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Commercial Banking and Economic Growth in Nigeria

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ABSTRACT

This study investigates the contribution of commercial banks to economic growth in Nigeria using secondary data covering the period of 1980-2016 that were sourced from the Central Bank of Nigeria (CBN). The analysis of the study was conducted using regression model of the Ordinary least Square (OLS) technique to ascertain the relationship between financial intermediation (also including other growth-inducing variables) and economic growth in Nigeria. The results show that financial intermediation-our yardstick for commercial banks operation, has a positive and significant impact on economic growth in Nigeria. Hence, it is therefore recommended that monetary authority should be sensitive to the behavior of the aforementioned variables so as to ensure economic growth and development in the country. Government should enforce a guiding principles or laws that will be regulating and monitoring the banking activities to curb corrupted practices which are a bane for growth. The study strongly recommends the strict implementation of the risk-focused and rule-based regulatory framework by the regulators. This it is believed will reduce the high incidence of huge bad debts profile of banks and consequently improve the assets quality of banks for better performance. The Central Bank of Nigeria (CBN) being banks' supervisory/regulatory agent should intensify its efforts towards effective monitoring and ensure that the gains from the commercial bank activities are sustained in the growth of the Nigerian economy.

Keywords: *Commercial banking, Economic growth, Financial intermediation, Capital stock, Prime rate*

INTRODUCTION

The issue of economic growth has been widely discussed in economic science and at present still serves as the main topic of debate among economic scholars. Much attention has been given to the sources of growth, with respect to which source plays the lead role in economic growth of a country. In the literature, a vibrant and robust financial system has been identified, undoubtedly, as a vital catalyst propelling the growth rate of an economy (Ogege and Shiro, 2013; Yauri, Musa, and Kaoje,2012; Aurangzeb, 2012).

Economic growth is defined as a positive change in the national income or the level of production of goods and services of a country over a certain period of time. This is often measured in terms of the level of production within the economy. Other possible measures include total factor productivity and growth ranges from real per capita GDP. The importance of financial institutions in generating growth within the economy has been widely discussed in the literature (Aurangzeb, 2012; Sanusi, 2011; Ekpenyong and Acha, 2011). Early economists such as Schumpeter (1911) identified banks' role in facilitating technological innovation through their intermediary role. He believed that efficient allocation of savings through identification and funding of entrepreneurs with the best chances of successfully implementing innovative products and production processes are tools to achieve this objective.

The financial structure of any country is usually described in terms of the various types of financial institutions operating within it. In Nigeria, the most developed segment of its financial system is the banking system, which consists mainly of commercial banking. Commercial banks, as financial intermediaries in Nigeria, play an all-important role in serving the general public and in ensuring sustainable growth in the country. The commercial bank-led growth nexus can be viewed from the growth-inducing functions of commercial banks. Traditionally, commercial banks serve as the

safe house for the public. They welcome deposits and other valuables from the public for safe keeping. Also, they facilitate monetary transactions in the economy through the use of current account on which cheques are drawn. Corollary, from the deposits mobilized, the commercial banking system extends credit facilities to potential investors for the promotion of economic activity, and thus, the commercial banking system serves as an important channel that links both savers and investors in the economy.

Furthermore, as part of their of asset portfolio, the commercial banking does propel economic growth through its investment function. Commercial banks invest its excess deposit on real investment such as real estate, partnering with private individuals in real production of goods, procuring and leasing of equipment etc. It is significant to note that bank investments expanded astronomically under the period of review. Commercial banks' investment in real asset rose has continued to increase over the years till date. Commercial banks also represent a vital link in the transmission of government's economic policies, particularly through the monetary policy to the rest of the economy. Monetary policy, which is an economic program adopted by the government to manage the growth of its money supply, the availability of credit, and interest rates, works mostly through the commercial banking system by manipulating commercial banks' reserves, through monetary policy instruments. Fluctuations in the availability and cost of bank credit also have profound implications. If interest rates are high, the cost of credit will be high and this could be deflationary. This is not surprising because bank deposits represent the most significant component of the money supply used by the public, and changes in money growth are highly correlated with changes in the prices of goods and services in the economy.

