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ROLE OF BANKS IN CAPITAL FORMULATION AND ECONOMIC GROWTH IN NIGERIA

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ABSTRACT

This study examines the role of banks in capital formation and economic growth in Nigeria for the period 2000-2014. It is a known fact that banks play an indispensable role in maintaining the delicate balance system between money and credit. This study employed the use of OLS multiple regression technique in analyzing the data collected from CBN statistical Bulletin. The explanatory variables employed are: Commercial Banks Credit (CBC) and Investment by Banks (BINV) while the dependent variables include the Gross Fixed Capital Formation (GFCF) and Gross Domestic Product (GDP). In the second regression analysis, the GFCF served as an explanatory variable. From the result of the analysis, it was discovered that commercial banks credit (CBC) impacts on both the Gross Fixed Capital Formation (GFCF) and the Gross Domestic Products (GDP). The GFCF in turn impacts positively on the GDP. It is therefore recommended that efforts should be made by the monetary authorities to effectively manage the banks maximum lending as to enhance capital formation needed for optimal investment and economic growth.

Key Words: Capital Formation, Economic Growth and Banking Industry

INTRODUCTION

The indispensable role of banks in any given economy (advanced and emerging) cannot be over emphasized. The Nigerian banking industry is majorly composed of Deposit money banks, development banks and the Central Bank of Nigeria (CBN), which is the apex bank. The apex bank exercises supervisory and regulatory authority over the banking industry. Banks have always been perceived as engine of growth in an economy because they perform a resource allocation function, by mobilizing and channeling resources from surplus economic units to deficit economic units. They help in stimulating the level of economic activities in various sectors of the economy, thus increasing the level of utility and want to the individual and the community at large.

Banks are the cornerstones of the economy of a country. Economic activities cannot be smooth without the flow of money and credit. The economics of all market-oriented nations depend on the effective operation of complex and delicately balance systems of money and credit. Banks are an indispensable element in these systems. They provide the bulk of the money supply as well as the primary means of facilitating the flow of credit. “Consequently, it is submitted that the economic well being of a nation is a function of advancement and development of her banking industry.

The financial deregulation in Nigeria that started in 1987 and the associated financial innovations have generated an unprecedented degree of competition in the banking industry. The deregulation initially pivoted powerful incentives for the expansion of both size and number of banking and non-banking institutions providing financial services led to increased competition amongst various banking institutions, and between banks and non-banking financial intermediaries.

Apart from the keen competition with the range of financial activities, banks have also faced problems associated with a persistent showdown in economic activities, severe political instability, virulent inflation, worsening economic financial conditions of their corporate borrowers and increasing incidence of fraud and embezzlement of funds. Another major problem banks have had to content with is the inconsistency in monetary and regulatory policies. The surveillance and regulatory measures of the Central Bank of Nigeria (CBN) have unfortunately been unable to keep the pace with the rapidity of the changes in the financial system.

All these factors: –deregulation, competition, innovation, economic recession, political instability, escalating inflation, and frequent reversal in monetary policy have combined to create a challenging and precarious financial environment for banks. Consequence of the new financial environment has been rapidly declining profitability of the traditional banking activities. Thus, in a bid to survive and maintain adequate profit level in this highly competitive environment, banks have tended to take excessive risks, But, then the increasing tendency for greater risk taking has resulted in insolvency of a large number of the banks. It is expected that banks should be healthy enough as to keep braise with the required capital formation for an advanced economic growth.

STATEMENT OF THE PROBLEM

The major role of banks in any given economy is for ensuring a sound financial system and economic stability. A sound financial system and economic stability is a function of the gross fixed capital formation and economic growth. Capital formation is the net addition to capital stock while gross domestic product is the total value of all the goods and services produced by a country over a specified period of time.

It then becomes important to always evaluate the relationship between banking, capital formation and economic growth. Banks in their intermediation role mobilizes the deposits and creates the credits required for the capital formation and economic growth. It is the aim of this study to evaluate how these activities of banks, capital formation and economic growth relates in Nigeria.

Objectives of the Study

The aim of the study is to empirically investigate the role of Nigerian banks in Capital Formation and economic growth. The specific objectives are as follows:

i. To analyze the impact of banks' deposit mobilization on capital formation and economic growth in Nigeria.
ii. To investigate the impact of other bank's performance indicators such as credits to the economy and banks investment on Nigeria's economic growth.
iii. To determine the association existing between capital formation and economic growth in Nigeria.

