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An Evaluation of the Roles of Financial Institutions in the Development of Nigeria Economy

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Abstract

This study aims at evaluating the financial institutions and their roles in the development of the Nigeria economy. Two variables where selected by the researcher to explain the roles of financial institutions in the development of the economy. The analytical tool used was the simple linear regression involving the use of the ordinary least square [OLS]. Data for the period of [2001-2011] was used. From the result of the regression, we found out that there is significant relationship between the roles of financial institution [credit to the private sector] and the development of the Nigeria economy because about 65% variation in Gross Domestic Product [Y] was explained by the total bank loans to the private sector [X] while about 35% of the variation was unexplained due to some internal and external factors listed in the work. The researcher further recommended that the financial institutions in the country should increase their participation in areas of investment and development lending and also engage in the sponsorship of capital intensive projects in order to bridge the 35% unexplained gap and also a consistent monitoring of borrowers to ensure compliance and reduce the risk of nonpayment to the barest minimum.

Keywords*:* Loans, Financial Institutions, Economic growth, Risk, Mismanagement

Introduction

The Nigeria economy revolves round the hub of an active financial system. This system consists of financial institutions, financial markets, financial instruments and improved rules and regulations that facilitate and regulate the flow of funds from surplus units to the deficit units. By surplus units we mean those economic units whose income exceeds their expenditures within a specified period of time; thus facilitating lending within this period. Deficit on the other hand refers to those economic units whose financial need or expenditure exceeds their income within any given period; hence they need loans from these surplus units.

The financial institution as a corporate entity that deals in financial claims, is controlled by the government through various regulatory bodies such as the CBN, NDIC and the SEC who supervise their activities.

In Nigeria, the financial institution engages in mobilizing funds from the surplus sector of the economy and lends such funds to the deficit sector. In this way, it intermediates between the people with surplus funds and those in deficit and because of this vital role, it is called a financial intermediary [OGBOGHRO, 2013].

There are basically two groups of financial institutions in Nigeria namely, the banks and non-banks financial institutions. To enable a thorough examination of the problem under study a focus will be based on the banking institutions mostly and their roles in economic development. An analysis of the role of banks in the Nigeria economy by approaching the matter from the points of lending which combines both borrowers [deficit unit] and savers [surplus unit] will aid a better understanding of the problem. It is pertinent to note that financial institutions borrow from ultimate lenders as a separate transaction and lend to ultimate borrowers. Hence, they involve in a double exchange of securities, whereas one would have ordinarily been in the absence of any financial intermediary to facilitate direct finance which has a high risk.

The financial intermediary function of these institutions offers a secondary security on itself to lenders in exchange for money and use the money for acquisition of primary securities and share liabilities and also lend as a way of advances.

In discharging this function, banks are now reluctant and restrained due to their excessive exposure to intensified risk; this in turn is not healthy for the profitability of money deposit banks and their likes. Thereby this has discouraged many institutions from facilitating this loan granting function.

Some scholars argued that banks should continue the financial intermediary service as this is important because these institution help to facilitate the channeling or transfer of funds [savings] from the surplus units to the deficit spending units through the administration of loans to different sectors of the economy which will further increase the productivity of the economy.

For instance the personal savings of an individual lodged in the bank can be lent to another individual or a business firm for further money creation.

More so, large scale production and high degree of specialization of labour can only be possible if there is an efficient recycling system of funds [funds flow].

Business firms can obtain the funds they need, to buy capital goods from the necessary institution: This is done through the use of marketable collaterals as a pledge to secure the loans.

The federal government and governmental units e.g Money Banks (CBN) and Nigeria deposit insurance corporation [NDIC] are able to carry out a wide range of activities on the domestic and international scene only if an efficient means exist for raising funds for making payments and for borrowing [NJOKU P.O, 2005]

A preview of the statistics of bank lending trend show that total loans given to the private sector are fluctuating and remained the same in the last 10years plus the period under review.

There is also no commensurate increase in the gross domestic product (GDP) as values remain unstable in the period under review.

Statement of the Problem

In Nigeria, banking business is quite risky and a lot of fear is being exercised in establishing bank branches in both the rural and urban areas of the country, so as to exercise their ultimate purpose of existence; which is their ability to lend confidently and sufficiently and to undertake risky but economically beneficial development oriented investments which rather depends crucially on profits being earned by depositor. Justifiably about 65-70% of banks total revenue is derived from investment being loans granted by banks to their customers. It has to be noted that those profitable business of the banks are associated with enormous risks which may either be as a result of exogenous or endogenous factors which include:

Lack of adequate capital in banks, increasing rate of bad debts, inherent and sprawling fraud rate in the economy, meeting the security requirements by financial institutions (banks) and fluctuation of interest rates due to unstable level of inflation.

