exhibits a significant relationship with ITR with correlation coefficient of 0.9714. PROF is strongly correlated with ITR given a correlation coefficient of 0.7649. The correlation between BC and ITR is insignificant with a negative coefficient of 0.4853, while variable EXR and ITR shows weak positive correlation coefficient of 0.2945.

4.9 Result of a Pairwise Correlation on the Effect of Environmental Sustainability on the Performance of Selected Companies in Nigeria.

ITR	INR	PROF	BC	EXR	ITR
ITR					
	1.0000				
INR					
	0.9714*	1.0000			
PROF					
	0.7649*	0.7786*	1.0000		
BC					
	-0.4853	-0.4817	-0.1634	1.0000	
EXR					
	0.2945	0.4186	0.4526	0.2104	1.0000

Source: Researcher's Computation, 2022

Hypothesis Three

Decision Criteria: if $F_{calc} > F_{tab}$; reject Null hypothesis and accept alternative hypothesis.

If $F_{calc} < F_{tab}$; accept Null hypothesis and reject alternative hypothesis.

H₀₃: There will be no significant relationship between financial deregulation and the profitability of Nigerian deposit money bank

Decision Criteria:

With a calculated F-value of 60.43 as compared with a tabulated F-value of 5.19 (at 5% level of significance), the null hypothesis is rejected while the alternative hypothesis is accepted, with the conclusion that There is significant relationship between financial deregulation and the profitability of Nigerian deposit money bank.

4.4 Discussion of Findings

The first objective seeks to examine the relevance of financial sector reforms on economic development of Nigeria within a period of ten years (2011-2020). Findings from the study identified components such as Exchange rate, Inflation rate, Interest rate and Bank credit to have a significant effect on the performance of Nigerian deposit money bank (proxied by Gross domestic product) given a P-value of 0.0261, R-Squared of 0.8526 and adjusted R² of 0.7346. This result shows that financial sector reforms have relevance on deposit money banks of Nigeria.

Furthermore, the second objective is to examine the financial deregulation on the Nigerian deposit money bank performance. Result from the analysis revealed that the combined effect of financial deregulation on indicators on deposit money bank is significant given a P-Value of 0.0073 and F-Value of 60.23, R² of 0.9132 and adjusted R² of 0.8438. The study rejects

the null hypothesis and accepts the alternative hypothesis, which shows that financial deregulation in Nigerian deposit money bank affect the performance of Nigerian Deposit Money Banks.

The last objective evaluates the significance of financial deregulation on the profitability of Nigerian deposit money bank within the study period. The explanatory variables were found to have exhibited a combined significant effect on significance of financial deregulation on the profitability of Nigerian deposit money bank following the joint significant value of $P = 0.0036$, $R^2 = 0.8001$, adjusted $R^2 = 0.6401$ with the alternative hypothesis is accepted. Therefore, there is significant relationship between financial deregulation and the profitability of Nigerian deposit money bank. The result goes in line with the previous findings.

From the analysis, in the short-run credit to private sector is positively related to gross domestic product while the result drifts apart in the long-run as it depicts a negative value with the dependent variable. This variable did not conform to economic apriori expectation, but the reason is not farfetched. In Nigeria, over the years; the banking sector serves only the government and influential borrowers hence, private sector borrowers are left with little or no credit. It also implies that credits to private sector are used for commerce (buying and selling), or diverted to some unproductive ventures, rather than production activities, which would have increased economic growth. Moreover, the amount of credit to the private sector, as a proportion of the total credit to the economy, is too negligible to contribute positively to economic growth. This negative result is in consistent with the work of some researchers earlier reviewed¹.

The econometric results further revealed that financial deepening has a negative effect on economic growth in Nigeria. This result negates the apriori expectation stated in this study.

The implication of this negative relationship is that financial system in Nigeria is weak and can best be described as an inhibitor and that banks are only in business to reap “wind fall” profit. It also implies that the supply of these financial assets is not enough to raise the economy to the desired level. If financial markets are weak, the effectiveness of transmitting policy through money supply will be limited². Thus, necessitating the development of financial sector so as to efficiently and effectively mobilize and allocate funds within the system to guarantee reasonable returns for savers and investment needs of the borrowers in order to contribute to economic growth. The result negates the work of a researcher who holds the view that financial deepening plays positive and significant role in the growth of per capita output in the 34 selected Sub-Saharan African countries including Nigeria but the findings support the work of some researchers³.

The analysis also indicated that real interest rate of borrowing is indirectly linked with the economic progress of Nigeria in the long-run with a negative coefficient. This suggests that the government has engaged so much contractionary monetary policy (a situation whereby the money supply policy was not able to address the investment opportunity trend of the economy) to the detriment of the Nigerian economy.