Due to the critical nature of these roles, and the fact that the ability of commercial banks to effectively impact on economic growth hinges largely on their soundness and efficiency, the Nigerian government has continued to take variety of measures to safeguard the commercial banking sub-sector through reforms. Such reforms often focus on increased risk management procedures and enhanced corporate governance in order to strengthen and reposition the banking industry to enable it contribute effectively to the development of the real sector through its intermediation process. In addition, such reforms may involve a comprehensive process of substantially improving the regulatory and surveillance framework; fostering healthy competition in banking operations, ensuring an efficient framework for monetary management, expansion of savings mobilization base, enforcement of capital adequacy, and the promotion of investment and growth through market-based interest rates. The need for reforms as an on-going basis has become more imperative with the increasing sophistication of the global financial products. The recent experience from the global financial crisis has further underscored the imperatives for countries to embark on banking reforms on a regular basis.

Therefore, since the commencement of the deregulation policy of the economy in September 1986, the commercial banking set-up in Nigeria has witnessed rapid growth, and the banking industry is today described as vibrant, highly competitive and a critical factor in the growth of the economy.

RESEARCH PROBLEM

The role of commercial banking system as it relates to economic growth of a nation has been empirically attested for positively in the literature (Yakubu and Affoi, 2014; Aurangzeb, 2012; Olokoyo, 2011; McKinnon, 1973; Shaw, 1973; Schumpeter, 1911). This it does from the enormous and impeccable growth-inducing functions this financial sub-sector plays in the development of an economy. Moreover, this ideal channel of growth has been accepted within the Nigerian context, which has motivated series of banking reforms and laws in the banking system in order to create a competitive, resilient, vibrant and healthy commercial banking system. For instance, the establishment of the Central Bank of Nigeria in 1959 to regulate the activities of commercial banks; the indigenization policy of 1977, which paved way for Nigerians to become active participants and to halt capital flight out of the sector needed for further expansion; the financial liberalization starting from the mid-80's (during the SAP period) that brought in an explicit partial deregulation of the sector to encourage healthy competition and market-based/oriented financial sector as well as series of other reforms like the recapitalization and consolidation strategy by the Soludo-led administration.

However, in spite of these structural changes and remarkable growth observed in the commercial banking sector in terms of the number of banks in operation, bank density and their assets portfolio relative to other non-bank institutions in the financial sector in Nigeria, its performance has remained relatively unsatisfactory with respect to the growth process. In line with this assertion, Maduka and Onwuka (2013) wrote thus**,** despite the growth record of banks and non-bank financial institutions in Nigeria, and financial liberalization policy, the Nigeria economic growth is sluggish. The per capita income is less than $4,000. Most of the industries are winding up and thus giving rise to unemployment. At this juncture, it might be necessary for one to ask if the financial market in Nigeria is underdeveloped to support the investment needed to boost economic growth. This may be partly due to dearth of empirical studies which will shed light on how commercial banks can contribute meaningfully to economic growth in Nigeria. In particular, to contribute to economic growth the nexus between growth and investment, quality of service, savings mobilization must be clearly understood through an empirical investigation. This is so far lacking or insufficiently explored.

OBJECTIVES OF THE STUDY

The main objective of this study is to examine the relationship between commercial banking operations and economic growth in Nigeria. The specific objectives are to:

- To explore the relationship between growth and the level of financial intermediation.
- Ascertain the impact of banks' lending interest rate on growth through investment.

