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BANKING SECTOR REFORMS AND THE PERFORMANCE OF BANKING BUSINESS IN NIGERIA – AN ECONOMETRIC ANALYSIS

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ABSTRACT: *The study examines the effect of financial reforms on banking sector efficiency in Nigeria from 1986- 2016. The objective of the study is to evaluate the extent to which exchange rate, (EXCH), interest rate (INT) and liquidity (LQT) have affected the efficiency of banking operations in Nigeria. The dependent variable in measuring banking sector efficiency is proxy by Nonperforming Loan (NPL). The OLS regression was adopted for test of the three hypotheses formulated. The findings indicate that financial reform targets have significantly affected banking sector efficiency in Nigeria in the long run. The study recommends that the regulatory and supervisory framework should be strengthened while interest rate policy should be made to stimulate savings through high real deposit rate and lending rate so as to promote financial deepening and thus banking efficiency.*

KEYWORDS: Financial Reforms, Exchange Rate, Interest Rate, Liquidity, Banking Efficiency.

INTRODUCTION

Financial reforms connote changes, re-organization, restructuring, re-shaping and overhauling of the fin4ncial system to get rid of imperfections and possible distortions affecting smooth operation and performance of the system. Akpan (2012). Financial reforms could be as a result of general economic and social refonns introduced in a country. Different sectors of the economy embark on reforms to improve their system and ensure efficiency. The banking sector is no exception. Financial reforms focus mainly on restructuring financial sector institutions and markets through various policy measures. Anyanwu (2010). In other words, financial reforms should enhance the banking sector intermediation role towards achieving efficiency.

Since the introduction of the Structural Adjustment Programme (SAP) in 1986, several financial reforms have taken place in Nigeria, such as exchange rate reforms, interest rate reforms, monetary policy reforms, banking sector reforms and capital market reforms. These financial reforms were geared towards achieving efficiency in all financial sectors of the economy (banking sector inclusive) and enhance financial deepening.

Banking sector is not limited to deposit mobilization and withdrawal. The major rOle is to channel idle funds from the industry to the real sector of the economy in form of investment which stimulates economic growth. According to Lemo (2005) as cited in Azeez and 01cc (2012) financial reforms were designed to enable the banking industry develop the required resilience to support the economic development of a nation by efficiently performing its function of financial intermediation. In Nigeria, financial reforms started with the deregulation of interest rate in 1987 to the popular bank recapitalization and consolidation of 2004 through mergers andacquisition. Adelege and Oriavwote (2014) according to available CBN statistics of 2004, only ten banks out of eighty nine account for 53.20% of total assets, 56.2% of total deposit liabilities and 43.3% of total credits in the industry. For an efficient banking industry

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in Nigeria, the number of banks was reduced to twenty five larger, better capitalized banks. By 2009, some banks were declared distressed while five banks were found to be insolvent based on the volume of nonperforming loan. Such banks are Union Bank, Oceanic Bank, Afribank, Finbank and Intercontinental bank. The various reforms we undertook in Nigeria were targeted at making the system more effective and strengthening its growth potentials thus efficiency (Sanusi 2012).

Statement of the Problem

It has also been argued that financial reforms have affected banking sector performances positively. Obamuyi and Olorunfemi (2011) and Osabuohiren (2008) opined that financial reforms impacted positively 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. This caused 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. This justify the reason for the study.

Purpose/Objective of the Study

The objectives of the study are to examine how Exchange Rate reforms have affected banking sector efficiency, to evaluate the impact of interest rate reforms on banking sector efficiency and to analyze how the liquidity reforms have affected banking sector efficiency.

Research Hypothesis

The study is guided by the following hypotheses

H_{o1}: Exchange rate reforms have no significant effect on banking sector efficiency.

H_{o2}: Interest rate reforms have not impacted positively on banking sector efficiency.

H_{o3}: Liquidity rate reforms have no significant effect on banking sector efficiency.

Significant of the Study

The study will be of immense value to policy makers, government, financiers and researchers. The study will also constitute a major source of secondary data to researchers and students on financial sector reforms and banking efficiency.

Conceptuals Framework

Over the past decade, many Sub-Sahara African countries have embarked on Structural Adjustment Programmes designed to reverse their poor economic performances, In all, 19 Sub-Sahara African countries have made serious effort to transform their economies into a market-based economic system, while 15 other countries adopted some limited form of structural adjustment programmes. Ziorklui S.Q. (2001). 1-lowever, many of these countries realized that their SAP could not succeedwithout a well functioning financial sector mobilizing financial resources for investment and private sector growth.

