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Banking structure and performance : a study of the Nigerian banking system and its contribution to Nigeria's economic development, 1960-1980.

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BANKING STRUCTURE AND PERFORMANCE:

A STUDY OF THE NIGERIAN BANKING SYSTEM AND ITS CONTRIBUTION

TO NIGERIA'S ECONOMIC DEVELOPMENT, 1960-80

BY

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A Thesis presented in fulfilment of the requirements for the Degree of Doctor of Philosophy of the University of Wales

July 1984

TO MY PARENTS

OKEKE AND IJEOMA AGUOKOGBUO

AND

MONICA

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GENERAL NOTES

1. SYMBOLS

-	nil or negligible
...	not available or not applicable

2. ROUNDING

Totals may differ from the sum of the constituent items because of rounding

3. LIST OF ABREVIATIONS

CBN	Central Bank of Nigeria
NIDB	Nigerian Industrial Development Bank
NBCI	Nigerian Bank for Commerce and Industry
NSE	Nigerian Stock Exchange
ACB	African Continental Bank
UBA	United Bank for Africa
BBWA	Bank of British West Africa
CNFS	Committee on the Nigerian Financial System
NEPD	Nigerian Enterprises Promotion Decree
CLCB	Committee of London Clearing Bankers
OFN	Operation Feed the Nation
IRD	Integrated Rural Development
ADA	Agricultural Development Area
RBDA	River Basin Development Authority
GRP	Green Revolution Programme
LNG	Liquified Natural Gas
NRDSC	National Reconstruction and Development Savings Certificate
ACGS	Agricultural Credit Guarantee Scheme
GFCF	Gross Fixed Capital Formation
OECD	Organisation for Economic Co-operation and Development

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SUMMARY

The purpose of this study is to show that within the context of Nigeria's development effort, financial development with respect to the banking system has aided investment and economic development to a greater extent than is generally recognised. This study, therefore, sets itself the task of a detailed examination of the structure of the Nigerian banking system as a service producing industry, the analysis of the economic performance of the banking system and the prescribing of policies and regulations to improve the banking system's structure and performance.

The structure of the Nigerian banking system is reflected in its historical pattern of growth, ownership, the network branch expansion, assets and liabilities composition and the legal and regulatory framework. The economic performance is reflected in output, profitability and the efficiency with which the banks have met some requirements indeispensable for economic development such as the contribution to saving-investment process and the provision of adequate finance to various sectors of the economy. A banking system, as a service industry, suffers from output measurement problem. Surrogates were used to measure the output of the Nigerian banking systems. The profitability of the banking system was measured by the ratios of profit after tax/capital and profit after tax/assets.

The determinants of the Nigerian banking system's lending and profitability performance are based on the hypothesis: the demand, policy and structure variables significantly affect the performance of the Nigerian banking system. The evidence from the analysis indicates

that policy and demand factors were more important in influencing the performance of the banking system. The bank market structure as measured by the bank offices rather than the deposits concentration ratio was significant in influencing the Nigerian banking system's performance.

The study is rounded up by prescribing policies and regulations to improve the structure and performance of the Nigerian banking system.

S E C T I O N A

INTRODUCTION AND OBJECTIVE OF THE STUDY

CHAPTER ONE

OBJECTIVE AND METHODOLOGY OF THE STUDY

1-1 INTRODUCTION

Financial resources have long been considered a very important factor, if not the most important factor in economic development. Consequently the mobilization of resources have been identified as crucial in achieving rapid economic "take-off" in the developing countries. A first step to resource mobilization for development purposes, is the mobilization of financial resources. The mobilization of financial resources leads to capital formation. Capital formation requires the release of domestic goods and services for real investment or the importation of resources from outside or as is usually the case, a combination of the two.

For an economy that wants to increase its real capital formation, the objective must be to provide a climate receptive to the importation of resources from abroad and the encouragement of domestic savings. The latter approach requires an institutional arrangement which encourages and mobilizes savings on one hand, and which channels savings so mobilized into productive investment, on the other.

It is noteworthy that national governments in most developing countries have at various periods made conscious efforts to speed up the pace of economic development. They have invested huge sums of money in both infrastructural and directly productive projects because of the lethargy of the private sector in investing in these areas. But in most cases, the available investable fund is hardly adequate for sustained economic development programmes.

The financial mobilization problem is very closely tied up with the savings problem, and developing countries are generally characterised by a low rate of domestic savings. However, the inadequacy of the domestic savings rate seems rather exaggerated. With few exceptions, namely the very poor countries, the gross domestic savings rate has been found to be fairly high in a large number of developing countries. What is really lacking is the efficiency in the process by which savings being accumulated in the economy are translated into savings useable for productive investment (Khatkhate and Riechel, 1980). In developing countries, savings tend to remain idle or to be dissipated owing to the inherent inadequacy and inefficiency of institutional channels.

Many developing countries have, over the years, relied very much on the inflow of financial resources from outside in various forms: official and private portfolio capital flows as well as direct foreign investment, as a means of speeding up their economic development. In general, however, these countries have shown preference for direct foreign investment because they regard direct foreign investment as a means of counteracting the sluggish trend in official and private portfolio capital flows. Besides, direct foreign investment embodies the power to exercise control by the investor, a knowledge ingredient which may be managerial, technical or of some other kind, and production technology all of which do not accompany portfolio capital and very much needed in the developing countries (Onah, 1979).

Generally, capital from outside can be very helpful in speeding the pace of economic development and can act as a catalytic agent in making it possible to harness domestic resources particularly in a developing country. But foreign capital, no matter how large the inflow, cannot absolve a recipient country from the task of mobilizing domestic resources. In the developing countries, experience has shown that foreign capital alone cannot create any permanent basis for a higher standard of living in future and that greater dependence on internal sources of finance facilitates more the successful implementation of any planned economic development.

The recent events in the developing countries have pointed out the stark realities of the importance of domestic savings and have reinforced the need for greater emphasis on mobilization of domestic financial resources for development purposes. The developing countries have started the 1980s in an atmosphere of crisis and disappointment. They have generally incurred enormous deficits because of the costs of the oil bills which have trebled since 1978 in the non-oil producing countries and because of the difficulties of increasing their exports as the recession in the OECD countries deepens. To finance these deficits, the developing countries have been forced to take up loans in the international markets. Consequently, interest and amortization charges are becoming an unreasonably heavy burden. The conditions of international credits are becoming more and more difficult.

In an effort to mobilize domestic savings, some national governments of the developing countries have concentrated on tax efforts (Chellia, Bass and Kelly, 1975; Rosenberg, 1977). But taxation in developing countries meets with serious problems which make its performance as a source of revenue for development purposes unsatisfactory. Bangs (1968) for instance, asserts that income taxes typically belong to a fairly advanced stage of economic development. Taxes do not play a major part in the finances of many developing countries "because these countries are not generally capable of administering effectively even the normal tax revenues' (Awadalla, 1980, p.22) and because of the high cost of administration due to insufficient infrastructural facilities and shortage of personnel. These handicaps make taxation a secondary tool of domestic resource mobilization.

Greater dependence on domestic sources of finance therefore, require a wide range of independent, well organised and adapted financial institutions which have to mobilize internal resources for the purpose of capital formation and allow the capital to be invested conveniently and freely into desired development projects. Commercial banks are thus the major relevant important financial institutions in most developing countries which encourage and mobilize savings and also channel savings into productive investment, first because of their network of offices, second because commercial banks through normal credit operations often activate savings lying idle elsewhere, and third because the banks' are highly liquid and thus attract savers (Khatkhate and Riechel, 1980).