METHODOLOGY

This section extensively examines the method and procedure adopted to conduct and advance the study of the impact of commercial banking on Nigerian economic growth under the following subheading: model specification, method of data analysis, evaluation of parameter estimates and test of research hypothesis and decision rules

Model Specification

The model for this study will be based on the insight gain from the theoretical framework and modifications made. This modification was the introduction of some of the commercial bank variables in the model. These commercial banking variables include bank performance, financial intermediation, capital stock, bank bad debts, liquidity ratio, prime rate and inflation rate. Thus, economic growth which will be the dependent variable will be proxied by gross domestic product growth rate (GDP) while the explanatory variables include bank performance proxy by bank profit, financial intermediation measured as ratio of private credit to GDP, capital stock proxy by rate of domestic investment to the GDP, bank bad debts, liquidity ratio, prime rate and inflation rate. Therefore, the model for this study is stated as followed:

The structural form of the model is:

$$Y = f(X_1, X_2, X_3, X_4, X_5, X_6, X_7) \quad \ldots \quad \ldots \quad \ldots \quad \ldots \quad (1)$$

Mathematically, the model is specified as:

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \beta_6X_6 + \beta_7X_7 \quad \ldots \quad \ldots \quad (2)$$

The econometric form of the model can be express, thus:

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \beta_6X_6 + \beta_7X_7 + \mu_i \quad \ldots \quad (3)$$

Where Y = Economic growth proxied by GDP growth rate

X_1 = Bank Performance proxy by bank profit

X_2 = Financial Intermediation measured as ratio of private credit to GDP

X_3 = Capital Stock proxy by rate of domestic investment to the GDP

X_4 = Liquidity ratio

X_5 = Bank Bad Debts

X_6 = Prime Rate

X_7 = Inflation Rate

β_0 = Intercept

β_1 - β_7 = Partial slope coefficients or Parameters of the model

μ_i = Stochastic error term, which is normally distributed

Evaluation Technique and Procedure

The economic technique employed in the study is the ordinary least square (OLS). This is because the OLS computational procedure is fairly simple a best linear estimator among all unbiased estimation, efficient and shown to have the smallest (minimum variance) thus, it become the best linear unbiased estimator (BLUE) in the classical linear regression (CLR) model. Basic assumptions of the OLS are related to the forms of the relationship among the distribution of the random variance (μ_i).

OLS is a very popular method and in fact, one of the most powerful methods of regression analysis. It is used exclusively to estimate the unknown parameters of a linear regression model. The Economic views (E-views) software will be adopted for regression analysis.

Stationarity (Unit Root) Test

The importance of this test cannot be overemphasized since the data to be used in the estimation are time-series data. In order not to run a spurious regression, it is worthwhile to carry out a stationary test to make sure that all the variables are mean reverting that is, they have constant mean, constant variance and constant covariance. In other words, that they are stationary. The Augmented Dickey-Fuller (ADF) test would be used for this analysis since it adjusts for serial correlation.

Decision Rule

If the ADF test statistic is greater than the MacKinnon critical value at 5% (all in absolute term), the variable is said to be stationary. Otherwise it is non stationary.

Cointegration Test

Econometrically speaking, two variables will be cointegrated if they have a long-term, or equilibrium relationship between them. Cointegration can be thought of as a pre-test to avoid spurious regressions situations. As recommended by Gujarati (2008), the ADF test statistic will be employed on the residual.

Decision Rule

if the ADF test statistic is greater than the critical value at 5%, then the variables are cointegrated (values are checked in absolute term)

Evaluation of Parameter Estimates

The estimates obtained from the model shall be evaluated using three (3) criteria. The three (3) criteria include:

- The economic a priori criteria.
- The statistical criteria: First Order Test
- The econometric criteria: Second Order Test

Evaluation based on economic a priori criteria

This could be carried out to show whether each regressor in the model is comparable with the postulations of economic theory; i.e., if the sign and size of the parameters of the economic relationships follow with the expectation of the economic theory. The a priori expectations, in tandem with the manufacturing sector growth and its determinants are presented in Table 3.1 below, thus

Table1. *Economic a priori expectation*

Parameters	Variables		Expected Relationships
	Regressand	Regressor	
β_0	GDP	Intercept	+/-
β_1	GDP	BFOR	+
β_2	GDP	FINT	+
β_3	GDP	CAPS	+
β_4	GDP	LQR	+
β_5	GDP	BADT	-
β_6	GDP	PRIM	-
β_7	GDP	INFL	-

Source: *Researchers compilation*

A positive '+' sign indicate that the relationship between the regressor and regressand is direct and move in the same direction i.e. increase or decrease together. On the other hand, a '-' shows that there is an indirect (inverse) relationship

between the regress or and regress and i.e. they move in opposite or different direction.

