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Influence of Banking Sector Reforms on the Capital Market

Ekwevugbe, James Unurhoro[1] and Brotoboh Dennis Efemuaye[2]

[1]Department of Business Administration and Management
[2]Department of Banking and Finance
Delta State Polytechnic, Otefe-Oghara, Nigeria

ABSTRACT

The impact of financial sector reforms on the Nigerian economy is examined in this article. The financial sector is without a doubt a vital component of a country's economy, and any reforms carried out in it ripple out to other sections of the economy, signaling a watershed moment for the economy and its people. In order to conduct this investigation, the ordinary least square approach was used. The research spans the years 1980 to 2008. It is clear that the financial sector advancements that occurred in Nigeria's economy at one point or another had an impact on the economy's activities. This does not, however, imply that financial sector changes are primarily to blame for the sector's improved performance. Improvements in financial intermediation were deemed a crucial condition for promoting investment, increasing productive capacity, and fostering economic growth in this research study. As a result, macroeconomic stability is suggested, as all other activities affect or are affected by it. Political stability is also important since it influences the financial sector's effectiveness.

Keyword: Central Bank of Nigeria, Financial Sector, Financial Intermediation, Sector Reform, Non Bank financial Institution.

INTRODUCTION

The greatest achievement of most developing countries as an important task is to increase the rate of economic growth, in that over the years, banks have tried to respond to competitions, systematic weaknesses, and macroeconomic instability by engaging in quite a lot of survival strategies. The Nigerian financial system has undergone several years of reforms, designed to position Nigeria as Africa's financial hub. These reforms have resulted to financial widening characterized by big and reliable banks, an efficient payments systems and improved financial inclusion in the economy. Often times, the major reason for these reforms are to produce a safe, sound, strong, reliable and diversified banking system that will provide sustainable financial development for economic growth and equally ensuring that "Nigerian Deposit Money Banks (DMBs) perform dynamic roles in the regional, national and international financial system (Emefiele, 2014 & Soludo, 2004)".

Reforms are referred to as inventions, fresh ways or schemes put in place to improve or change the old ways in which things were being done which are usually introduced either in response to changing developments, operational challenges or as proactive procedures both to strengthen the banking structure as well as avoid total crisis. Banking reforms therefore, is the totality of regulatory actions, policies or strategies, directives and incentives intended to ensure a diversified, strong and reliable banking system which will guarantee the safety of depositors' money, perform dynamic developmental roles and become competent and competitive players within the economy. The various phases of reforms embarked upon in "Nigerian banking sector were the un-guided liaise faire (1930-1959), the control or regulated era (1960-1985), the deregulated era (1986-1992), the re-regulated era (1993-1998), the banking consolidation (1999- 2004), the banking reforms of 2009 and cashless policy of2011 till date (Anyanwu, 2012)". Hence, reforms that are undertaken to achieve some major areas such as macroeconomic goals; mobilization and expansion of savings, promotion of interest rates that enhances
growth, laying the foundation for economic growth, engendering healthy competition in the provision of services; promotion of investment culture and improved regulatory and surveillance framework in Nigeria.

Consequently, the study intends to bridge or fill the gap in the areas or fields of economic literature and empirically determine the causal association between banking sector reforms and economic growth and whether banking reforms cause economic growth or banking reforms are a consequence of economic growth; which policy makers, economist, financial and development experts are yet to reach any consensus on this topical issue in Nigeria. In doing this, emphasis was laid on four basic banking reforms in Nigeria- interest rate reform, foreign exchange reform, recapitalization reform and corporate governance reform. This study is meant to cover selected reforms that have taken place in Nigeria, within the period of 1970 – 2019, both years inclusive in the analyses.