According to Lemo (2005) as cited in Igariga (2010), the objective of financial reforms is to guarantee an efficient and sound financial sector. The author opines that Nigerian financial

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sector was designed to enable the banking industry develop the required resilience to support the economic development ofthe nation by efficiently performing its function of financial intermediation.

Theoretical Framework

The theory of this study is therefore propounded in McKinnon new growth theory (1973) and Shaw (1973) hypothesis. The authors believe that a developed financial sector encourages economic growth and development. They argue that banking efficiency which will result in economic growth is hindered in the depressed financial system by low level of savings caused by interest rate regulation, instability of exchange rate, etc. Blum, et al (2002) as cited in Abubakar and Gani (2013).

Empirical Review

Azeez and Oke (2012) examined the effect of banking reforms on the economic growth of Nigeria from 1986 to 2010 using econometric techniques of Augmented Dickey Fuller (ADF), unit Root test, Johansen Co-integration test an error Correction Mechanism (ECM). The empirical result shows the presence of long run relationship among the variables. The overall findings suggest that banking reforms have not adequately and positively impacted on the economy. Abdulsalam and Thrahim (2013) studied the impact of banking sector development on economic growth in Nigeria from 1970-2010 using the Johansen and Juselius (1990) approach to co-integration and Vector Error Correction Modelling (VECM). The findings of the study indicate that credit to the private sector, interest rate spread and government expenditure exert significant negative influence. Adelegun and Oriavwote (2014) studied banking sector reform and unemployment in Nigeria. Co integration approach was used to assess the data which covered the period between 1980 and 2011. Both the result of the static long run model and short run dynamic model indicates that the banking sector reforms in Nigeria have actually increased the level ofunemployment inNigeria. Akpan (2012) examined the impact of financial sector reforms on the economic growth and development of Nigeria. Ex-post facto research design and multiple regression analysis were conducted. It was discovered that among other things that financial sector reform distort the growth and development ofNigeri&s economy as they significantly led to development without growth. Tomola and Sola (2011) examine the implications of financial reform and interest rate behavior on economic growth in Nigeria. Co-integration and error correction model were used on time series data from 1970-2006. The result demonstrates that financial reform and interest rates have significant impact on economic growth in Nigeria.

METHODOLOGY

Data for the study were secondary data generatedfrom Central Bank of Nigeria (CBN) Statistical Bulletin, CBN Annual Report and Statements ofAccounts.

Model Specification

The models for the study were adapted from the work of Tomola and Sola (2011) and Adelegun and Oriavwote (2014). The models are based on the theoretical proposition that reforms have to reposition the bank for better performance. Thus,

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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 ofNigerianNaira 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 shownbelow.

NPL $a_0 + a_1$EXCH + a_2INT + a_3LQT+ μ (2)

a_0 is the intercept of the model while a1,a2,and a3 are the coefficients of the explanatory variables. p. is the error term.

Analysis of Data

Table 4.2: Results of the Relationship between Banking sector efficiency and financial reforms using OLS regression technique.

Dependent Variable: NPL

Method: Least Squares

Date: 05/08/17Time: 15:03

Sample: 1986-2013

Included observations:28

Variable	Coefficient	Std. Error	t-Statistic	Prob.
EXCH	-0.149831	0.033366	-4490540	0.0002
IN T	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

Source: Researcher's Computation

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The result gave the coefficient of determination (R^2) of 0.611192. This indicates that about 61% 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 below 5%, 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 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 implicate that financial sector is helpful in determining banking sector efficiency
2. The study implicates the stabilization of exchange rate policy, if we are to realize our objective of the banking sector efficiency
3. 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. The study also implicate that government should ensure an enabling environment for business to thrive.

CONCLUSION AND RECOMMENDATIONS

The results indicate that using Ordinary Least Square (OLS) regression technique, about-61% of factors that determine banking sector efficiency is explained by the financial reforms. We therefore conclude that financial reforms significantly influence banking sector efficiency in Nigeria. Though long run relationships exist between the selected variables for measuring banking sector efficiency and the financial reform targets, 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 effect 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. Government should also ensure an enabling environment for business to thrive.

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