The positive relationship of exchange rate supports the work of some researchers but negates the work of another researchers^{4,5}. The financial policy shift depict a negative relationship in the short-run on economic growth, suggesting that the totality of the reform has not achieved the optimal growth rate in Nigeria within this short period but in the long-run exhibits a positive relationship with the dependent variable. This long-run effect negates the findings of some researchers⁶.

The Breusch – Godfrey serial correlation test shows that we cannot reject the null hypothesis of no serial correlation of any order. Heteroskedasticity test reveals homoskedasticity of the

residuals at 5% level of significance, that is, the variance of the error terms were consistent. Therefore, the study can conclude that the model is free from any order of serial correlation. The error correction model which captures the speed of adjustment of the model to short-run disequilibrium conditions has a negatively signed co-efficient. This depicts the presence of a feedback mechanism for the model in the incidence of external shocks. The result shows a moderate speed of adjustment to short-run shocks of approximately 52 per cent. Hence short-run deviations from equilibrium position are re-adjusted per time in order to maintain balance in the system in the long-run⁷.

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Chapter Five

Conclusion

5.1 Summary of Findings

The main objective of the study is to examine impact of financial deregulation on the the Nigerian deposit money bank within a period of (2010-2020). The specific objectives of the study were to examine the relevance of financial sector reforms on economic development of Nigeria, determine the effects of financial deregulation of the performance of the Nigerian deposit money bank and assess significance of financial deregulation on the profitability of Nigerian deposit money bank within the study period.

All secondary data used were obtained from central bank of Nigeria statistical bulletin covering the period 2010 to 2020. Both descriptive and inferential statistical tools were employed in this study. Descriptive tools include mean, standard deviation, minimum and maximum values. For the inferential statistics, the study employed multiple regression model and Pearson pairwise correlation to analyze the secondary data.

The main findings from the empirical analysis are that components such as Exchange rate, Inflation rate, Interest rate and Bank credit to have a significant effect on the performance of Nigerian deposit money bank (proxied by Gross domestic product) given a P-value of 0.0261, R-Squared of 0.8526 and adjusted R2 of 0.7346. Also, result from the analysis revealed that the combined effect of financial deregulation indicators on Economic Development is significant given a P-Value of 0.0073, R2 of 0.9132 and adjusted R2 of 0.8438. The study further shows that financial deregulation indicators exhibited a combined significant effect on the performance of Nigerian deposit money banks following the joint significant value of $P = 0.0036$, $R^2 = 0.8001$, adjusted $R^2 = 0.6401$.

5.2 Conclusion

This study examined the activities and performance of financial deregulation on the Nigerian deposit money bank sector performance. With respect to the objectives of the study, the following conclusions were reached:

- i. Components such as Exchange rate, Inflation rate, Interest rate and Bank credit affect the performance of Nigerian deposit money bank.
- ii. Financial deregulation in Nigerian deposit money bank affects the performance of Nigerian Deposit Money Banks within the study period.
- iii. There is no significant relationship between financial deregulation and the profitability of Nigerian deposit money bank within the study period.

5.3 Recommendations

In view of the findings in this work, the following recommendations are hereby suggested:

- i. For Nigeria to benefit from the current wave of globalization especially in the area of banking operations, its financial services must go beyond liberalization. Government needs to maintain a stable macroeconomic policy especially in the area of stable inflation, realizable exchange rate policies and fiscal balance.
- ii. The country needs to be more involved in international services such as shipping, Insurance, Banking, etc. Nigeria still needs to create and secure economic environment without which domestic and foreign investors will continue to shy from the many profitable business opportunities the country offers. It is highly noted to this end that the importance of the financial reform in our economy cannot be overemphasized. Hence, if our vision is to ensure a sound and reliable banking

structure for the 21st century, now is the time to plan for the required, dynamic, qualified, and competitive banking system.

- iii. To promote the growth of the financial sector as well as the real sector of the Nigerian economy, there is need to strengthen the supervisory abilities of the regulatory bodies. This will go a long way in building confidence in the financial sector and enables the sector to discharge its financial intermediation role efficiently
- iv. The reform programme will also redefine the nature of competition in the banking industry such that each institution will have no choice but to assign priority to its capacity to deliver superior value to its clients. Hence, there is the need for more reform in the banking sector, such that the interest rate and inflation rate can be reduced to a digit and exchange rate can be reduced, controlled and managed. Also, there is need for institutions and political economy to remain stable, so that business environment can attract investors, by way of promoting capital flow into the economy.