For clarity, the financial sector does not only mean the banking sector, the banking sector only holds major stake in the financial sector of the economy making it more pronounced than other sectors of the economy. We also have the Non-Bank Financial institutions (NBFI) which includes Insurance companies, Discount Houses, Unit trust, the capital market institution through which bond, stocks and
other securities are traded, interest rates are determined and financial services are produced and delivered around the world. The money and capital markets, alongwith the financial system that support them, are an exciting area for study. The capital market has also experienced a lot of reforms over

the years and is still in place, especially as regards the capital requirements of the operators, the operational and ethical standards of the institutions and the modalities of the market mechanism. There forms in the system impacted positively on the growth of the financial system and the economy in general. What goes on daily in these markets and within the financial system, as a whole, has a powerful impact on the economy. Broad changes are forever remaking the financial market as new institutions, new methods, new problems and new services continually appear. The reforms often seek to act proactively to strengthen the system, prevent systemic crisis, strengthen the market mechanism, and ethical standards. Likewise recent reforms have also been evident in the banking sector with the abolishment of universal banking, reduction in the tenure of MD/CEO of banks, introduction of Asset Management Company with its sole responsibility of buying back toxic assets from banks currently in need and return capital to the banks, improve liquidity and prepare grounds for the Central Bank of Nigeria to exit from the affected banks.

Statement of the Problem

In spite of sundry reforms implemented so far, the Nigerian banking sector has not been able to measure up to its expectations as the driver of economic growth and development. Apparently, there have been wide interest rate margins, undue reliance on foreign exchange and its attendant fluctuations, unsustainable and weak capital base, internal control infractions and managerial weaknesses resulting to inadequate disclosure of financial statements. There has been excessive reliance on foreign exchange market through revenue from petroleum products. These have caused continuous fluctuations in exchange rate in the economy. Many of the banks conducted only limited lending to certain preferred sectors while engaging predominantly in more lucrative short-term illegal arbitrage foreign exchange "round-tripping" activities. Moreover, the banking system has undergone through several recapitalization with small or negligible impact to meet the challenges posed by liquidity, technical insolvency and operational crises as well as lack of public confidence in the system.

Various opinions have been raised, objecting that financial reforms have affected banking sector performances positively. An opinion by certain researchers like Obamuyi and Olorunfemi (2011) and Osabuohiren (2008) on the issues of financial reforms, was a positive impact on banking sector efficiency while researchers like Akpan (2012),Adelegon and Orianwote (2014) and Azeez and Oke, (2012) argued that despite the reforms, banking sector has not adequately achieved efficiency. All these arguments or opinions resulted to a knowledge gap and calls for further research to bridge the gap. This study therefore intends to find out if actually the financial reforms have affected banking sector efficiency in Nigeria. A justifiable reason for the study.

Objectives of the Study

The study's major goal is to look into the impact of banking sector reforms on Nigeria's economic growth. The specific objectives are to:

i. Determine the relationship between interest rate spread and economic growth in Nigeria;
ii. Analyze the effect of exchange rate on economic growth in Nigeria;
iii. Assess the effect of banks' capital base or size on the growth of the Nigerian economy;
iv. Determine the relationship between corporate governance disclosure index and gross domestic product growth rate in Nigeria;

Financial Repression Hypothesis (Mckinnon –Shaw, 1973)

"The theory upon which this study shall be based principally is the Mckinnon (1973) and Shaw (1973) financial repression hypothesis, which holds that financial development correlates with economic development and growth if authorities were not to interfere in the operation of financial institutions".

It also known that banks have great influence on growth and development in a developing economy of country. "Financial repression as defined by Fry (1988),is an indiscriminate distortion of financial prices, including interest rates and foreign exchange rates which reduces the real rates of growth and the real size of the financial system relative to non-financial magnitudes". "Therefore financial repression arises primarily when a country imposes ceilings on nominal deposit and lending interest rates at a low level in relation to inflation (Nzotta, 2009)". As rated by McKinnon-Shaw banking intermediation theory, "the Central Bank of Nigeria (CBN) believes that the efficient functioning of a nation's economy depends on the strength of its financial system (CBN, 2009)". There also exists an extensive body of literature on the link between financial sector development and economic growth, "there is no consensus on the effect of explanatory variables on economic growth (Levine, 1999 &Fadare, 2010)".