Objective of the Study

This paper seeks to spot light the roles of financial institutions in the development of the Nigeria economy and to provide quality recommendations on how this institutions can be managed to ensure economic development.

Hypothesis

HO: There is no significant relationship between the roles of financial institution [credit to the private sector] and the development of the Nigeria economy.

Significance of the Study

The paper seeks to establish a link between the roles of financial institutions and the economic development in Nigeria. Hence the work is expected to benefit the following:

1. It will enable firms to be aware of services offered by financial institutions and utilize them effectively.
2. It will help financial institutions to have various ways to manage their lending activities to ensure a profitable result
3. Finally, the research will arouse further curiosity by researchers into the role of financial institutions in the development of the Nigeria economy.

Conceptual Framework

Financial Institutions and Economic Development

In the developed economies, financial institutions mobilize savings in form of deposits, premium, weekly or monthly contributions from their customers. Banks mobilize savings from their customers by way of opening various accounts such as savings, current and fixed deposits.

Various rules guide the operation of these accounts. The insurance companies collect premiums from their customers in exchange for undertaking to bear their risks, while the credit and thrift cooperative societies collect contributions from their members in like manner; workers contribute part of their salaries to pension funds in order to be paid a bulk sum on retirement. These institutions provide the public with opportunity to save, thereby helping them to accumulate wealth.

These funds mobilized by the financial institutions as explained above are used to extend loans to deserving customer. These institutions have good methods of arriving at a decision as to who is credit worthy and deserving of their loans. The bank provide credit to the economy to finance consumption and investment spending, the bank through its intermediary function gather funds from millions of small savers to form a pool of investable funds which they lend to firms and other individuals with viable projects or investment ideas to finance production and consumer's spending. By borrowing on short term and lending on long term to customers, meaningful productive investment take place and viable economic growth is enabled.

This system of borrowing short and lending long is met by applying several business tactics such as diversification of depositors fund in such a manner that will encourage a fair liquidity in the banks.

Also they may put arrangements in place with other banks that they could easily draw on in case of unexpected large withdrawal.

Edward B. Titchener (1998) and P.W.V Hornick (1987). Posits that the Classical and neo-Classical Economics is Concerned Primarily with the optimal growth of those resources overtime, they hold that countries develop economically via a well diversified bank and market. In a market economy economic benefits flow from the market to participants be they individuals or companies for self-interest and voluntary acts. This behavior is efficient and produces the greatest overall economic growth.

Methodology

Population of the Study and Model Specification and Justification

The population of this work encompasses the total accumulated loans given out by the commercial banks to the private sector [Lo] and the gross domestic product of the country [GDP] from 2001 to 2011.

As a result of the nature of the study the analytical tool used is the ordinary least square [OLS]. Under the OLS, the simple regression was adopted to test the hypothesis since the research work tends to study the relationship between just two variables. Thus, the model expresses economic development [GDP] as a function of various levels and categories of loan given to the private sector.

Thus, the growth model is specified as follows and variables defined for clarity purpose.

GDP = F [Lo]

GDP = a+ bE + E
Where
GDP = Gross Domestic Product
Lo = Loans to the Private Sector
E = Standard Error of test
bE = Sample Standard Deviation
Calculation for 't' test is given as

$$t = \frac{bi - b\wedge}{bt}$$

Where: bi = Estimate bi
b^ = Hypothesized bi Ho: bi = bj^
bt = Sample Standard deviation

Sources of Data Collection

The study exclusively used secondary sources of data. The data to be generated are quantitative time series data on gross domestic product and the total accumulated loans to the private sector, from the Money Bank (CBN), statistical bulletin; between the period of 2001 to 2011.

Data Analysis

Presentation of Data for Analysis

Table 1:

Year	Gross Domestic Product [GDP] in ₦ Billions	Commercial Bank Loans [Lo] in ₦ Billions
2001	357.0	279.6
2002	433.2	360.6
2003	477.5	433.9
2004	527.6	568.7
2005	561.9	197.7
2006	595.8	252.4
2007	634.3	482.1
2008	672.2	779.9
2009	719.0	966.8
2010	775.5	919.8
2011	788.6	961.4

Source: Money Bank (CBN) statistical Bulletin 2011 financial statistics book and data files catalog source world development indication.