Evaluation based on statistical criteria: First Order Test

This aims at the evaluation of the statistical reliability of the estimated parameters of the model. In this case, the F-statistic, standard error, t-statistic, Co-efficient of determination (R^2) and the Adjusted R^2 are used.

The Coefficient of Determination (R2)/Adjusted R2

The square of the coefficient of determination R^2 or the measure of goodness of fit is used to judge the explanatory power of the explanatory variables on the dependent variables. The R^2 denotes the percentage of variations in the dependent variable accounted for by the variations in the independent variables. Thus, the higher the R^2, the more the model is able to explain the changes in the dependent variable. Hence, the better the regression based on OLS technique, and this is why the R^2 is called the co-efficient of determination as it shows the amount of variation in the dependent variable explained by explanatory variables.

However, if R^2 equals one, it implies that there is 100% explanation of the variation in the dependent variable by the independent variable and this indicates a perfect fit of regression line. While where R^2 equals zero. It indicates that the explanatory variables could not explain any of the changes in the dependent variable. Therefore, the higher and closer the R^2 is to 1, the better the model fits the data. Note that the above explanation goes for the adjusted R^2.

The F-test

The F-statistics is used to test whether or not, there is a significant impact between the dependent and the independent variables. In the regression equation, if calculated F is greater than the table F table value at the chosen level of significance, then there is a significant impact between the dependent and the independent variables in the regression equation.

Econometric criteria: Second Order Test

This aims at investigating whether the assumption of the econometric method employed are satisfied or not. It determines the reliability of the statistical criteria and establishes whether the estimates have the desirable properties of unbiasedness and consistency. It also tests the validity of non-autocorrelation disturbances. In the model, autocorrelation, multicolinearity and heteroskedasticity test are used to test for the reliability of the data for predication.

Test for Autocorrelation

The Durbin-Watson (DW) test is appropriate for the test of Second-order autocorrelation and it has the following criteria.

1. If d* is approximately equal to 2 (d* =2), we accept that there is no autocorrelation in the function.
2. If d*= 0, there exist perfect positive auto-correlation. In this case, if 0<d*< 2, i.e. if d* is less than two but greater than zero, it denotes that there is some degree of positive autocorrelation, which is stronger the closer d* is to zero.
3. If d* is equal to 4 (d*=4), there exist a perfect negative autocorrelation, while if d* is less than four but greater than two (2<d*< 4), it means that there exist some degree of negative autocorrelation, which is stronger the higher the value of d*.

Test for Multicolinearity

This means the existence of an exact linear relationship among the explanatory variable of a regression model. It is use to determine whether there is a correlation among variables.

Decision Rule

From the rule of Thumb, if correlation coefficient is greater than 0.8, we conclude that there is multicolinearity but if the coefficient is less than 0.8 there is no multicolinearity.

Test for Heteroscedasticity

The essence of this test is to see whether the error variance of each observation is constant or not. Non-constant variance can cause the estimated model to yield a biased result. White's General Heteroscedasticity test would be adopted for this purpose.

Decision Rule

We reject H_0 if $F_{cal} > F_{tab}$ at 5% critical value. Or alternatively, we reject H_0 if $\chi^2_{cal} > \chi^2_{0.05}$ and accept if otherwise at 5% critical value.

PRESENTATION OF RESULT

The summary of preliminary tests discussed in the methodology is presented in the tables below.