Research Questions

To achieve the above objectives, the following research questions were formulated:

1. What is the relationship between bank investments in Nigeria, gross fixed capital formation and GDP?
2. What is the relationship between the Gross Fixed Capital Formation (GFCF) and GDP?
3. To what extend does commercial bank credit (CBC) influence the GFCF and GDP?

Significance of the Study

The findings and recommendations of the study will benefit the managers of banks, regulatory authorities and the academics.

Literature Review

Theoretical and empirical research carried out by various researchers on role of banks, capital formation and gross domestic products are found in schools or academics' achieves. Banks are an indispensable element in these systems. They provide the bulk of the money supply as well as the primary means of facilitating the flow of credit. Consequently, it is submitted that the economic well being of a nation is a function of advancement and development of her banking industry.

Savings and Capital Formation

Savings, which we define as the part of incomes not immediately, consumed, but reserved for future consumption, investment or for unforeseen contingencies is considered as an indispensable weapon for economic growth and development. Its role is reflected in capital formation through increased capital stock and the impact it makes on the capacity for an economy to generate more and higher incomes. Rose (1986) sees the importance of savings beyond capital formation. To her, savings are a catalyst for capital formation but equally, a major determinant of the cost of credits based on the law of scarcity, which holds that "when the former is low and scare, it becomes more costly to obtain. The classics as well as modern growth models hold that savings constitute the principal parameter, and determinant of economic growth. This idea is upheld by Rose (1986) which showed that on the average, third world countries with higher growth rates incidentally are those with higher saving rates. Capital mobilized from domestic sources is very fundamental for a country's development not only because it has a low cost, but also due to the fact that it is durable and permanent. Adam (1985) considers that most of this domestic savings will come from the rural areas especially in countries with a dominant rural because there is a greater saving capacity and growth potentials. Thillairajah (1994) and Padmanabhan (1988) sharing the same opinion, explain the high marginal propensity to save by the unstable economic conditions that generally prevails in these areas (unstable incomes, fluctuations in harvest etc).

But unfortunately, in spite of these advantages, most of the saving potentials of rural communities in developing economies remain not mobilized especially in respect to the formal financial system on which an economy depends for growth Nwankwo (1994). To permit an efficient and suitable mobilization of savings in general and rural savings in particular, a number of factors must be fulfilled. These, according to Hussein and Thirlwall (1999) are classified into the capacity to save and the willingness to save. Whereas the capacity to save is influenced by the level of per capita income, growth of these incomes, population age structure and income distribution: the willingness to save on the other hand depends more on the country's financial system through variables such as the level of financial deepening, and inflation. They however concludes that the number, proximity and diversity of financial institutions (willingness to save factor) serving the various needs of savers play a dominant influence over the primeval factor of the capacity to save. But there appear to be a strong link between the rates of growth of financial circuits and how develop and efficient a country's financial system can sustainably mobilized domestic savings.

Functions of Commercial Banks

Jhingan (2001) and Agu (1988) discussed the functions of commercial banks and they are divided into two categories:

i) Primary functions, and
ii) Secondary functions including agency functions.

i) Primary Functions: The primary functions of a commercial bank include:
 a) Accepting deposits, and
 b) Granting loans and advances

ii) Secondary Functions: Besides the primary functions of accepting deposits ad lending money, banks perform a number of other functions which are called secondary functions. These are as follows;
 a) Issuing letters of credit, traveler's cheques, circular notes etc.
 b) Undertaking safe custody of valuables, important documents, and securities by providing customers with facilities of foreign exchange.
 c) Providing customers with facilities of foreign exchange
 d) Transferring money from one place to another; and from one branch to another branch of the bank.
 e) Standing guarantee on behalf of its customers, for making payments for purchase of goods, machinery, vehicles etc.
 f) Collecting and supplying business information
 g) Issuing demand drafts and pay orders, and

h) Providing reports on the credit worthiness of customers.

Capital formation has been the major bane to economic growth and development of the peripheral countries. From the previous literature, the developing countries are faced with the macroeconomic problems – such as: balance of payment; high foreign debt burden; inflationary pressure; high interest rate; etc.

Determining the bane of capital formation, Shuaib, Ekeria and Ogedengbe, (2015) examined the impact of fiscal policy on the growth of the Nigerian economy using time series data from 1960-2012, found a long-run relationship among the variables examined.