Relevance of Mckinnon-Shaw hypothesis to the Study:

In their analysis (also referred to as complimentarily hypothesis), they concluded that alleviating financial restrictions by allowing market forces to determine the real interest rates rise toward their competitive market equilibrium. This means that artificial ceilings on interest rates reduce savings, capital accumulation and discourage the efficient allocation of resources. In the views of the duo, market forces and financial liberalization could bring an optimum financial structure and development as well as efficient mobilization of savings and credit allocation. The analyses also concluded that greater ease ofentry into the banking sector encourages competition. This promotes the prospects for higher savings, investment supply of real credit and thus the potential for financial deepening.

Review of Empirical Literature

Financial or Banking reforms have been an ongoing phenomenon around the globe right from the 1980s, but it is more intensified in recent times because of the effect of globalization. Apparently, the major constraints to successful financial reforms in Nigeria are inconsistency in policy mix, inappropriate sequencing, inadequate regulation and supervision. Though, from the historical antecedents, the major ailment of the sector has been identified as maladapted banking system culture. That is, its institutional structure, culture, orientation and modes of operation of the main actors are mainly of foreign transplanted type, not appropriately adapted and oriented to suit local structural peculiarities, as well as being, not made relevant to the developmental needs of the economy concerned (Ojo, 2010).

The Nigerian financial system is one of the biggest in Sub-Saharan Africa (SSA), consisting of banking and non-banking financial institutions. "Banks are ordinarily catalytic and developmental institutions, for a developing economy like ours (Okoi and Stephen, 2014)". In the banking institutions, we have twenty one (21) deposit money banks, over eight hundred and eighty four (884) micro finance banks, the agricultural and rural development banks, bank of industry, urban development bank, sixty-four (64) licensed finance companies, about forty two (42) primary mortgage institutions, over one hundred insurance companies, five (5) discount houses, various pension administrations and custodian organizations and over two thousand five hundred and twenty (2,520) bureau de change by end of 2014 (Olowe, 2008 in Ibor, 2016). However, a deposit money bank dominated the financial sector accounting for 93 per cent and represents the major form of financial savings.

Xuezhi and Benson (2013), on their path also examined the role of financial development and economic growth in Tanzania. These researchers reported on the evidence from savings and credits cooperative societies in Tanzania. The statistical tools employed were Newey-West standard errors regression model and Wald Granger causality tests analysis. The findings these researchers showed that there was a strong positive association between the financial services and the economic growth, and also there was two-way Granger causality between them. In addition, it was discovered that savings were more important in fostering economic growth as compared to credits/loans. The findings further revealed that Savings and Credits Cooperative Societies (SACCoS) facilitate economic development in Tanzania and therefore should be promoted with more emphasis on the savings objective.

The study added that enormous bad debts profile or poor asset quality has a negative impact to bank performance and was statistically significant. There was a positive and significant effect between interest rate and bank performance. However, capital and interest rate contributed positively to the growth of Nigerian banks, and the economy. The study strongly recommended that strict implementation of the risk-focused and rule-based regulatory framework by the regulators; which would reduce the high prevalence of huge bad debts profile of banks, and subsequently improve the assets quality of banks for better performance in the economy.

The study quipped that the results from the implementation of the reforms were disappointing, as the reforms never impacted positively on the stability of the economy for the period under review. However, the study added that even though there was an increase in financial resources mobilized by banks in nominal terms during their formed eras, there was no improvement in the quality and efficiency of financial services that were provided by banks in the period under review. The study attributed the huge deterioration in the health of the banking sector to faulty premises of the reforms, wrong sequencing of reforms, frequent reversals and policy summersaults by the regulatory and supervisory authorities and the clear lack of will by the government to sustain the tempo of these reforms. The study therefore, recommended that the basic structural weakness of the banking sector such as corporate governance of banks and the state of non-performing assets of banks should be critically addressed before embarking on any further banking reforms. The study added that the main four areas of potential conflict between the Central Bank of Nigeria and the government, namely, interest rate policy, deficit financing, credit policies and the management of substandard banks should be streamlined in order to create a conducive atmosphere for a robust banking reform in the future.

METHODOLOGY

The data generated for the study were secondary data, obtained from the Central Bank of Nigeria (CBN)Statistical Bulletin, CBN Annual Report and Statements of Accounts.