Unfortunately, the importance of the financial sector for growth and development has only recently been fully appreciated. Because of the importance of the commercial banks in mobilizing savings in the developing countries, governments of a wide range of these countries have assumed direct control of financial institutions. Other governments, such as Nigeria, have elected to participate in the management and ownership of financial institutions with private interests, while still others are satisfied to direct and regulate institutions that are exclusively in private hands. In all cases, as Abdi (1977, p.1) observed, 'financial intermediation has taken an added importance in the search for ways to improve the growth prospects of these economies'.

Many writers, Schumpeter (1934); Gurley and Shaw (1955); Patrick (1966); Goldsmith (1969); Gurley (1969); Cameron (1972); and McKinnon (1974), to name but a few, have shown that the financial sector plays an important role in economic development, and the banking system, the basic component of the sector, must undertake new activities in order to help realise the development potential and to alleviate the financial constraints and distortions that exist in the capital market. Although the relative magnitude of the impact attributed to banks and other financial institutions in development differ among authors, their studies have aroused such great interest among students that the role of financial institutions in economic growth of developing countries has come under increasing scrutiny by student, economic planners as well as other policy makers in other countries. The studies done by Ojo (1974); Abdi (1977); Abu-Koash (1978); Rietti (1979) on Nigeria, East Africa, Jordan and Latin America respectively are examples.

In Nigeria the study of financial institutions has proceeded in two phases with varying emphasis on the different groups of financial institutions. In the 1950s and 1960s, most of the studies were concerned with the operations of the commercial banks. This is understandable, since non-bank financial institutions were relatively unimportant in the financial system during the periods. There were such studies as Uzoaga (1961); Brown (1966); and Perham (1947). The main objective of these authors was the description of the monetary and banking system in Nigeria. It is certain that in the process of description and analysis they made relevant contributions on the impact of banking system on the economic development of Nigeria. However, notwithstanding this, they were not very concerned with the role of banking system per se in the economic development of Nigeria.

Another observation is that since the publication of their works profound changes have occurred in the economy generally and in the financial system in particular. Some specialised financial institutions have been established with the objective of filling the gap of meeting the long- and medium-term financial needs of industrial, commercial and agricultural sectors of the economy. Other important changes include the increase in the number of commercial bank offices in the country from 160 in 1959 to 917 in 1982 and the change in the ownership of financial institutions. Indeed in any economy, as Gurley and Shaw (1967, p.7) observed, the financial structure is continually reshaped by the efforts of economic units to break out of the confines of existing financial arrangements, particularly when gaps in the financial system exist. The same has been true of the Nigerian financial structure since the 1960s.

The second phase of the study of the Nigerian financial system started in the 1970s with the greater attention focused on the role of the financial system as a whole in fostering economic development. The best known serious work in this area is that of Ojo (1974). Apparently such general studies with one chapter devoted to the commercial banks cannot deal adequately with the role of the commercial banking system in the development of Nigeria.

The present study takes account of the changes that have taken place in the banking system since 1960 which in no small measure have affected the structure and performance of the Nigerian banking system and also try to make up for the inevitable shortfall in the treatment of commercial banks in the general study of the financial system.

1-2 OBJECTIVE OF THE STUDY

The fundamental purpose of this study is to show that within the context of Nigeria's development effort, financial development with respect to the banking system has aided investment and economic development to a greater extent than is generally recognised. In other words, the study strives to explore and analyse critically the structure of the Nigerian banking system and to see to what extent it has helped in the process of general economic development of the country.

Analysis of the structure and performance of a banking system can be approached from two distinct yet related viewpoints:

1. as a service producing industry, or
2. as an instrument of monetary policy.

This study is therefore concerned with a detailed examination of the historical pattern of growth, structure and operations of the Nigerian banking system during the period 1960-80 as a service producing industry; the analysis of the determinants of the economic performance of the banking system; the investigation of the banking system's specific contribution to the process of economic development in Nigeria; and the prescribing of policies and regulations to improve the banking system's performance.

The study concentrates on the operations of the banking system in Nigeria with a view to resolving a few key questions about its development and performance. Among these questions is to what extent the commercial banks have contributed to the saving-investment process in Nigeria. Other questions include, how efficiently the bank have met some requirements indispensable for economic development such as the provision of adequate finance to the preferred sectors, and the monetization of the subsistence sector of the economy.

As far as information and data availability permits, the economic performanceof the banking system will be reflected in its output, profitability and growth. This aspect will further be analysed by empirical investigation using simple correlation analysis. This, to some degree, distinguishes the present study from a few previous studies on the Nigerian banking system and complements at the same time the few but undoubtedly significant and useful pioneering efforts in this area.

It is pertinent at this juncture to define the term "banking system" as used in the present study. The term banking system refers specifically to the commercial banks.

1-3 HYPOTHESIS OF THE STUDY

The pertinent attributes of a useful hypothesis are:

1 its variables are operational,

2 its relationships have empirical content and are reasonably stable, and

3 it has policy implications.

The above attributes weighed heavily in postulating the hypothesis of this study. The broad hypothesis of this study therefore is:

> That within the context of Nigeria's development effort, financial development with respect to the banking system has quickened in recent years, and that the banking system has aided investment and economic development to a greater extent than is generally recognised.

The above broad hypothesis is examined under the following manageable hypotheses:

1 that the Nigerian banking system has significantly improved its performance in using resources over the years as a service-producing industry;

2 that there is an upward trend in the mobilization of financial resource by the Nigerian banking system;

3 that the Nigerian banking system has performed creditably efficient in its financial intermediation as reflected in the loans and advances provided to the economy;

4 that the economic performance of a banking system is a function of its structure demand and policy variables;

5 that in implementing the successive five-year development plans, and thereby financing the private and the public sectors of the economy, the Nigerian banking system has performed an important role in allocating financial resources efficiently.

1-4 THE RATIONALE FOR THE STUDY

One major justification why the study concentrates on commercial banking system is the dominant role of the commercial banks in the Nigerian financial system. Commercial banks, merchant banks, savings banks, mortgage banks, insurance companies, pension funds and other non-bank financial institutions, the security markets, apart from the Central Bank of Nigeria, constitute the major institutions of the Nigerian financial sector. Of these institutions, commercial banks are the most significant financial intermediaries measured in terms of assets size and GDP. Between 1970 and 1980, for example, the total assets of the commercial banks represented 55 per cent of the total assets of the financial system. In relation to the GDP, their assets amounted to 20.5 per cent in 1970 and 27.1 per cent in 1980. It is thus almost superfluous to try to rationalise the pivotal role and pride of place that should be accorded to commercial banks. By sheer size in relation to the economy as a whole, and to the financial system, commercial banks in Nigeria deserve special consideration.

Since commercial banks are dominant institutions in the Nigerian financial system, a unique role is expected of them and it is worth investigating how they have performed the role and justified their overwhelming position.

With the recent changes in the structure and ownership of the Nigerian banking system as a result of the CBN rural banking scheme and the Federal Government's indigenisation programme, it is necessary to conduct a detailed analysis of the performance of the commercial banks. Such a study would contribute to resolving the question of whether the structure and ownership of the banks matter for economic development or not.