5.4 Contribution to Knowledge

The study is important to the deposit money banks in Nigeria, academia, and other stakeholders. In the academia field, the result of this study is a contribution to the existing literature on the subject and serves as a catalyst for further research on innovative ways of financial deregulation on the Nigerian deposit money bank sector performance.

It is useful as a source of reference to researchers, academics, policy makers, students and other stakeholders interested on the effect of financial deregulation on the Nigerian deposit money bank sector performance. The study is expected to contribute to the methodology by employing financial deregulation to analyse the effect of e financial deregulation on the Nigerian deposit money bank sector performance in developing countries like Nigeria.

5.5 Suggested Area of Further Research

The following suggestions for further research were made by the researcher:

- i. Need for Proper financial deregulation policies in Nigeria.
- ii. Impact of financial deregulation on the Nigerian deposit money bank sector performance.
- iii. Nigerian deposit money bank: The way forward.
- iv. Challenges and Prospects of Nigerian deposit money banks.

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Appendix I

List of Quoted NDMBs on the floor of NSE

S/N	Nigerian Deposit Money Banks	Quoted/ Unquoted
1	Access Bank Plc	Quoted
2	Citibank Nigeria Limited	Unquoted
3	EcoBank Nigeria Plc	Quoted
4	Enterprise Bank	Unquoted
5	Fidelity Bank Plc	Quoted
6	First Bank Nigeria Limited	Quoted
7	First City Monument Bank Plc	Quoted
8	Guaranty Trust Bank Plc	Quoted
9	Heritage Banking Company Limited	Unquoted
10	KeyStone Bank	Unquoted
11	Mainstreet Bank	Unquoted
12	Polaris bank	Quoted
13	Stanbic IBTC Bank Limited	Quoted
14	Standard Chartered Bank Nigeria Limited	Unquoted
15	Sterling Bank Plc	Quoted
16	SunTrust Bank Nigeria Limited	Unquoted
17	Union Bank of Nigeria Plc	Quoted
18	United Bank for Africa	Quoted
19	Unity Bank of Nigeria Plc	Quoted
20	Wema Bank Plc	Quoted
21	Zenith Bank Plc	Quoted
22	Tajbank Limited	Unquoted
23	Jaizbank bank	Unquoted
24	Titantrust bank	Unquoted
25	Globus bank	Unquoted
26	Providus bank	Unquoted

27	Coronation bank	Unquoted
28	FBNQuest Merchant bank	Unquoted
29	Rand bank	Unquoted
30	FSDH bank	Unquoted
31	Nova bank	Unquoted

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Appendix II

Regression Matrix

Variable	Observation	Mean	Standard Deviation	Minimum	Maximum
Year	10	2008.5	3.02765	2004	2013
GDP	10	716.009	143.1997	527.58	950.11
EXR	10	1233.737	578.5552	400.41	2078.31
INR	10	120143.5	76139.38	42802.99	249798.2
ITR	10	30629.69	11518.5	20730.6	57990.2
BC	10	206.3	8.628763	192	215

Dependent variables	Independent variables	Coefficient	Standard Error	T	p> t	[95% interval]	conf.
GDP	EXR	.2899558	.0689144	4.21	0.008	.1128057 .467106	
	INR	.0000599	.0003994	0.15	0.887	-	.0009667 .0010865
	ITR	-.0104484	.0025184	-4.15	0.009	-.0169223	-
	BC	-.863164	2.643678	-1.46	0.204	-10.65895	
	Constant	1468.087	551.2917	2.66	0.045	2.932626	50.94668 2885.228

R-squared =0.9132 Adj. R-squared = 0.8438 P≤0.05 F (4,5)= 60.43

GDP	EXR	INR	ITR	BC	GDP
GDP					
	1.0000				

EXR	0.6604*	1.0000		
INR	0.4038	0.7389*	1.0000	
ITR	0.0148	0.7184*	0.5791	1.0000
BC				0.0207
	-0.5974	-0.2973	0.0301	1.0000

Variable	Observatio n	Mean	Standard Deviation	Minimum	Maximum
YEAR	10	2008.5	3.02765	2011	2020
INR	10	9398.08	5348.566	2112.5	19077.4
ITR	10	30629.69	11518.5	20730.6	57990.2
EXR	10	116932.2	80325.93	10689.7	249798.2
BC	10	206.3	8.628763	192	215
PROF	10	2143988	1130975	973526	4021780

Dependent variables	Independent variables	Coefficient	Standard Error	T	p> t 	[95% conf. interval]
INR	ITR	.1188681	.1002932	1.19	0.289	-

