IMPACT OF BANKING SECTOR INTERMEDIATION ON THE NIGERIAN ECONOMY

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ABSTRACT

This paper assesses the role of the banking sector in the channeling of funds to private enterprises for productive investment by examining relationships between the mobilization and allocation functions of the banking sector and economic growth in Nigeria using a regression model. The study employed gross domestic product as proxy for economic growth, while total private sector deposit (TPSD) and credit to the private sector (CPS) were proxies for banking sector intermediation. The results revealed that there was a positive and significant impact of mobilized funds on economic growth and a negative and significant impact of allocated funds on economic growth. This indicates that the real sector did not benefit by way of accessing credit from the banking sector, although the banking sector showed the capacity to channel funds in form of credit to the private sector during the period under study. This is an indication that the Nigerian banking sector is still underdeveloped. In line with these findings, policy makers should come up with initiatives to motivate the deposit money banks to make funds available to the private sector by making it easier for entrepreneurs to access credit.

Keywords: Banking Sector, Intermediation, Economic Growth

JEL Classification: E02, E51, G21

1. INTRODUCTION

The intermediation process involves moving funds from surplus sectors of the economy to deficit sectors. This process is important in an economy because the economic units which save are not always identical with those units that invest. The financial system of a country is charged with the responsibility of ensuring that this process is carried out effectively and efficiently. The extent to which the transfer process is carried out is dependent on the level of development of the financial sector as well as the savings habit of the populace. As pointed out by Beck, Levine and Loayza (2000), the critical function of financial intermediation is not just pure capital accumulation, but more important is the allocation of society's savings to their best uses to ensure economic growth. The banking sector is a very important and integral part of a country's financial system and is primarily responsible for financial intermediation. Banks as financial intermediaries are expected to serve as avenue for people to save that part of income that has not been expended on consumption. From the accumulated savings they are expected to extend credit to entrepreneurs and other businesses. In this way, banks support and promote efficient allocation of resources in an economy. It follows, therefore that financial stability and sustainable economic growth can be achieved only in the presence of a robust and healthy banking sector. According to Ajakaiye (as cited in Ukeje, Essien, Yakub & Akinboyo, 2004), Nigeria has been classified as a low savings and even lower investment economy. The major factors which are responsible for this range from low savings deposit rates to poor banking habit of the people. The quality, cost and availability of loanable funds have also been seen to constrain the expansion of business and employment generation.

The Nigerian financial system was marked by rapid expansion in monetary aggregates in the years 2000 to 2003, influenced by the monetization of enhanced oil receipts. The growth in monetary aggregates exceeded the prescribed targets by substantial margins. For instance, the demand deposits component of narrow money supply (M1) increased significantly by 59.1 per cent in 2002 and 45.4 per cent in 2003. However, credit to the private sector increased slightly in 2000 from the previous year by 1.7 percentage points. In 2003, overall bank credit to the private sector increased by 27.1 per cent, but fell short of the target growth rate of 32.3 per cent (CBN, 2000, 2003). Aggregate financial savings rose by 88.1 per cent in 2008 compared with 2007. The Deposit Money Banks (DMBs) maintained their dominance as the majority depository institutions within the financial sector accounting for 77.6 per cent of the total financial savings compared with 76.0 per cent in 2007. Credit to the private sector grew by 59.4 per cent in 2008, but its growth decelerated when compared with the 90.8 per cent recorded in 2007 (CBN, 2008). Financial savings increased in 2018 and there was an improvement in intermediation efficiency indicator measured by the ratio of currency outside banks to broad money supply, which stood at 5.7 per cent, compared with 6.2 per cent in 2017. However, the capacity of the banking system to finance the economy declined, with the ratio of private sector credit to GDP at 17.8 per cent in 2018, down from 19.6 per cent in 2017 (CBN, 2018). Majority of DMBs' credit went to the less productive sectors of the economy, as only 40.9 per cent and 40.2 per cent of the total credit went to the productive sector (comprising of agriculture, solid minerals, exports and manufacturing) in 2002 and 2003 respectively. This situation worsened in 2008 as only 26.2 per cent of DMBs' credit went to the productive sector, but improved in 2018 with 41.0 per cent of banks going to priority sectors (CBN, 2003, 2008, 2018). From the foregoing, it appears that financial savings have been growing at a much faster rate than aggregate bank credit to the private sector, signaling reluctance by the banks, not only to extend credit to the private sector, to the productive sector in particular.