Summary of Stationary Unit Root Test

Establishing stationarity is essential because if there is no stationarity, the processing of the data may produce biased result. The consequences are unreliable interpretation and conclusions. We test for stationarity using Augmented Dickey-Fuller (ADF) tests on the data. The ADF tests are done on level series, first and second order differenced series. The decision rule is to reject stationarity if ADF statistics is less than 5% critical value, otherwise, accept stationarity when ADF statistics is greater than 5% criteria value. The result of regression is presented in appendix 2 and the summary is shown in table 2 below.

Table2. *Summary of ADF test results*

Variables	ADF Statistics	Lagged Difference	1% Critical Value	5% Critical Value	10% Critical Value	Order of Integration
GDP	-6.015868	1	-3.653730	-2.957110	-2.617434	*I*(1)
BFOR	-5.560503	1	-3.653730	-2.957110	-2.617434	*I*(1)
FINT	-5.763376	1	-3.661661	-2.960411	-2.619160	*I*(1)
CAPS	-6.592829	1	-3.653730	-2.957110	-2.617434	*I*(1)
LQR	-8.016727	1	-3.653730	-2.957110	-2.617434	*I*(1)
BADT	-3.765735	1	-3.653730	-2.957110	-2.617434	*I*(1)
PRIM	-8.920547	1	-3.653730	-2.957110	-2.617434	*I*(1)
INFL	-5.261656	1	-3.661661	-2.960411	-2.619160	*I*(1)

Source: *Researchers computation*

Evidence from unit root table above shows that none of the variables are stationary at level difference that is, *I*(0), rather all the variables are stationary at first difference, that is, *I*(1). Since the decision rule is to reject stationarity if ADF statistics is less than 5% critical value, and accept stationarity when ADF statistics is greater than 5% criteria value, the ADF absolute value of each of these variables is greater than the 5% critical value at their first difference but less than 5% critical value in their level form. Therefore, they are all stationary at their first difference integration.

Table3. *Summary of Johansen Cointegration Test*

Unrestricted Cointegration Rank Test (Trace)				
Hypothesized		**Trace**	**0.05**	
No. of CE(s)	**Eigenvalue**	**Statistic**	**Critical Value**	**Prob.****
None *	0.918806	207.2214	125.6154	0.0000
At most 1 *	0.759516	126.8723	95.75366	0.0001
At most 2 *	0.625027	81.26898	69.81889	0.0046
At most 3 *	0.475212	49.88015	47.85613	0.0319
At most 4	0.360774	29.24781	29.79707	0.0578
At most 5	0.323563	14.92791	15.49471	0.0607
At most 6	0.072795	2.418592	3.841466	0.1199
Unrestricted Cointegration Rank Test (Maximum Eigenvalue)				
Hypothesized		**Max-Eigen**	**0.05**	
No. of CE(s)	**Eigenvalue**	**Statistic**	**Critical Value**	**Prob.****
None *	0.918806	80.34907	46.23142	0.0000
At most 1 *	0.759516	45.60331	40.07757	0.0108
At most 2	0.625027	31.38884	33.87687	0.0963
At most 3	0.475212	20.63234	27.58434	0.2990
At most 4	0.360774	14.31990	21.13162	0.3393
At most 5	0.323563	12.50932	14.26460	0.0930
At most 6	0.072795	2.418592	3.841466	0.1199

Source: *Researchers computation*

Summary of Cointegration Test

Cointegration means that there is a correlationship among the variables. Cointegration test is done on the residual of the model. Since the unit root test shows that none of the variable is stationary at level *I*(0) but stationary at first difference *1*(1), we go further to carry out the cointegration test. The essence is to show that although all the variables are stationary, whether the variables have a long term relationship or equilibrium among them. That is, the variables are cointegrated and will not produce a spurious regression. The result is summarized in the table 3 below for Trace and

Maximum Eigenvalue cointegration rank test respectively.

Table 3 indicates that trace have only 4 cointegrating variables in the model while Maximum Eigenvalue indicated only 2 cointegrating variables. Both the trace statistics and Eigen value statistics reveal that there is a long run relationship between the variables. That is, the linear combination of these variables cancels out the stochastic trend in the series. This will prevent the generation of spurious regression results. Hence, the implication of this result is a long run relationship between economic growth and other variables used in the model.