The fourth subset hypothesis above is related to the "Structure-Performance-Hypothesis" argument which has been variously tested by many writers (Kaufman, 1966; Ware, 1972; Fraser, Phillips and Rose, 1974; Yeats, 1974; Mingo, 1976 and Rhoades, 1977), to mention but a few, with data and information on the US banks. The need for further testing of the structure-performance hypothesis remains. As Kaufman (1966, p.429) pointed out 'the experiment should be replicated for other states and other types of banking organisation before the result may be considered sufficiently persuasive for determining policy'.

The economy-wide branch banking system in Nigeria provides a different kind of setting from the unit and limited banking organisation of the US for testing the hypothesis, and permits the scope of an inquiry into the performance of banks to encompass the entire banking system.

The banking system in a mixed economy like Nigeria has a heavy responsibility of financial stewardship because of its pervasive influence on financial markets. The ability to discharge this responsibility depends upon the efficiency with which the banking system operates. The ideally operating banking system would provide low-cost bank output with positive effects on investment and would lead the economy toward efficient allocation of resources.

The banking system should be reviewed and surveyed frequently in order to make certain that it is meeting all the productive credit needs of the economy at the lowest cost and that there are no credit gaps (Beckhart, 1965). Besides there is the continuing need to increase the current empirical and theoretical knowledge about the performance of the Nigerian banking system in order to develop effective regulation and to improve its operations and allocative efficiency. A highly performing banking system helps to promote a more specialised exchange economy with favourable repercussions on the rate of economic development.

A detailed analysis of the structure and performance of the Nigerian banking system will be concerned with the whole set of factors affecting the economic performance of the Nigerian banking system so that those factors which are determined to be important determinants may be optimally regulated. For instance, if the analysis prove that structure variables have insignificant effect on the performance of the banking system, the authorities should shift their regulatory emphasis from structure variables to policy variables.

Some writers on the role of commercial banks in the economic development of the developing countries have come to the conclusion that commercial banks have not contributed much to the growth of these economies. For example, Abdi (1977, p.96) concluded that 'the poor performance of post-independence banking system of East Africa ... is consistent with the experiences of most developing countries'. The question which arises is whether this generalisation could be true of the Nigerian experience. On the other hand, following a more recent study by Rietti (1979), it seems that the recent experiences of some developing countries have established complementary effects of modern financial institutions and markets on economic development efforts in a mixed economy. It is also necessary to investigate this assertion in the Nigerian situation. The conflicting conclusions make the investigation necessary.

Finally, as observed by Mathur (1971), and Bhatia (1978), the limited appreciation of the influence of financial technology embodied in the quality and variety of financial instruments developed by financial institutions on savings and capital formation in developing countries such as Nigeria is due to the dominant influence of Keynesian macro-economic models and the structural approach to economic development. According to the standard Keynesian macro-economic theory:

$$S = f(I, i, W) \tag{1.1}$$

where

S = Rate of savings

I = Income

i = Rate of interest

W = Wealth

Financial technology is not among the explicit arguments of equation 1.1. The reason for this omission can be traced to the

Keynesian "Portfolio Balance" theory which divides wealth accumulation into sets of sequential decisions. The decision to save and then the decision to hold the savings in some form of wealth, which involves asset choice, form this sequence. It is assumed in the portfolio balance theory, that the former decision precedes the latter, and therefore the availability of the different kinds of financial assets which provide a degree of choice in the portfolio balancing process, will not influence the level and rate of savings. Because the synchronization of receipts and disbursement of income is an important objective of saving entities, the kind of financial instruments made available by financial intermediaries will affect the magnitude of savings. Savings, therefore cannot be regarded as a given datum available for portfolio choice. The quantity of savings is influenced by financial technology and consequently equation 1.1 may be restated thus:

$$S = f(I,i,W,t) \tag{1.2}$$

where

$t = \sum_j \sum_n Ajn$ and

j and n are subscripts

Ajn = are the monetary value of the nth asset of the jth institution of the financial system

The technology (t), however depends on a number of factors: the extent to which the business units depend on external sources for their finance and how much on internal financing; the degree of reliance on the financial technique for promoting economic growth; the degree of monetization of the economy; and, how far intermediation by financial institutions satisfies the portfolio preferences of both lenders and borrowers by transforming the obligations of the borrowers into a more attractive set for lenders by reducing the level of risk associated with it.

1-5 METHODOLOGY OF THE STUDY

The focus of the study is on what exists, and therefore, the research procedure is descriptive-empirical. The analysis of the main issues is critical, theoretical and statistical.

The growth and the changes in the structure of the banking system will be examined from both an historical and analytical standpoint. Generally, the study will endeavour to abstract from various statistical evidence, and/or statistical relationships to reach conclusions. This implies that effort should be made to marshal enough quantitative and qualitative data and information in the critical analysis to validate or invalidate the hypothesis outlined above. Statistical evidence is used descriptively and analytically to give support to our arguments and conclusions.

1-6 DATA AND INFORMATION PROBLEMS

In a study of this nature in a developing country like Nigeria where data and information are not available, and, where available, are not very well documented in a systematic way, it is not unusual to encounter some data and statistical problems.

The present study was, therefore, confronted with a number of data and information problems. Firstly, one of the major difficulties is the non-existence of suitable time series data on certain areas of the study which could be subjected to rigorous analysis. In some cases where the data and information are available, they are so scattered that some necessary problems are involved in lumping them together for the purpose of comparative analysis. Secondly, there was the non co-operative attitude of some officials of some of the commercial banks and the CBN. "The information you require is classified secret" is a common reply to requests for data and information in some of the banks. The mentioning of these difficulties helps to explain why some part of the study is based on data and information for the years 1970-80 only. Effort is made, where possible, to supplement any dearth of data.

Most of the data needed for the study are obtained chiefly from the CBN publications such as Annual Reports, Economic and Financial Review, Bullion, Nigeria's Principal Economic and Financial Indicators. Other sources include the Federal Government of Nigeria official publications such as the National Development Plan documents, official gazettes, Banking Ordinances, Acts, Decrees as well as budget speeches; and the Federal Office of Statistics publications. Effective use is made of annual reports of the various commercial banks in Nigeria, and also the annual reports of International Monetary Fund - International Financial Statistics which provide information and data not only about Nigeria but also about other countries which may be necessary for any comparative analysis.

1-7 SCOPE OF THE STUDY

The period of interest of the present study is 1960-80. However, since economic conditions at any point in time very much depend on past developments, the analysis will as far as necessary be extended albeit cursorily to earlier periods. The period of this study is chosen for a number of reasons:

1 The period marks the end of the pre-independence movement, the attainment of political independence which culminated in government focusing attention on development and maintenance of economic stability.

2 Conscious effort was made by the federal government at developing the economy during this period. The first Nigeria's development plan, the 1962-68 Plan was carried out within this period. Since then two successive five year National Development Plans, 1970-74 and 1975-80 have been formulated and implemented. To implement these plans, there was a great need for increased government expenditure. Such expenditure requires huge inflows of funds into the coffers of the government. Since other sources of finance were inadequate to meet the needed development programmes, and foreign aid was not forthcoming as expected, the government had relied very much on the banking system for the provision of funds to make up for the deficits at various plan periods.