The need for a developing country like Nigeria to increase in its capacity not only to mobilize funds efficiently, but also channel same effectively to achieve higher levels of industrialization and development cannot be overemphasized. Thus, having a well-functioning banking sector has been a concern of the Nigerian government. To this end, the Central Bank of Nigeria (CBN) has initiated and carried out a number of policies to boost growth and development of the sector to enable it carry out its intermediation functions more effectively and efficiently and also position it to compete more favourably on the global scene. The banking consolidation programme of 2004 and more recently, the e-banking reforms, like the Automated Trading

Machine (ATM), Point of Sales (POS), Bank verification number (BVN), and Internet banking are some of the initiatives which the CBN has carried out to enhance the functioning of the sector. With all these initiatives in place, the supply of credit to the private sector by the banks still falls below expectation. However, for banks to foster economic growth and development, it follows that the services and functions they provide should be able to galvanize the various sectors in the economy into action that will bring about growth and development.

It has been acknowledged that most Nigerian businesses and firms lack adequate finance, as Onuoha (2013) identified inadequate finance as one of the major problems of the manufacturing sector. Since the growth process of the Nigerian economy depends to a large extent on the development of the real sector because of its potential to not only provide goods but also employment to its citizens, its financing deserves more than a cursory attention. The Nigerian banking system which was established to be a source of funding for the productive sector can therefore be assessed in terms of how it has impacted the economy through its intermediation role.

A number of studies have been carried out to determine the relationship between financial sector and economic growth, many of which investigated the role of banks on economic growth. While many studies reported positive impact (King & Levine, 1993; Levine, 1998; Levine & Zervos, 1998), a few reported negligible or insignificant role (Ali, 2012; Abusharbeh, 2017). In Nigeria, results from such studies have been mixed as well.

The financial intermediation role involves mobilization of savings and also channeling or allocation of such funds in form of credit to the productive sectors where they can result to economic growth. In assessing the role of banks, it follows that these separate functions be investigated to assess the extent to which banks have been able to perform these functions. There is a dearth of studies which specifically address the impact of the separate functions of banking intermediation using proxies to address funds mobilized and actual funds accessed by firms and this study fills this gap. This study therefore sets out to examine the relationship between distinct functions of banking sector intermediation on economic growth. These distinct functions are savings mobilization and fund allocation (channeling) in form of credit to the real sector. The question is to what extent has the Nigerian banking sector been able to impact the economy? The specific objectives are to determine the impact of the mobilization and allocation functions of the Nigerian banking sector on economic growth. The findings would be beneficial for banking sector development policy in Nigeria.

2. REVIEW OF RELATED LITERATURE

2.1 Theoretical Literature

The primary functions of financial institutions are to mobilize savings of investors and allocate these funds to investment projects. Since many investment projects are large they require funds that cannot be provided by any single investor. Consequently, the aggregation of these savings becomes necessary. Financial intermediaries mediate between the providers and users of funds, by pooling the savings of many investors and by so doing enable the undertaking of large-scale projects.

The role of financial systems in economic development has been an area of interest in financial economics. Earlier studies of Bagehot (1873) and Schumpeter (1911) stressed the critical role of the banking system by identifying the linkage of financial sector and economic growth. Authors like Robinson (1952), Goldsmith (1969), McKinnon (1973) and Shaw (1973) identified this linkage but were divided on the direction of causality. While Robinson (1952) argues that economic growth will lead to expansion of the financial sector, Goldsmith (1969), McKinnon (1973) and Shaw (1973), in contrast, emphasized the positive role of financial systems on economic growth. They demonstrated that the financial sector could be a catalyst for economic growth if is healthy and well-developed. .

The theory of financial intermediation tries to explain why financial intermediaries exist. Financial intermediaries reduce transaction costs; provide liquidity and information (Andries, 2009). According to Englama, Raheem, Ihekuna, Sanni and Inuwa (2004), the benefits accruable from a healthy and well developed financial system relate to savings mobilization and efficient intermediation roles. First, through the financial intermediation function of financial institutions, savers and borrowers are linked up and this reduces transaction and search costs. Second, by borrowing short-term and lending long-term, they create liquidity in the economy. Third, they reduce information costs, provide risk management services and reduce risks involved in financial transactions. Fourth, the intermediaries bring the benefits of asset diversification to the economy. Fifth, they mobilize savings from atomized individuals for investment, thereby solving the problem of indivisibility in financial transactions. Finally, mobilized savings are invested in the most productive ventures irrespective of the source of the savings.