Table4. *Summary of regression results*

Dependent Variable: GDP				
Method: Least Squares				
Sample: 1980 2016				
Included observations: 37				
Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C	10.39384	2.743570	3.788435	0.0008
BFOR	0.000681	0.002028	2.835664	0.0008
FINT	1.101821	0.158127	6.643917	0.0005
CAPS	-0.225789	0.019114	-4.349242	0.0089
LQR	0.010829	0.034933	0.309979	0.7590
BADT	0.002184	0.005738	0.380595	0.7066
PRIM	-0.248487	0.107840	-3.449620	0.0067
INFL	-0.150350	0.029958	-4.680660	0.0048
R-squared	0.360525	F-statistic		20.94054
Adjusted R-squared	0.288359	Prob(F-statistic)		0.000005
S.E. of regression	24.34303	Durbin-Watson stat		1.883838

Source: *Researchers computation*

Summary of Findings

The study attempted to explain the impact of commercial banking on Nigerian economic growth from 1980 -2016 using Ordinary least Square (OLS) technique method. All data used are secondary data obtained from the Statistical Bulletin of Central Bank of Nigeria (CBN). In executing the study, the OLS techniques was applied after determining stationarity of our variables using the ADF Statistic, as well as the cointegration of variables using the Johansen approach and was discovered that the variables are stationary and have a long term relationship among the variables in the model. From the result of the OLS, it is observed that bank performance, financial intermediation, liquidity ratio and bank bad debts have a positive impact on economic growth while capital stock, prime rate and inflation rate have a negative impact on economic growth in Nigeria. This implies that a unit increase in bank performance, financial intermediation, liquidity ratio and bank bad debts, will lead to an increase in the economy. On the other hand, increases in capital stock, prime rate and inflation rate will lead to a decrease in the economy. From the regression analysis, the result show that capital stock and bank bad debts did not conform to the a priori expectation of the study, where as bank performance, financial intermediation, liquidity ratio, prime rate and inflation rate conform to the study a priori postulation. The F-test conducted in the study shows that the model has a goodness of fit and is statistically different from zero. In other words, there is a significant impact between the dependent and independent variables in the model. The findings of the study also show that bank performance, financial intermediation, capital stock, prime rate and inflation rate are statistically significant in explaining the Nigerian economy while liquidity ratio and bank bad debts are statistically insignificant in explaining the Nigerian economic growth. Finally, the study shows that there is a long run relationship exists among the variables. Both R^2 and adjusted R^2 show that the explanatory power of the variables is very low and/or weak. The standard errors show that all the explanatory variables were all low. The low values of the standard errors in the result show that some level of confidence can be placed on the estimates.

Conclusion and Recommendations

The study confirms that bank performance, financial intermediation, capital stock, prime

rate and inflation rate are statistically significant in explaining the Nigerian economy while liquidity ratio and bank bad debts are statistically insignificant in explaining the Nigerian economic growth. Based on this, it is concluded that effective commercial banking is a regulatory imperative for a sustainable economic growth in Nigeria. The study brought to the fore, those variables which could be termed as growth-induced variables such as financial intermediation, bank performance, capital stock, liquidity ratio, bank bad debts, prime rate and inflation rate. Hence, it is therefore recommended that monetary authority should be sensitive to the behavior of the aforementioned variables so as to ensure economic growth and development in the country. Government should enforce a guiding principles or laws that will be regulating and monitoring the banking activities to curb corrupted practices which are a bane for growth. They study strongly recommends the strict implementation of the risk-focused and rule-based regulatory framework by the regulators. This it is believed will reduce the high incidence of huge bad debts profile of banks and consequently improve the assets quality of banks for better performance. The Central Bank of Nigeria (CBN) being banks' supervisory/regulatory agent should intensify its efforts towards effective monitoring and ensure that the gains from the commercial bank activities are sustained in the growth of the Nigerian economy.

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