Shuaib, Ekeria and Ogedengbe, (2015) examined the impact of inflation rate on the economic growth in Nigeria. The study explored secondary data for the period of 1960 to 2012 and found that there was no integrating relationship between inflation and economic growth for Nigeria data.

Ugwuegbe and Uruakpa, (2013) investigated the impact of capital formation on economic growth in Nigeria. The empirical findings suggested that capital formation has positive and significant impact on economic growth in Nigeria for the period under review.

Kanu&Ozurumba, (2014) examined the impact of capital formation on the economic growth of Nigeria using multiple regressions technique. It was ascertained that in the short run, gross fixed capital formation had no significant impact on economic growth; while in the long run; the VAR model estimate indicates that gross fixed capital formation, total exports and the lagged values of GDP had positive long run relationships with economic growth in Nigeria.

In the work of Bakare (2011) asserted that capital formation influences the economic welfare of a country. It helps in meeting all the requirements of an increasing population in developing economy. It leads to the proper exploitation of natural resources and the establishment of different types of industries, levels of increase and the varied wants of the people are satisfied. They consume a variety of commodities, their standard of living rises and their economic welfare increases. Capital formation raises the level of national income. Bakare, (2011) using cointegration to ascertain the relationship between capital formation and economic growth, his result showed that capital formation has a direct relationship with economic growth of Nigeria.

To ascertain the relationship between capital formation and economic development, Jhingan (2006) asserted in his work that capital formation could not only result on the investment in capital equipment that leads to increase in production but again lead to employment opportunities. He further stressed that capital formation leads to technical progress which helps release the economies of large-scale production and/or increases specialization and/or thus provides machines, tools and equipment for the growing labour force. Capital formation also leads to the expansion of market. He further accentuated that capital formation helped to remove market imperfections by the creation

n of economic and social overheads capital, and thus breaks the vicious circles of poverty both from the demand size and supply side.

METHODOLOGY

The study used ex-post facto research design because the events of the study are historical .In this investigation, the study used explanatory variables which include Commercial Banks Credit (CBC) and Investment by Banks in Nigeria (BINV). The dependent variables are Gross Fixed Capital Formation (GFCF) and Gross Domestic Product (GDP). Explicitly, the model for the study is specified as below:

$GFCF = b_o + b_1 CBC + b_2 BINV + t$ ....(1)

$DGP = b_o + b_1 CBC + b_2 BINV + t$ ....(1)

Where:

GDP = Gross Domestic Product

GFCF = Gross Fixed Capital Formation

CBC = Commercial Banks' Credits

BINV = Commercial Banks' Investments

t = Stochastic variable or error term

a_0 = Intercept

b_1, b_2, b_3 = Parameter estimates

DATA PRESENTATION AND ANALYSIS

The data used in this study were collected from CBN statistical Bulletin of various issues, CBN Economic and financial review, annual reports and statement of accounts, and presented in table 1 below.

Table 1: Data for Regression Analysis

(1) YEAR	(2) GDP	(3) CBC	(4) BINV	(5) GFCF
2000	429,722	102,266.28	22,672.52	331,057
2001	441,519	109,125.82	25,447.73	372,136
2002	459,443	113,175.46	34208.69	499,682
2003	492,231	124,516.31	45,385.87	865,876
2004	536,749	140,025.08	49,669.90	863,073
2005	589,412	160,577.55	60,181.69	804,401
2006	654,055	176,827.95	82,171.94	1,546,530
2007	727,087	231,826.58	93,533.35	1,936,960
2008	818,407	306,613.19	108,951.89	1,936,960
2009	960,011	398,143.69	130,859.29	3,050,010
2010	1,170,993	467,118.17	134,047.72	9,183,060
2011	1,345,767	528,010.18	149,563.90	9,897,200
2012	1,558,174	622,643.64	181,173.39	10,282,000
2013	1,701,191	757,252.72	209,936.80	11,478,100
2014	1,928,517	891,621.62	226,372.41	13,593,800

Source: CBN Statistical Bulletin & CBN Economic and Financial Review
Note: Colum 2, 3, 4, & 5 are presented in N'000,000

Presentation and Analysis of Model 1 Results
The regression analysis for GFCF = b_o+ b_1CBC + b_2 BINV + t is hereby presented in table (2) below