Analysis of Data

Table 2:

	X (Lo)	Y (GDP)	XY	X^2	$X-\bar{X}$	$Y-\bar{Y}$	$(X-\bar{X})^2$	$(Y-\bar{Y})^2$	$(X-\bar{X})(Y-\bar{Y})$	$(X-\bar{X})\,Y$
	279.6	357.0	99,817	78,176	-284.3	-237.8	80,826.5	56548.8	67606.5	-101495.1
	360.6	433.2	156,212	130,032	-203.3	-161.6	41,330.9	26114.6	328533	-88069.6
	433.9	477.5	207,187	188,269	-130	-117.3	16900	1375933	15249	-62075
	568.7	527.6	300,046	323,420	4.8	-67.2	23.0	4515.8	-322.6	2532.5
	197.7	561.9	111,088	39,085	-366.2	-32.9	134,102.4	1082.4	12048	-205767.8
	252.4	595.8	150,380	63,706	-31.5	1	97,032.3	1	-311.5	-185591.7
	482.1	634.3	305,796	232,420	-81.8	39.5	6691.2	1560.3	-3231.1	-51885.7
	779.9	672.2	524,249	608,244	216	77.4	46,656	5990.8	16718.4	145195.2
	966.8	719.0	695,129	934,702	402.9	124.2	162,328.4	15425.6	50040.2	289,685.1
	919.8	775.5	713,305	846,032	355.9	180.7	126,664.8	32652.5	64311.1	276,000.5
	961.4	788.6	758,160	924,290	397.5	193.8	158,006.3	37558.4	77035.5	313,468.5
Total	**6203**	**6543**					**870562**	**195.210**	**331,997**	**331,997**

$$\bar{X} = \frac{Ex}{n} = \frac{6203}{11} = 563.9$$

$$\bar{Y} = \frac{Ey}{n} = \frac{6543}{11} = 594.8$$

Regression of Y on X is given by
Y = a +bx
Where:
a = Intercept, b = Slope

$$b = \frac{E[x - \bar{x}]y}{E[x - \bar{x}]}$$

A. $b = \frac{331{,}997}{870562}$

b = 0.38

$a = Y - b\bar{X}$

$a = 6543 - 0.38\ [563.9]$

$a = 6543 - 214.3$

$a = 6328.7$

$y = 6328.7 + 0.38x$

B. Coefficient of Determination

$$R^2 = \frac{b \sum [x - \bar{x}][Y - \bar{Y}]}{\sum [Y - \bar{Y}]^2}$$

$$R^2 = \frac{0.38\ [331997]}{195{,}210}$$

$$R^2 = \frac{126158.9}{195{,}210}$$

$R^2 = 0.65$

Thus equation $Y = 6328.7 + 0.38$

Where

X = Loans to the private sector

Y = Gross Domestic Product

C. Standard Errors of Estimate [se]

First, calculate for the unexplained variation

$$\sum e^2 = \sum [Y - \bar{Y}]^2 - b \sum [x - \bar{X}]\ [Y - \bar{Y}]$$

$= 195.210 - 0.38\ [331{,}997]$

$= 195{,}210 - 126158.9$

$= 69051\ .1$

$$Se^2 = \sqrt{\frac{\sum e^2}{n-2}}$$

$$= \sqrt{\frac{69051}{11-2}}$$

$$= \sqrt{\frac{69051}{9}}$$

$$= \sqrt{7672}$$

$= 87.59$

D. Calculate for ‘‘T’’

$$t = \frac{bi - b*}{sb}$$

The t-statistics for bi estimated in a simple regression equation for single variable 11 at 1% level of significance is 24.725.

Interpretation of Result

To explain the roles of financial institutions in the development of the Nigeria economy, two explanatory variables were employed, commercial bank loans to the private sector and the gross domestic product of the economy. Hence, from the result of simple linear regression, the coefficient of determination [R^2] of 0.65 shows that 65% of variation in Gross Domestic Product [GDP] [Y] is explained by the independent variable [X] total loans to the private sector.

From the analysis above, we can see that total loans remained consistently positive and significant in the method employed in the estimation. This shows a positive relationship between total commercial bank credit to the private sector and the GDP in testing for individual significant of the independent variables using the t-test.

Conclusion

From the findings of this study, there was a concrete conclusion that lending to the real and productive sector of the economy has been a major contribution of financial institution and this has led to a significant increase in investment and production which has further affected the total output of the country significantly despite some lags or loopholes.

Recommendations

The recommendations for the findings of this study are as follows:

i. Pressing needs for domestic financial institutions to increase their participation in areas of investment lending, development lending and also engagement in sponsoring of huge capital projects, since the analysis shows that their contributions to the development of the economy is 65% leaving behind a gap of 35%.

ii. Qualified field officers should be employed and retrained to meet the challenging needs of sound management.

iii. Extension of branches of financial institutions to the rural areas and other parts of the country as this will increase stimulation of savings and development of the rural areas.

iv. Government regulatory authorities should check the side effect of policies formulated before implementation. Policies such as frequent increase in banks capital base and the abolition of universal banking system should be considered properly before implementation as this policies can hinder the discharge of bank duties to the economy.

v. There should be a consistent monitoring of borrowers to ensure compliance and adherence to their proposal and feasibility study in order to reduce the risk of non payment to the barest minimum.

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