Model Specification

The adapted models for the study were obtained from the work of Tomola and Sola (2011) and Adelegun and Oriavwote (2014). These models were based on the theoretical proposition that reforms have to reposition the bank for better performance. Thus, NPL = f(EXCH, INT, LQT) (1)

Where: NPL = non-performing loans of the banks as proxy for bank efficiency.

EXCH = exchange rate reform measured as exchange rate of Nigerian Naira to US dollar

INT = interest rate reform measured as maximum lending rate of the banks.

LQT = liquidity reform measured as average Liquidity Ratio as the cash reserves of the commercial banks deposited with the CBN.

The model forms of the functions are shown below.

$NPL\ a_0 + a_1EXCH + a_2INT + a_3LQT + \mu$

a_0 is the intercept of the model while a_1,a_2, and a_3 are the coefficients of the explanatory variables. p. is the error term.

Analysis of Data

The table below shows the Results of the Relationship between Banking sector efficiency and financial reforms using OLS regression technique.

Dependent Variable: NPL
Method: Least Squares
Date: 05/07/2020 Time: 15:03
Sample: 1986-2019
Included observations:28

VARIABLE	COEFFICIENT	STD. ERROR	T- STATISTIC	PROB.
EXCH	-0.149831	0.033366	-4490540	0.0002
INT	1.047382	0.314201	3.333481	0.0028
LQT	-0.270013	0220427	-1224954	0.2325
C	7.17571	11.55363	2.352136	0.0272
R-SQUARED	0.611192	MEAN DEPENDENT VAR.		26.49071
ADJUSTED R-SQUARED	0.562591	S.D. DEPENDENT VAR.		14.89185
S.E. OF REGRESSION	9.849002	AKAIKE INFO CRITERION		7544181
SUM SQUARED RESID	2328.068	SCHWARZ CRITERION		7.734496
LOG LIKELIHOOD	-101.6185	F-STATISTIC		12.57572
DURBIN- WATSON STAT	2.334861	PROB(F-STATISTIC)		0.000038

Researcher's computation

The obtained result gave the coefficient of determination (R2) of 0.611192. This indicates that about61% of factors that determine banking sector efficiency is explained by the financial reforms.

The F-value is 12.57572 with probability value of 0.000038. Since the F-probability is below5%, we conclude that financial reforms significantly influence banking sector efficiency. The Durbin Watson value of 2.334861 indicates that the model from where the result is obtained is robust.

The Summary of Results

The obtained results revealed that Exchange rate reform in Nigeria has had negative effect on the efficiency 6f the banking system. Interest rate reform in Nigeria has had positive effect on the efficiency of the banking system. Liquidity rate reform in Nigeria has had negative but insignificant effect on the efficiency of the banking system.

The implication of the Study

1. The study showed the implication that the financial sector is helpful in determining banking sector efficiency.
2. Identified by the study, that also implicates the stabilization of exchange rate policy, if we are to realize our objective of the banking sector efficiency.
3. It also showed that the interest rate policy should be such that will stimulate savings through high yield deposit rate and lending rate so as to deepen our financial sectors efficiency.
4. It has been identified by the study that also implicate that the government should ensure an enabling environment for business to thrive.

Conclusion and Recommendations

The obtained result indicates that the use of Ordinary Least Square (OLS) regression technique, of about-61%of the factors that determine banking sector efficiency is explained by the financial reforms. The research istherefore concluded that the financial reforms significantly influence banking sector efficiency in Nigeria. Even though there has been a long run term relationships that exist between the selected variables for measuring banking sector efficiency and the financial reform targets, therefore a policy should be made strictly for the stabilization of our exchange rate. The study recommends that the regulatory and supervisory framework should be strengthened further. Also, interest rate policy should be made to stimulate savings through high real deposit rate and lending rate so as to affect financial deepening and thus banking efficiency. Since the reforms have significantly impacted positively on banking sector efficiency though at long run, there is need for more financial reforms re-appraisal for a better banking performance. It is also suggested that the government should also ensure an enabling environment for businesses to thrive.

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