Table 2: Regression Results of Model 1

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1314487	715934.4	-1.836045	0.0912*
CBC	25.03258	6.831617	3.661225	0.0032***
BINV	-26.98275	26.40296	-1.021959	0.3270
R-squared	0.940222	Mean dependent var		4450498
Adjusted R-squared	0.930259	S. D. dependent var		4853135
S. E. of regression	1281639	Akaike info criterion		31.14203
Sum squared resid	1.97E+13	Schwarz criterion		31.28364
Log likelihood	-230.5652	Hannan-Quinn criter		31.14052
F-statistic	94.37179	Durbin-Watson stat		1.430803
Prob (F-statistic)	0.000000***			

Source: Eview 9.5 Computation 2017. Note: *, ** and *** stands for 10%, 5% and 1% levels of significance respectively.

From the regression results above, the R-squared (R^2) value of 0.940222 implies that 94.02% of the changes in Gross fixed capital formation (GFCF) is explained by the independent variables while the remaining 15.98% are as a result of unspecified variables. The F.statistics value of 94.37 and the probability of 0% show that the model is strongly significant. The DW value of 1.43 shows the absence of auto-correlation since it is in the neighborhood of the rule of thumb of 2. The above results show that there is positive and significant impact of Commercial Bank Credit (CBC) on Gross Fixed Capital formation (GFCF) with coefficient of 25.03258 and a probability of 0.0032. BINV is not significant at 5% level.

Presentation and Analysis of Model 2 Results

The regression analysis for GDP = b_o + b_1CBC +

b_2BINV + b_3GFCF is presented in table 3 below.

Table 3: Regression Results of Model 2

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	276238.17	18332.22	15.06844	0.0000***
CBC	0.923406	0.224987	4.104266	0.0017***
BINV	1.959358	0.622809	3.146002	0.0093***
GFCF	0.028277	0.006531	4.329615	0.0012***
R-squared	0.997372	Mean dependent var		920888.3
Adjusted R-squared	0.996655	S. D. dependent var		501376.4
S. E. of regression	28996.55	Akaike info criterion		23.61092
Sum squared resid	9.25E+09	Schwarz criterion		23.79973
Log likelihood	-173.0819	Hannan-Quinn criter		23.60891
F-statistic	1391.551	Durbin-Watson stat		1.634492
Prob (F-statistic)	0.000000***			

Source: Eview 9.5 Computation 2017. Note: *, ** and *** stands for 10%, 5% and 1% levels of significance respectively.

From the regression result in table 3 above, the R-squared (R^2) value of 0.997372 shows that the explanatory variables in the model accounted for 99.73% of the changes in the dependent variable (GDP). The F-statistic value of 1391.55 is far greater than the table value and implies that the model is significant. The DW value of 1.63449 is less than 2 and shows the absence of auto-correlation among the variables. The independent variables CBC, BINV, & GFCF are all significantly even at 1% level with probability values of 0.0017, 0.0093 and 0.0012 respectively and t-statistic values are all greater than 2. All independent variables also have positive coefficient. The above results show that the CBC, BINV and GFCF have strong positive relationship with gross domestic product GDP.

SUMMARY, CONCLUSION AND RECOMMENDATIONS

Summary of Findings

The results of findings in model 1 show that the commercial bank credit (CBC) contributes significantly to gross fixed capital formation (GFCF) while the bank investments (BINV) does not.

In model 2, the results show that all the explanatory variables: commercial bank credits (CBC), Bank Investment (BINV) and Gross Fixed Capital Formation (GFCF) contribute greatly to the gross domestic product GDP during the period under investigation.

CONCLUSION

The result of the two models and the analysis of the results enabled the study to conclude as follows:

(a) That the commercial bank credits is a significant economic tool to build and improve the required capital formation in the Nigerian Economy.

(b) That the gross fixed capital formation, the commercial bank credits and the bank investments are sound economic tools to improve the gross domestic product which is a measure of a nation's economic performance, growth and stability.

Recommendations

Based on the summary of findings and

conclusion, the study made the following recommendations.

(1) Monetary authorities should make a policy thrust as to enhance the commercial bank credits which contribute to capital formation and gross domestic products.

(2) Banks should be addressed to increase their investment within the country since it has positive impact to GDP.

Efforts should be made by all stakeholders within the economy as to achieve optimal capital formation for greater industrialization, economic growth and stability.

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