3 The CBN was established in 1958, just before the start of the period covered by the present study. The CBN in pursuance of the statutory objectives made conscious effort at building a sound financial system. Money and capital markets' foundations were laid and nurtured during this period. Subsequently the financial system became well regulated and directed to serve the needs of the economy.

1-8 PLAN OF THE STUDY

The present study is divided broadly into three sections: A, B and C. Section A, which is further divided into two main chapters, deals with the introduction and objective of the study. Chapter Two gives a survey of the economic and political developments of Nigeria by outlining trends in production, political structure and development and the structure of the Nigerian financial system.

Section B deals specifically with the structure of the Nigerian banking system. This section is again divided into two chapters Chapters Three and Four. Chapter Three examines the evolution and development of the Nigerian banking system. The operations of the Nigerian banking system is critically analysed in Chapter Four.

Section C is concerned with the performance analysis of the Nigerian banking system. It is divided into six chapters: chapters five to ten. Chapter Five investigates the relationship between economic development and financial structure development and examines the role of financial institutions in the saving-investment process. It is mainly a theoretical analysis which is examined in relation to the Nigerian situation. Chapter Six attempts to measure the economic performance of the banking system in terms of output, profits and profitability and intermediation activity. The allocational efficiency of the Nigerian banking system is discussed in Chapter Seven. This is examined in terms of the role of the banks in financing the priority sectors of the economy while Chapter Eight discusses the public sector borrowing from the banking system. This will reveal the role of the banking system in financing the public sector investment expenditures. Chapter Nine deals with the determinants of the profitability and lending performance of the Nigerian banking system. The last chapter outlines the summary, conclusions and suggestions for improvement in the structure and performance of the Nigerian banking system.

CHAPTER TWO

THE NIGERIAN ECONOMY : A GENERAL SURVEY

2-1 INTRODUCTION

This chapter outlines the institutional background of the study and the trends in the development of the economy. It is intended to provide background information relevant to the appreciation of the rest of the study. The objective of the survey, therefore is to furnish the reader, particularly one unfamiliar with the Nigerian economy, with the information necessary for the appreciation of the study.

As noted earlier, the changes that have occurred in the Nigerian economy in the last twenty years can be described as profound. Many of them are now irreversible. The changes have made the conclusions reached in earlier studies unacceptable any longer. It is against this understanding that this chapter intends to consider the trends in the development of the economy.

The chapter is divided into five parts. The second part deals with the size of the country in terms of geographical area and population. It will also highlight the changes in the political structure of the economy. Section three examines briefly the development in the four main sectors of the economy : Agriculture, Mining, Manufacturing and Foreign Trade. The fourth section briefly accounts for the financial infrastructure of the Nigerian economy. It examines, first, the size and structure of the financial system and then the relative importance of the main institutions. The last section is the conclusions.

2-2 THE DEVELOPMENT OF THE NIGERIAN ECONOMY

2-2.1 The size and population of Nigeria

The Federal Republic of Nigeria is located at the bottom of the western bulge of Africa and lies South of the great Sahara Desert, between 3 and 15 degrees E longitude and 4 and 14 degrees N latitude. It extends from the coastline northwards for over 650 miles and from east to west, it covers a distance of about 700 miles. It is bounded on the south by the Gulf of Guinea, on the west by the Peoples Republic of Benin, on the east by the Cameroun Republic and on the north by the Niger and Chad Republics. The country comprises an area of 923,773 square kilometres. It is about four times the size of Great Britain, and it is larger than all Germany, France, Belgium and Holland put together.

The population of Nigeria by the 1963 Nigerian census was 55,670,052. Since 1963 attempts to have an acceptable census figure for Nigeria have been unsuccessful. Provisional estimate based on the projection of the 1963 census figure at 2.5 per cent increase per annum places the population of Nigeria by 1982 at 89.1 million. Nigeria has the highest number of population not only in black Africa, but on the whole of African continent. Twice as many people are living in Nigeria as in the United Arab Republic, the second largest populated country in Africa.

Nigeria is in the process of demographic transition - that of a rising birth rate and a declining mortality rate resulting in a potentially high population growth rate estimated at 2.5 per cent per annum. This is going to be one of the most pressing social problems of the country which will be made all the more difficult by the need to provide the burgeoning population with education, social services, food, vocational training and adequate sources of employment. The high growth rate is also linked to a dynamic process of urbanization which poses a challenge for the allocation of resources to alleviate congestion.

Table 2.1 Nigeria : Rural and urban population 1963

(Millions)

States	1963 population	Urban* population	Rural population	Urban population as % of total population	Rural population as % of total population
Benue	4.009	0.356	3.653	8.88	91.12
East Central	7.228	0.879	6.349	12.16	87.84
Kano	5.775	0.344	5.431	5.96	94.04
Kwara	2.399	0.473	1.926	19.72	80.28
Lagos	1.444	1.042	0.402	72.16	27.84
Midwest	2.536	0.284	2.252	11.20	88.80
North Central	4.098	0.486	3.612	11.86	88.14
North East	7.793	0.883	6.910	11.33	88.67
North West	5.734	0.580	5.154	10.12	89.88
Rivers	1.545	0.249	1.296	16.12	83.88
South East	3.623	0.283	3.340	7.84	92.12
West	9.488	4.843	4.645	51.04	48.96
Total	55.670	10.702	44.968	19.22	80.9

Source : O Olayide (1982) Nigerian Rural Development Study. Rural development paper No. 1, University of Ibadon, June 1982, p.23

Note * : Urban areas refer to towns with population of 20,000 or more.

Table 2.1 shows the distribution of Nigeria's population by states and by rural and urban towns. It shows a marked concentration of population of Nigeria in the rural areas. The urban population of the country ranges from 6 per cent to 51 per cent among the states with a national average of 19 per cent. Apart from Lagos and Western States with rural population of only 27.84 per cent and 48.96 per cent respectively, the rural population in the other states varies from 80.28 per cent to 94.04 per cent with a national average of 80.8 per cent.