2.2 Empirical Literature

A number of empirical studies on the relationship between financial systems and economic growth have been carried out. Studies on the link between financial systems and economic growth have varied in methods and results.

King and Levine (1993) examined a cross-section of eighty countries from 1960 to 1989 to test Schumpeter's hypothesis that finance matters. They used four banking system development measures namely, ratio of liquid liabilities; ratio of deposit money banks' domestic assets to deposit money banks' domestic assets plus central banks' domestic assets; ratio of credit and ratio of credit issued to non-financial private firms to Gross Domestic Product (GDP). They found that finance precedes economic growth and that higher levels of financial development are positively associated with faster rates of current and future economic growth; physical capital accumulation, and economic efficiency improvements both before and after controlling for numerous country and policy characteristics, thus confirming Schumpeter's hypothesis of positive linkage between financial development and long-run growth.

Levine (1998) examined forty-three countries from 1976 to 1993 and found significant relationship between banking development and long-run rates of economic growth. Banking development was measured as credit allocated by commercial and other deposit-taking banks to the private sector divided by GDP.

Odhiambo (2007) investigated the dynamic causal relationship between financial development and economic growth in Kenya, South Africa and Tanzania using data from 1980 to 2005. They used three banking sector development measures, namely, ratio of liquid liabilities of banks (BLL), private sector credit (PSC) and ratio of currency to narrow money (CC-M1). Using co-integration and error based Granger causality tests, all three countries were found to have stable long-run relationships between financial development and economic growth, while causality is sensitive to the development measure used. When BLL is used as the financial development indicator, there is bi-directional causality in Kenya, uni-directional causality from growth to finance in South Africa, and uni-directional causality in Tanzania, while the use of PSC and the ratio of currency to narrow money (CC-M1) as financial development measures revealed bi-directional causality in Tanzania and uni-directional growth-led finance in Kenya and South Africa.

Ali (2012) examined the relationship between banking sector development and economic growth in Lebanon from 1992 to 2011 using Granger causality test and ordinary least square (OLS) method. He found a one-way causality running from economic growth to banking sector measures such as deposit growth and credit to local private sector. He also found that credit provided by banks to the resident private sector, and the banking sector size, efficiency, and concentration do not impact economic growth significantly. These results provide support for the demand-following hypothesis regarding the link between financial sector development and economic development in Lebanon.

Abusharbeh (2017) investigated the impact of banking sector development on economic growth in Palestine. He employed credit facilities, depositors' funds, the number of branches and interest rate as banking sector indicators and gross domestic product as economic growth measure. Using quarterly data from 2000 to 2015 and ordinary least square regression, he found that banking credits are positively related to economic growth, but that interest rate, customers' deposits and number of branches have no significant impact on economic growth. He pointed out that the result supports the supply-leading theory and indicates that there is strong real benefit from banking credits policy due to the significant effect on Palestinian economy.

A number of studies have been carried out in Nigeria to investigate the relationship between banking sector and economic growth. Adelakun (2010) examined the relationship between financial development and economic growth in Nigeria by using ordinary least squares (OLS). The result showed that there is a substantial positive effect of financial development on economic growth in Nigeria. Chinaemerem and Chigbu (2012) investigated the impact of banking sector development variables on economic growth in Nigeria from 1960 to 2008, using error correction model (ECM) and Granger causality test. They used two measures of financial development, namely, money supply (MS) and credit to private sector (CPS). The results showed that money supply (MS) and credit to private sector (CPS) are positively related to economic growth of Nigeria.

Ibrahim (2012) examined the impact of financial intermediation on economic growth in Nigeria from 1970 to 2010, using error correction model (ECM) and Engel-Granger technique. He employed two indicators of financial intermediation: ratio of broad money supply (M2) to nominal gross domestic product (NGDP) and the ratio of domestic credit to private sector (PSC) to the nominal gross domestic product (NGDP). The results revealed that financial intermediation using broad money supply to GDP has a significant impact on economic growth in Nigeria.

