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Commentary

The Effects of Financial Liberalisation on Banks Performance

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DESCRIPTION

The financial sector boom was accompanied by financial disintermediation, which resulted in a decline from 1986 to 1992. This decline was attributed to deposits in financial institutions and loans to the private sector, both of which were relative to GDP. Thus, rather of engaging in financial intermediation, the growing number of banks and human capital in the financial industry were directed into rent-seeking and competition. Rent-seeking practises of the ruling elites are the main focus of political economy interpretations of the liberalisation and boom-and-bust period. Liberalization measures were implemented selectively to preserve patronage opportunities and shield the ruling elites and their allies from the financial repercussions of these reforms while pressing forward with structural reforms in numerous sectors. Political and military leaders had several opportunities for patronage thanks to the burgeoning banking sector and the new arbitrage opportunities made possible by the multi-tiered exchange rate system. Political influence was used in the licencing of banks, and top military leaders and politicians frequently served on bank management boards.

However, the transition of rent-seeking and arbitrage from the real to the financial sectors, which was further encouraged by macroeconomic instability, also gave rise to new echelons of wealth and power. Financial sector reform is anticipated to result in higher nominal and real interest rates through the elimination of the components of financial repression, particularly controlled interest rates. This is the hypothesis' postulate. A higher real interest rate tempts consumers to spend instead than save. On the other hand, greater interest rates on savings encourage people to save more, but for a shorter period of times. The overall result would depend on which of the two impacts predominates because they operate in diametrically opposed directions. The substitution impact would overcome the wealth effect, according to the McKinnon Shaw doctrine. A switch in the investors' wealth portfolio from non-financial to financial assets will help financial savings even more.

The need to restore macroeconomic and financial stability prior to the start of large-scale financial liberalisation is emphasised in the feasible sequence of financial liberalisation. By reducing fiscal deficits and tightening monetary and credit policy, macroeconomic stability will be attained by reducing inflationary pressures. Nigeria implemented a significant financial liberalisation programme as part of the Structural Adjustment Program (SAP) in 1986. Credit allocation quotas were loosened, interest rates and entry into the banking sector were liberalised. The government maintained a multiple exchange rate regime while removing direct foreign exchange rationing for the real sector at the same time, ushering in a new era of arbitrage and rent-seeking for financial institutions with exclusive access to foreign exchange auctions. This led to the rapid entry of many new companies, particularly merchant banks, into the banking sector. The number of banks increased from 41 to over 120 in the years that followed, and both employment and GDP contribution from the financial system almost tripled.

Specialized banks have been developed since the start of the structural adjustment programme to satisfy the constantly growing credit demands of societal segments that are not sufficiently served by the current system. The Peoples Bank, which is meant to meet the needs of small and medium-sized business owners in society, and Community banks, whose capital requirements are fulfilled by the communities in which they are based, are these. Both of them aim to foster independence by offering credit facilities at the community level. A large number of new and small institutions that are heavily involved in the intermediation process are present in the financial system in addition to these significant financial institutions. These consist of financial firms, leasing firms, mortgage lenders, savings and loan organisations, and venture capital firms. The majority of these have gained notoriety as a result of the system-wide financial innovation brought on by the beginning of financial liberalisation. Their distinctive single-unit offices, share aggressiveness in mobilising savings, and creation of investment outlets distinguish them as viable potentials for

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the fostering of enhanced intermediation given a well-developed money and capital market, despite the fact that their activities are primarily restricted to urban areas.

Transformation of the financial structure, monetary policy reforms, foreign exchange reforms, liberalisation of capital movement, and capital market reforms are the five primary areas where the financial sector has been attempted to be reformed. This financial structure reform includes actions made to boost competition, expand the regulatory authorities' role in oversight, and improve linkages between the public and private sectors and the financial industry. The introduction of an auction-based system for the issuance of treasury certificates, for example, is intended to encourage a greater reliance on market forces in the determination of yields on government debt instruments through the market. This will increase bank efficiency through increased competition and management. The financial sector's reformation policy fits with the liberalisation strategy. As a result, the study is in favour of bank liberalisation because it improved bank performance. It determined interest rates and the decision by the Federal government to sell its share-holdings in some commercial and market banks thereby revising such banks to private ownership.