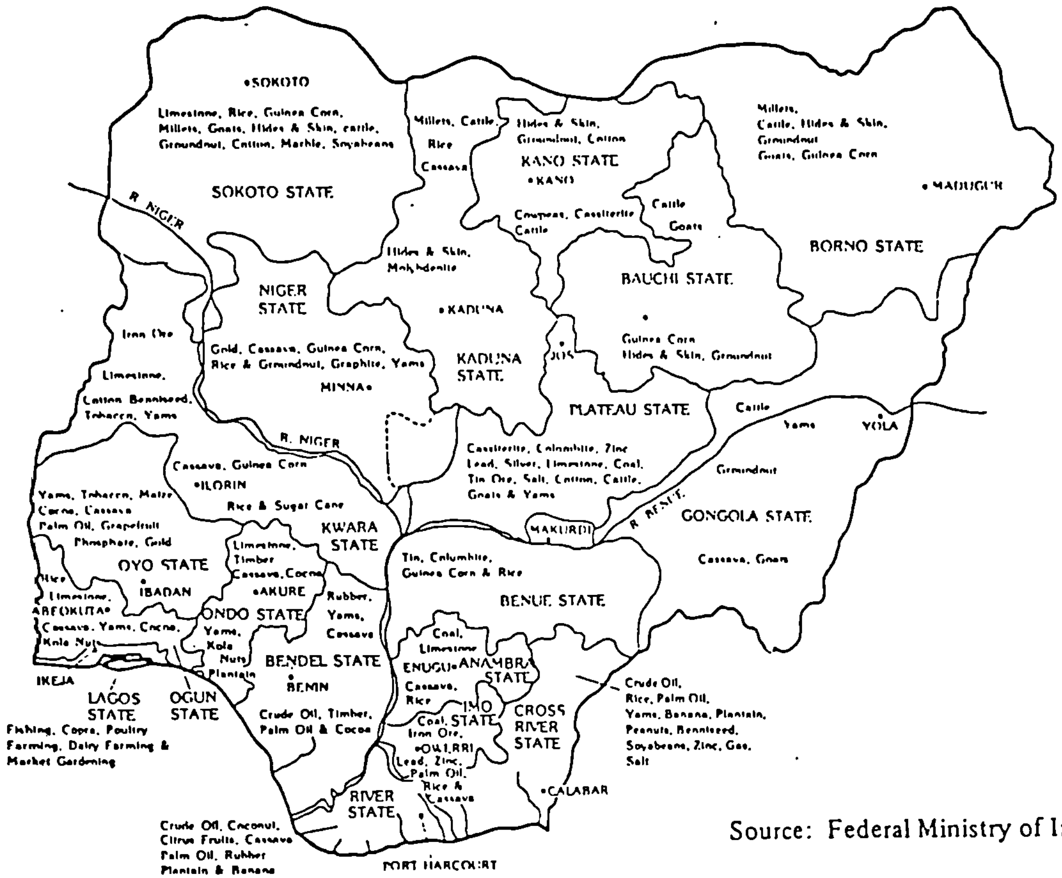
2-2.2 The political development and production structure

Nigeria became a British colony in 1886 and remained so until 1 October 1960 when she achieved independent political status. The British colonial administration in Nigeria introduced the Federal system of Government in 1954, and the country was structured into three regions : the Northern, the Eastern and the Western Regions. There was also the Federal Territory and southern Camerouns which later opted out to join the other Camerouns. A fourth region was added in 1963, when the Mid-West Region was carved out of the former Western Region. The Federation of Nigeria thus functioned under four Regional Governments and a central Government from 1963 to 1967.

The initial objective of splitting Nigeria into three regions was, first, to make for easy administration. The size and population of Nigeria made regionalisation an administrative necessity. On this point Stapleton (1958) has contended, 'the splitting of Nigeria into three Regions may have been a political necessity, but there is little doubt that it is economically a backward step. To divide the country still further would only lead towards economic chaos'. The second reason was to 'meet the ethnic and communal diversities in Nigeria' - Uzoaga (1981, p.1). It is estimated that there are about 250 ethnic groups in Nigeria, each having a separate language and culture of its own. Three or four regions could not in any way meet adequately the communal diversities and in fact it is doubtful whether any manageable number of regions or states will ever take adequate care of these ethnic differences. The problem of ethnicity in Nigeria is clearly brought out by President Shagari who observed, 'the first six years of post independence rule, and even more so, the last six years of pre-independence rule were characterised by ignorance and unfamiliarity and therefore fear and mistrust among the various ethnic groups or - to be more accurate - <u>the nationalities that inhabit Nigeria</u>'. (Emphasis is mine)

The Government of Nigeria was disrupted twice in 1966 by military coup d'etats. The distrust and fear among the various ethnic groups generated by the two events led to the attempted secession of the Eastern Region under the name of the Republic of Biafra. In an attempt to arrest the ensuring crisis, the Federal Government further split the country into 12 states in 1967. Unfortunately this was not enough and adequate action to stop the crisis which culminated in a civil war that lasted from May 1967 to January 1970. The Federal Government was again disorganised in another military coup d'etat which overthrew it in July 1975, and, in 1976, the new Federal Government, by decree, restructured the country into the present 19 states. (See map)

Fig 2.1 States, main agricultural and mineral resources of Nigeria



Source: Federal Ministry of Information

The country was thus under the military rule for the period of 13 years (1966-1979). The Civilian Government was elected into office on 1 October 1979 and Nigeria adopted a presidential democratic system of Government 'freely elected by all of us' - Shagari 1981.

2-3 PRODUCTION TRENDS IN THE ECONOMY

'One of the objectives of monetary and fiscal policy is to provide the economy with a financial system that is flexible enough to respond promptly to changes in the flow of output and prices' - Okigbo (1981,p.5). The discussion of production trends in the country is very important for two main reasons. First, the structure of production will indicate the structure of final demand in the economy which will in turn determine the character of demand for money and other financial assets. Second, the trend of the economy's output will indicate differential pressures on the financial institutions exerted by the different units of the economy.

2-3.1 Agriculture

The structure of production in the economy is shown in Table 2.2. Certain key sectors are revealed as the important determinants of production and hence of demand in the economy. These sectors are agriculture, mining and quarrying, distribution, general Government, manufacturing and building and construction. These six sectors among them accounted for 88.8 per cent of the gross domestic product (GDP) in 1960 with agriculture alone accounting for 63 per cent. The share of agriculture has declined tremendously over the years. Its share of GDP declined from 63 per cent in 1960 to 23.5 per cent in 1975. By 1977 it was 19.2 per cent and reached a low of 17.2 per cent in 1981.

Table 2.2 **Trends in the structure of production in Nigeria 1960-1981 at current factor cost**

(Percentages)

Sector	1960	1966	1969	1973	1975	1977	1979	1980	1981
1 Agriculture, livestock, forestry, fishing	62.94	54.97	48.87	27.60	23.50	19.20	17.98	17.98	17.70
1.1 Agriculture and livestock	55.19	47.65	42.84	18.00	17.40	13.90	12.80	...	...
1.2 Forestry	6.09	4.10	2.28	4.00	2.20	2.00	1.93	...	...
1.3 Fishing	1.58	3.21	3.74	3.80	3.90	3.30	3.25	...	...
2 Mining and quarrying	0.58	4.83	6.99	24.50	26.30	27.60	25.94	32.90	31.60
3 Manufacturing and crafts	4.79	6.90	8.04	5.00	5.00	5.40	6.65	8.00	8.70
4 Electricity and water	0.41	0.58	0.71	0.40	0.30	0.40	0.46	0.40	0.40
5 Building and construction	4.79	5.35	4.60	7.30	6.80	9.30	11.11	11.20	10.90
6 Distribution	12.40	12.90	12.93	18.70	20.00	20.00	19.19	16.90	17.60
7 Transport and communications	4.89	4.49	3.99	3.80	3.30	5.00	5.22	4.50	4.80
8 General government	3.31	3.08	7.17	5.50	9.20	7.80	7.74	5.70	6.00
9 Services	5.77	6.90	6.69	7.10	5.60	5.30	5.69	...	...
9.1 Education	2.81	3.37	3.05	...	2.70	2.80	3.40	...	...
9.2 Health	0.52	0.81	0.82	...	1.30	1.60	1.20	...	...
9.3 Other	2.44	2.71	2.82	...	1.60	0.90	1.60	2.70	2.80
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Sources: 1:PNC Okigbo,(1981)Nigerian Financial System,UK Longman p.6

2 : Nigeria, Federal Republic of (i) Third National Development Plan (1975-80), vol 1, Federal Ministry of Economic Development, Lagos 1975;
(ii) Fourth National Development Plan (1981-85), vol 1, Federal Ministry of Economic Development, Lagos 1981.