						.1389438	.3766799
EXR	.0578191	.0166172	3.48	0.018	.0151031	.100535	
BC	-294.3442	106.5641	-2.76	0.040	-568.276	-20.4125	
PROF	-.0020401	.0011419	-1.79	0.134	-		
					.0049753	.0008952	
Constant	64093.36	22071.47	2.90	0.034	7356.837	120829.9	

R-squared = 0.8526 Adj. R-squared = 0.7346 P ≤ 0.05 F (4,5) = 70.23

INR	ITR	EXR	BC	PROF	INR
GDP	1.0000				
EXR	0.5157	1.0000			
INR	0.7100*	0.5750	1.0000		
ITR	-0.4680	0.0207	0.0250	1.0000	
BC	0.2741	0.5328	0.6808*	0.0467	1.0000

Variable	Observatio n	Mean	Standard Deviation	Minimum	Maximum
YEAR	10	2008.5	3.02765	2011	2020
ITR	10	35373.36	25684.8	11411.07	80092.56
INR	10	160.11	108.013	48.6	343.7

PROF	10	783.26	335.0659	332.1	1179.7
BC	10	1754.733	293.1935	1244.7	2082
EXR	10	2296.55	858.2045	957	3619.1

Dependent variables	Independent variables	Coefficient	Standard Error	T	p> t 	[95% conf. interval]
ITR	INR	350.4833	170.5178	2.06	0.018	-1816.15 2517.117
	PROF	-109.5416	182.9432	-0.60	0.657	-2434.056 2214.972
	BC	11.71945	23.81048	0.49	0.709	-290.8214 314.2603
	EXR	-1.658809	5.917415	-0.28	0.026	-76.8467 73.53908
	Constant	70103.6	126383.7	0.55	0.678	-1535754 1675961

R-squared = 0.9888 Adj. R-squared = 0.9441 P<0.05 F (4,4)= 22.12

ITR	INR	PROF	BC	EXR	ITR
ITR					
	1.0000				
INR					
	0.9714*	1.0000			
PROF					

	0.7649*	0.7786*	1.0000		
BC					
	-0.4853	-0.4817	-0.1634	1.0000	
EXR					
	0.2945	0.4186	0.4526	0.2104	1.0000

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Biodata

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B. Educational Background

1. Educational Institutions Attended with Dates and Qualifications

- Ottun Nursery and Primary School, Sango Ota, Ogun State 1991 – 1996
- Local Government Secondary School, Atan Ota, Ogun State 1997 – 2003
- Federal Polytechnic Offa, Kwara State 2004 – 2006
- Federal Polytechnic Offa, Kwara State 2007 – 2009
- Joseph Ayo Babalola University, Ara- Ikeji, Osun State 2013 – 2015
- LAUTECH, Ogbomosho, Oyo State 2012
- LAUTECH, Ogbomosho, Oyo State 2017 – 2019
- Lead City University Ibadan, Oyo State 2019 – till date

2. Academic Qualifications Obtained (with Dates)

- Primary School Leaving Certificate 1997
- Secondary School Certificate 2003
- Ordinary National Diploma (OND) Statistics 2005
- Higher National Diploma (HND) Statistics 2007
- Postgraduate Diploma (Accounting) 2012
- Bachelor of Science (B.Sc) Economics 2015

- Master in Business Administration (MBA Financial Management) 2017

3. Professional Qualifications with Dates

- Associate Member, Chartered institute of banker of Nigeria ACIB 2021
- Graduate Member, Nigeria Institute of Management (Chartered) NIM 2010

C. Working Experience with Dates

- Cash in Transport Officer
Access Bank Plc, 8-10 commercial Road, Apapa, Lagos state 2008-2009
- Transaction/PAYING TELER
Afribank Nig Plc/ Mainstreet Bank Limited now Polaris Bank
51/55 Broad Street, Marina Lagos State/Alaba branch 2009-2013
- Team Lead Customer Care Officer
Access Bank Plc, Agbara Branch
- Teller Service Representative (TSR)/Utility Teller
Access Bank Plc., Agbara Branch 2013 – till date
- Casting of Montly Salaries
Planning and Research statistics Department, Ado-Odo
Ota Local Government, Ota, Ogun State
- Subject Teacher
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D. Award and Fellowships if any

- Best Teller Award (Afribank Nigeria Plc.) 2010

E. Membership of Academic Professional Bodies

- Associate Member, Chartered institute of banker of Nigeria ACIB 2021
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F. Conferences and Workshops Attended with Dates

- Chartered Institute of Taxation of Nigeria Conference

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2020

Signature

Date

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University Compliance Certificate

This is to certify that this thesis by **Maroof Dare ADETORO** with Matric Number LCU/PG/000603 in the Department of Management and Accounting, Lead City University; Ibadan is in full compliance with the approved University format and style.

Signature

Date

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