Omoruyi and Osawmonyi (2013) employed ordinary least squares (OLS) and Granger causality test to empirically examine the relationship between banking sector development and economic growth in Nigeria over the period of 1981 to 2011. The result revealed that all the explanatory variables (total assets of deposit money banks/GDP (BA), private sector credit/GDP (PSC), liquid liability ratio of banks (BLL) were significant positive determinants of economic growth in Nigeria, with the exception of liquid liability ratio of banks (BLL) which although significant, had a negative sign in the regression results. They also found a one-way causality running from economic growth to banking sector development when total asset of deposit money banks/GDP (BA) was used as a measure of banking sector development. They recommended that monetary authorities should gear their policies towards strengthening and developing the banking sector and suggested measures such as improving the level of corporate governance, building reliable regulation and supervision for the banking sector which could promote faster economic growth.

Karimo and Ogbonna (2017) examined the direction of causality between financial deepening and economic growth in Nigeria for the period 1970 to 2013. The study adopted the Toda-Yamamoto augmented Granger causality test and employed bank total asset as a ratio of GDP and ratio of bank credit to private sector to GDP as banking sector deepening indicators. Results showed that the growth-financial deepening nexus in Nigeria follows the supply-leading hypothesis. This means that it is financial deepening that leads to growth and not growth leading to financial deepening. Their results contrast those of Omoruyi and Osawmonyi (2013) who report support for demand-following hypothesis.

Ogbonna (2018) re-examined the impact of financial deepening on the economic growth of Nigeria between 1970 and 2015 using Vector Error Correction Model, Impulse Response Function, and Forecast Error Decomposition, with a distinction between size and activity variables of financial deepening. The results showed that financial deepening and economic growth have a stable long-run relationship and that activity variables of financial deepening have more stimulating effect on economic growth than the size variables.

Much of the empirical studies on the impact of banking sector reported their findings with no attempt to highlight the impact of the distinct intermediation functions on economic growth. This study tries to fill this gap by examining the impact of the distinct financial intermediation functions, namely fund mobilization and fund allocation.

3. METHODOLOGY

3.1 Data

To study aims at providing empirical evidence on the impact of banking sector intermediation on economic growth in Nigeria. Secondary data used for the analysis were obtained from

Central Bank of Nigeria Statistical Bulletin. The secondary data (from quarterly records) included gross domestic product (GDP) which was proxy for economic growth and banking services data which were proxy for banking sector intermediation for the period 2012- 2017. The banking services data were total private sector deposit (TPSD) and credit to private sector (CPS) as explanatory variables; payment made on electronic banking channels, namely POS and ATM as control variables. Bank verification number policy was also included as a control variable. The study employed a multiple regression model and analyzed with the ordinary least squares technique.

3.2 Model specification

The model adopted for this study was specified using gross domestic product (GDP) as dependent variable while total private sector deposit (TPSD) and credit to private sector (CPS) were used as explanatory (independent) variables. Payments on POS and ATM and BVN policy were included as control variables. BVN was included in dummy form. The dummy variable (D) takes the value 1 in the years (2015-2017) when the BVN policy is in place; otherwise it takes the value 0. Thus, economic growth is expressed as a function of banking sector intermediation. In principle, we expect a positive relationship between economic growth and the various proxies of banking sector intermediation if indeed the banking sector has been mobilizing and channeling funds to stimulate economic activities.
The general form of our firm's output model is as follows:

Economic Growth = F (Banking sector intermediation) … (1)

Specifically, when the above model is adopted, equation (2) can be written as

$$GDP = F(POS, ATM, TPSD, CPS, BVN) \quad \dots (2)$$

Specifically, when the above model is adopted, equation (3) can be written as

$$GDP_t = \beta_0 + \beta_1 POS_t + \beta_2 ATM_t + \beta_3 TPSD_t + \beta_4 CPS_t + \beta_5 D_t + \varepsilon_{it} \quad \dots (3)$$

Where:

GDP_t = Gross domestic product in period t.

POS_{it} = Payments on POS in period t.

ATM_t = Payments made through ATM in period t.

$TPSD_t$ = Total private sector deposit in period t. It is a proxy for funds mobilized.

CPS_t = Credit to private sector. It is proxy for funds allocated to private firms.

D_t = Dummy for Bank verification number (BVN) policy

ε_{it} = Composite error term

β_o = Constant term (intercept)

$\beta_1, \beta_2, \beta_3, \beta_4$, and β_5 are the coefficients to be estimated.

From theoretical expositions and conventions, each model parameter estimate is expected to have a positive sign. Thus, a priori expectations from the model were as follows: $\beta_1, \beta_2, \beta_3, \beta_4$, and $\beta_5 > 0$.