In terms of exports agriculture was until recently the principal foreign exchange earner for the country. In 1962 agriculture accounted for 82 per cent of total export value of the country. Inspite of the war, its contribution to foreign exchange earnings in 1967 and 1968 were 62 and 73 per cent respectively.

However, with the spectacular developments in the petroleum sector accompanied by windfall earnings from the crude oil exports, the proportionate contribution of agriculture to foreign exchange earnings deteriorated significantly. Its earnings fell from 25 per cent in 1970 to as low as 3.9 per cent in 1976; it increased to 6.8 per cent in 1978 and declined to an alarming proportion of 2.4 per cent in 1980. (See Table 2.3)

Apart from export products the main staple food crops comprise roots, tubers, pulse and cereals. The level of food production has not expanded fast enough to keep pace with the population growth. Consequently the Government has been spending huge amounts in recent periods on food imports. Food imports have risen from 57.8 million naira in 1970 to 439.4 million in 1976 and further to 790.3 million naira in 1977. It is thus clear that the deterioration of the agricultural sector in Nigeria has reached a very disturbing level considering the sector's past and present potentials in terms of arable area, food supply, foreign exchange earnings and raw material supply.

Table 2.3 Relative earnings of agriculture and crude petroleum exports 1970-80

(Percentages)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Crude petroleum export	57.6	73.7	82.0	83.1	92.6	92.7	93.6	92.7	92.4	93.8	96.1
Export of major primary commodities	25.0	16.3	10.6	8.7	4.4	4.4	3.9	4.7	4.6	4.3	2.4

Sources : CBN : Nigeria's Principal Economic and Financial Indicators, (1970-78)

CBN : Annual Report and Statement of Account, (December 1980)

However, it should be realised that the sector has only lost its prime position in the economy to mining particularly petroleum. It remains next to petroleum, the largest contributor to output. Its importance is more than the figures can depict. It provides employment for some 70 per cent of the Nigerian population and it is an important source of raw materials for the economy's nascent industrial sector. It is the view of the Government that:

> ... agriculture and its related activities will continue to be the mainstay of Nigeria's economy in the foreseeable future. In the first place, the sector will continue to furnish the bulk of the nation's employment opportunities. Secondly, with a population growth rate of about 2.5 per cent annually, urbanization and real incomes projected to rise sharply, the demand for more and better staple food as well as animal products is expected to grow at a rate of about 5 per cent and 7 per cent per annum respectively. Finally, agriculture will have to meet most of the country's raw material requirements for local industry and for export which will continue to be an important earner of foreign exchange - (Third National Development Plan, 1975-80, p.8).

2-3.2 Manufacturing

A look at Table 2.2 shows that the contribution of manufacturing to GDP was about 5 per cent in 1960. It rose to 8 per cent in 1969 as a consequence of war period restrictions on some imported manufactures which 'led to a spurt of domestic investment in manufacturing, partly as a pure import substitution and partly just to satisfy domestic demand and meet keen shortages' Okigbo (1981, p.14). The sector's share of GDP declined to 3.9 per cent in 1974, which is also a consequence of the sudden increase in the relative contribution of petroleum to GDP.

In terms of value added, the growth of the manufacturing sector over the past two decades has been rapid and sustained. It has been described as one of the fastest growing sectors of the Nigerian economy being second only to the mining sector. Value added in the manufacturing and crafts, for example, grew at a compound annual rate of 10 per cent between 1963 and 1973 with the manufacturing alone growing at 12.2 per cent. At 1973/74 constant prices the manufacturing sector grew at annual compound rate of 15.6 per cent between 1975 and 1978. This is however, a question of growth from a small base. If one, for instance, relates value added in the manufacturing to non-oil GDP, the ratios will only range between 4 per cent and 9 per cent, which is a rather low rate compared with the potential in the country.

A disturbing aspect of the industrial growth in Nigeria is that the impressive growth rate is not matched by the favourable changes in the content of the growth. The import content of the manufacturing sector is very high. On the average, about 60 percent of the total raw materials consumed in the manufacturing sector is imported. It was estimated that 'for every naira of value added, the country spent 60k on imports of raw materials' (Fourth National Development Plan, 1981-85, p.139). This refers only to imports of non-factor inputs and this exists inspite of the fact that the manufacturing output is dominated by commodities which are local resource based. If account is taken of engineering skill, there can be little doubt that the extent of the national value added has been microscopic.

Another feature of the manufacturing sector in Nigeria is that it is dominated by low technology light industries such as food and beverages, tobacco, wearing apparels, which between them accounted for over 51 per cent of value added in the manufacturing in 1972. Engineering industries are virtually non-existent. The real engineering subsectors such as agriculture and industrial machinery and equipment contribute very little to the sector's output. It is also observed that the sector is dominated by assembly activities.

2-3.3 Mining

Nigeria is endowed with a variety of mineral resources. These include coal, petroleum, tin ore, limestone, columbite, cassiterite, iron ore, lead, zinc, gold and others. (See map). This sector is a major contributor to the nation's output. Its importance in the economy is, however, of a recent origin. The share of the sector in GDP in 1960 was only 0.58 per cent, but in 1974 its share reached a peak of 32.9 per cent (See Table 2.2). The increased contribution of this sector to the nation's output is largely a result of the increased share of petroleum subsector which accounted for about 89 per cent of all activities in the mining sector.

The production of petroleum rose steadily between 1975 and 1981 except for a decline in 1978, 1980 and 1981. Production increased from 651.3 million barrels in 1975 to 765.3 million barrels in 1977, declining to 692.3 barrels in 1978. In 1980 and 1981 the production stood at 756.1 million barrels and 522.1 million barrels respectively.

The importance of this sector to the growth of the economy is shown by its being the major contributor to the GDP and also the most important source of Government revenue and foreign exchange for the country. During the Third National Development Plan, 1975-80, for instance, the expected revenue from the petroleum subsector was about 85 per cent of the total Government revenue for each year of the plan.

Table 2.3 also indicates that since 1971 the dependence of Nigeria's export on petroleum has been total rising from 73.7 per cent in 1971 to 93.6 per cent in 1975 and to 96.1 per cent in 1980. Production of solid minerals, on the other hand, was generally on the decline.

2-3.4 Foreign Trade and Balance of Payments

Nigeria is an agricultural country and as would be expected, her export trade is predominantly primary products. There are a few relatively insignificant manufactures made up mainly of processed agricultural products. The major primary export products are cocoa, palm kernel, rubber and until recently palm oil. Prominent among the mineral are petroleum and columbite. A cursory look at Table 2.4 shows that Nigeria is tending toward a monoproduct export economy. The trend showed clearly since 1971. Between 1971 and 1980 the crude oil exports constituted about 89 per cent of total exports. This is, however, not in the interest of the economy. 'The danger of excessive reliance on oil has been illustrated by the adverse effects on our economy that untoward development in the oil market has had. This is why the Fourth National Development Plan, 1981-85 with a target growth rate of 7.2 per cent focuses on agriculture and manufacturing sector in order to reduce the damaging dependence on oil' - Shagari (1981).

Nigerian imports have increased in recent years in value and volume. In value terms, it increased from about 41 million naira in 1946 to 1,737.3 million naira in 1974 and in 1980 it stood at 9,658.1 million naira. Table 2.5 shows the share of each major group of imports. The share of machinery and transport equipment has been increasing over the years. The share of this group rose from 24 per cent in 1960 to 51 per cent in 1979, though it declined to an

Table 2.4 The distribution of major export commodities in Nigeria 1960-80

(Percentages)

	1960	1965	1970	1972	1974	1976	1977	1978	1979	1980
Cocoa	21.7	15.9	15.0	7.0	2.7	3.3	4.1	6.2	4.1	2.2
Ground nuts	13.5	14.1	4.9	1.3	0.1	...	-	...	...	...
Ground nut oil	3.1	3.7	2.6	0.8	0.2	...	...	...	...	...
Palm kernels	15.4	9.9	2.5	1.1	0.8	0.4	0.4	0.2	0.1	0.1
Palm oil	8.2	5.1	0.2	-	-	...	...	...	...	-
Hides and skins	2.5	1.7	0.6	0.5	0.2	0.1	0.1	0.1	...	-
Rubber (natural)	8.4	4.1	2.0	0.5	0.6	0.2	0.1	0.2	0.1	0.1
Timber (log and sawn)	4.1	2.3	0.7	0.6	...	-	-	-	-	-
Raw cotton	3.7	1.2	1.5	0.1	...	-	0.1	0.1	...	-
Crude petroleum	2.6	25.4	57.6	82.0	92.6	93.7	92.7	89.1	93.8	96.1
Columbite	1.3	0.4	0.2	0.1	-	...	-	...	...	...
Tin ore	3.6	-	...	...	...	...	...	-	-	-
Tin metal	...	5.6	3.8	1.3	0.4	0.2	0.2	0.2	0.1	0.1
Other exports	10.4	10.6	8.4	2.5	2.2	1.3	1.1	3.2	1.3	1.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source : CBN Annual Report and Statement of Accounts - various years estimated share of 47 per cent in 1980. The next major group is manufactured goods, which although still important has been declining from 37.6 per cent in 1960 to 20.4 per cent in 1979; it rose slightly to 21.5 per cent in 1980.

The most disturbing aspect of the structure of import bills is the increasing share of food imports. Its share rose from 7.6 per cent in 1970 to 12.4 per cent in 1978. By 1980 it was 11.3 per cent. Fajana (1979) gave the reason for this trend as the growth in population and income and the liberal trade policy on importation of food. The poor performance of the agricultural sector is, however, an important contributory factor.

The increase in the volume of imports coupled with the unfavourable world market prices of primary exports caused an adverse balance of trade in 1955-65 period. (See Table 2.6). The increased production of petroleum and the favourable world market price for crude oil helped to restore surplus trade balance in 1966 and since then Nigeria has enjoyed balance of trade surplus until 1978 when a deficit reappeared. Balance on current account has shown deficit over the years except in 1973-1975 and 1979-80; while balance on capital account has been positive over the years except in 1974 and 1976.

2-4 THE FINANCIAL SYSTEM

The committee on the Nigerian Financial System defined financial system as 'the congeries of financial institutions and arrangements which serve the needs of an economy. The service is rendered through:

1 the provision of financial resources to meet the borrowing needs of individuals and households, enterprises and governments;

Table 2.5 **Share of each major group of imports in Nigeria's import 1960-80**

(Percentages)

SITC sections	1960	1965	1970	1972	1974	1976	1977	1978	1979a	1980b
0 Food	11.1	8.4	7.6	9.6	8.9	8.6	10.4	12.4	10.3	11.3
1 Beverages and tobacco	2.8	0.7	0.5	0.4	0.5	1.2	1.9	0.8	0.7	0.7
2 Crude materials	1.0	2.4	2.2	2.1	3.7	1.5	1.1	1.3	1.5	1.4
3 Mineral fuels	5.2	6.3	2.9	1.0	3.2	3.4	1.8	2.1	2.8	2.5
4 Animal and vegetable oils and fats	0.0	0.0	0.1	0.1	0.2	0.5	0.7	0.9	0.7	0.8
5 Chemicals	5.7	7.3	11.7	10.4	11.0	7.7	7.0	7.9	7.2	7.6
6 Manufactured goods	37.6	32.7	29.9	27.1	30.1	22.1	22.1	22.5	20.4	21.5
7 Machinery and transport equipment	23.9	33.6	37.4	40.2	35.2	47.5	47.7	43.7	50.9	47.1
8 Misc manufactured goods	11.1	7.5	5.2	8.4	6.6	7.2	7.2	8.1	5.6	6.9
9 Miscellaneous transactions	1.6	1.1	2.5	0.7	0.6	0.3	0.1	0.2	0.2	0.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source : CBN Annual Report and Statement of Accounts - various years

Notes : a - provisional
b - estimated

2 the provision of facilities to collect and invest savings fund; and

3 the provision of a sound payment mechanism' - (Report of CNFS 1976, p.6)

It is clear from the above that the study of the financial system embraces more than that of the institutions that operate in the financial sector. Financial system includes 'the environment of rules and regulations governing the interaction of the different categories of the institutions among themselves and with others' (Okigbo, 1981, p.29). Revell (1973, p.1) also pointed out that the various institutions and markets 'are not the whole of the financial system, and they are not even an essential part of it'. He further contended that the 'essential feature of any financial system consists of a number of interrelationships between the persons and bodies that make up the economy'. These interrelationships reflect the structure of the financial system. However, due to the dearth of data and information, these interrelationships cannot be shown through one of the most appropriate means - the national balance sheet. We therefore proceed by classifying the different groups of the financial institutions and then try to show the extent of financial interrelationships by their relative impact on the economy.

2-4.1 The Structure of the Nigerian Financial System

There are various ways of classifying the financial institutions operating in a financial sector. They can be grouped as monetary and non-monetary financial institutions or in terms of uses of funds and sources of funds. Whichever method, the classification will come out more or less the same. We can now classify the institutions in the Nigerian financial system as follows:

Table 2.6 **Structure of the Nigerian balance of payments 1960-80**

(Million Naira)

	1960	1965	1970	1973	1974	1975	1976	1978	1979a	1980b
Merchandise	-101.0	-5.6	173.0	1166.9	4439.3	1487.1	1293.5	-741.7	2967.4	4084.5
Services	-36.2	-127.2	-268.0	-1078.8	-1314.7	-1367.7	-1455.0	-1474.6	1724.4	-2176.3
Balance on goods and services (1+2)	-137.2	-132.8	-95.0	88.1	3124.6	119.4	-161.5	-2216.3	1243.0	1908.2
Unrequited transfers	-3.4	5.4	45.0	-35.4	-62.1	-76.1	-97.8	-170.6	-233.5	-315.2
Balance on current account (3+4)	-140.6	-127.4	-50.0	52.7	3062.5	42.6	-259.3	-2386.9	1009.5	1593.0
Balance on capital account	68.0	132.0	61.2	144.8	-5.9	141.1	-50.6	1111.9	813.2	774.6
Net change in official and banking assets	73.4	-23.8	-58.2	-174.4	3083.5	-161.0	366.4	1293.6	-1868.9	2402.6
Errors and omissions	-0.8	19.2	47.4	-23.1	-18.7	3.5	-26.5	-	-	-

Source : CBN Annual Report and Statement of Accounts - various years

Notes : **a** - Figures for 1979 are provisional

b - Figures for 1980 are estimates

Minus sign indicates increase in assets/decrease in liabilities

Plus entries indicate decrease in assets/increase in liabilities

The Banking System : This comprises the Central Bank of Nigeria (CBN) and the commercial banks.