The model specified was estimated using the statistical software SPSS. The model was used to test the following hypotheses at the 5% level of significance;

Hypothesis 1: There is no significant impact of funds mobilized by the banking sector on economic growth

Hypothesis 2: There is no significant impact of the funds allocated to the private sector and economic growth.

4. RESULTS AND DISCUSSIONS

The result from the multiple regression analysis is presented in Appendix and summarized in Table 1.

Table 1: Summary of Regression Result

	Coefficient	Standard Error	T- Statistic	P-value
POS	-8.586	4.379	6.579	.003**
ATM	11.813	.455	21.309	.001**
TPSD	.455	.886	6.377	.003**
CPS	-.817	.907	6.282	.003**
D (BVN)	3124.607	7589.532	3.008	.040**
Constant	51230.719			
R	.998			
R Square	.996			
Adjusted R Square	.982			

Dependent Variable: GDP. Note: ** show significance at 5%

Source: SPSS 23 OUTPUT

Based on the regression result, the relationship between economic growth (GDP) and the explanatory variables can be determined by the equation:

$$GDP_t = 51230.719 - 8.586POS + 11.813ATM_t + 0.455TPSD_t - 0.817CPS_t + 3124.607D$$

The coefficient of determination, adjusted R^2 is .982. This means that 98.20% change (variance) in the dependent variable can be explained by the independent variables in the model. This means that the model can be used to aid policy formulation. From the empirical results, all the explanatory (total private sector deposit (TPSD) and credit to private sector (CPS)) and control variables are significant (p-values less than 0.05). For the control variables, while ATM and BVN policy had positive impact on the economy, POS had a negative impact.

For hypothesis 1 at 5% significance level, the coefficient for total private sector deposit (TPSD) is positive and significant (p-value less than 0.05). Thus, we reject the hypothesis that funds mobilized by the banking sector have not significantly impacted economic growth. The positive and significant relationship between TPSD which is the proxy for funds mobilized and economic growth indicates that the banks were efficient in mobilizing funds from the populace during the period under study. This result agrees with those of Ibrahim (2012), Chinaemerem and Chigbu (2012) and Omoruyi and Osawmonyi (2013) who found positive significant impact of banking sector deposits on economic growth and disagrees with Ali (2012) and Abusharbeh (2017) who found no significant impact.

In the second hypothesis the relationship between credit to private sector (CPS) and economic growth is negative and significant (p-value less than 0.05). We reject the null hypothesis that there is no significant relationship between the funds supply and firms' output and accept the alternative that there is a significant though negative relationship between funds allocated to the private sector and economic growth. The banking sector has negatively impacted economic growth. This indicates that the banking sector did not channel adequate funds in form of credit for productive investment in the economy within the period under study. This shows the inefficiency of the banking sector in channeling funds to business enterprises. The result disagrees with those of Chinaemerem and Chigbu (2012), Omoruyi and Osawmonyi (2013), Abusharbeh (2017) who found positive relationship between the banking sector credit to private sector and economic growth. The contrasting results may be due to the time period covered by the various studies. These findings from the two hypotheses have shown that although the Nigerian banking sector has the potential to mobilize funds from the economy, it has not translated into investment capital for the producing sector.

5. CONCLUSION AND RECOMMENDATIONS

In this study, an attempt was made to examine the impact of banking sector intermediation on economic growth of Nigeria. The findings of this research work has provided empirical evidence that although the Nigerian banking sector demonstrated the potential to mobilize funds from the private sector; this did not translate into effective credit for investment within the period under study. We can safely conclude that the Nigerian capital market has not impacted positively on the ailing economy by providing the much needed funds to the producing sector which has the greatest potential to impact the economic development of a nation.

Based on the findings of the study, the following recommendations have been made towards improving the role of the Nigerian banking sector in the provision of funds to the producing sector:

1. Policies which will encourage banks to channel more credit to the private sector should be put in place. This can be by the regulatory authorities guaranteeing more loans granted to the private sector by the banks and specifically to the productive sectors.
2. There is need to remove all impediments that may be preventing entrepreneurs and industrialists from accessing funds in form of credits from the banking sector in order to stimulate productive activities in the real sector. The CBN can do this by formulating

policies which will compel banks to relax some of the stringent requirements required by the banks.

3. To improve on the low level of development in the Nigerian banking sector as indicated by the low level of credit to the private sector, CBN as regulator should ensure better corporate governance in the banking sector by being more vigilant in their supervisory and monitoring roles.

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