Specialized or Development Banks : These are the Nigerian Industrial Development Bank (NIDB), the Nigerian Agricultural and Co-operative Bank (NACB), the Nigerian Bank for Commerce and Industry (NBCI) and various state owned investment companies.

Savings Institutions : These are the Federal Savings Bank, Mortgage Banks and Merchant Banks.

Insurance and Provident fund : These are the insurance companies and the national provident fund (NPF).

Security Markets : They comprise the money market and the Nigerian Stock Exchange.

A brief comment on each of these institutions is necessary.

2-4.1:1 The Banking System

The Central Bank of Nigeria (CBN)

At the apex of the Nigerian financial system is the Central Bank of Nigeria. The chain of financial developments in Nigeria started with the establishment of the CBN in 1958. Since then the CBN has become a dynamic agent and a catalyst of investment and economic growth in the economy. The expansion of the financial assets of the CBN attests to its dynamic role in the economy.

Table 2.7 shows that with the exception of the war years 1967-70, when the assets of the CBN declined and of 1974 when the oil revenue rose dramatically thereby leading to an equally dramatic increase in the financial assets of the CBN, the CBN has maintained a fairly stable expansion in its assets.

The Act establishing the CBN equipped it with various powers including the responsibility for the issue of national currency, maintenance of external reserves, promotion of monetary stability and a sound financial structure, serving as bankers' bank and banker to the Government and as a financial adviser to the Government.

Table 2.7 Distribution of assets of the financial system 1960-80

(Percentages)

	1960	1966	1970	1974	1977	1978	1979	1980
I Monetary sector (1+2)	84.9	78.9	87.1	91.6	90.0	89.3	90.5	89.8
1 Central bank	37.3	27.5	24.5	51.8	32.4	35.2	33.4	36.4
2 Commercial bank	47.6	51.4	62.5	39.7	57.6	54.1	57.1	53.4
II Other banks (a+b)	1.4	1.4	0.7	0.9	2.2	2.6	3.2	3.9
a Merchant banks	-	0.8	0.4	0.8	2.2	2.5	3.1	3.9
b Federal savings banks	1.4	0.5	0.3	0.06	0.05	0.05	0.04	0.03
III Non-bank financial institutions*	13.7	18.8	12.2	7.5	7.8	8.1	6.3	6.3
Grand Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Sources : CBN 1 Annual Report and Statement of Accounts - various years

2 Economic and Financial Review - various years

Notes * : Include mortgage banks, insurance companies, national provident fund, development banks

Besides performing the traditional function of issuing means of payment and controlling the money supply, the CBN has been able to implement monetary and exchange measures aimed at strengthening the institutional infrastructure of the financial system and expanding domestic financial markets with a view to making investment resources available to the priority productive sectors of the economy.

Commercial banks

Modern commercial banking in Nigeria dates back to the early colonial period when the African Banking Corporation opened office in Lagos in 1892. Being the oldest unit of the Nigerian financial system, it has been one of the most advanced of the financial institutions. The other financial intermediaries are restricted both in their capital resources and their scope of activity. Most of them are new developments. This gives the commercial banks an edge over the others particularly the other similar institutions such as the federal savings banks, merchant banks and mortgage banks in collecting deposits and extending credit to the economy.

Table 2.8 shows that between 1970 and 1980 about 97 per cent, on the average, of all deposits of the financial system came from the commercial banks. Commercial banks also accounted for over 80 per cent of all the institutional savings in Nigeria.

Since 1973/74 when the oil revenue surged portentously, the banking system has been experiencing a period of rapid expansion. The volume of the assets and liabilities has increased prodigiously. This is shown in Table 2.7. Commercial banks accounted for over 60 per cent of the resources of the financial system between 1970 and 1973 and for the period 1974 to 1980 the ratio was over 52 per cent.

Table 2.8 Deposits distribution of the main b k ' i

(Percentages)

	1970	1972	1974	1976	1977	1978	1979	1980
Commercial banks	98.9	97.4	98.0	98.0	97.9	97.2	97.1	96.4
Merchant banks	0.7	1.4	1.3	1.5	1.6	2.3	2.4	3.1
Savings banks	0.8	0.5	0.3	0.2	0.1	0.1	0.1	0.08
Mortgage banks	0.4	0.7	0.4	0.4	0.3	0.4	0.4	0.4
Total financial system	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
	(632.8)	(796.6)	(1,727.8)	(4,249.2)	(5,345.9)	(5,452.9)	(7,175.2)	(9,168.6)

Sources : CBN 1 Annual Report and Statement of Accounts - various years

2 Economic and Financial Review - various years

Notes : Figures in brackets are total in million naira

Table 2.9 **Relative share of commercial banks' credit to the private sector 1963-81**

(Percentages)

1963	1966	1970	1974	1976	1978	1980	1081
84.8	92.6	73.0	85.9	88.0	88.8	89.5	90.6

Source : CBN Annual Report and Statement of Accounts -various years

The share of commercial banks' credit to the private sector of the economy is shown in Table 2.9. Between 1963 and 1967 commercial banks accounted for over 90 per cent of all the credits to the private sector and between 1970 and 1975 they were responsible for over 82 per ent of the private sector credit and between 1976 and 1981 this share stood at 88.3 per cent. When compared with the developed industrial countries the participation of commercial banks in supplying credit to the economy in Nigeria as in most developing countries is much greater.

2-4.1:2 **Savings Institutions**

Merchant Banks

Among the savings type institutions, merchant banks are steadily becoming significant in the financial system. Merchant banking is a relatively new aspect of the financial development in Nigeria. Phillip Hill and Nigerian Acceptances Limited (NAL) were the only two merchant banks operating in the 1960s. Both merged under the name Nigerian Acceptances Ltd in 1969. Prior to that date their impact on the economy was not much felt. There are, at present, only five merchant banks operating in Nigeria. Most of them were established in 1974-75 period. It has been argued that the growth in the number of merchant banks during this period was a consequence of the rapid growth of the petroleum sector - depen e e irely on external trade and finance - in order to 'take adva t ge o the offshore banking service requirements of the petroleum ector and, indeed, of the offshore financial requirements of the e onomy arising from the petroleum boom' Okigbo (1981, p.121).

As Table 2.7 indicates the merchant banks' share of the assets of the financial system has been fluctuating between 0.8 per cent in 1966 and 0.8 per cent in 1974. Since 1974, however, there has been a marked rising trend in their share of assets of the financial system. Their share increased from 1.5 per cent in 1976 to about 4 per cent in 1980. Their share in the national savings rose from 1.6 per cent in 1971 to 4 percent in 1980.

The criticism against the merchant banks' operations in Nigeria has been that they operate on the short end of the market and therefore operate more or less like commercial banks instead of concentrating on terms loans in which they are supposed to specialize. While this criticism is to a certain degree cogent, it should be understood that it is an essential part of merchant banking function to engage in some measure of short-term business such as acceptances and discounting of bills and exchange.

The Federal Savings Bank

The federal savings bank started as the post-office savings bank. It was changed to federal savings bank by the Decree No 38 of 1974 with the objective to 'provide a ready means for the deposit of savings and so to encourage thrift. The savings bank is not to be used for the purpose of keeping a current account ...' - (Post Office Savings Bank Regulation - The Law of the Federation of Nigeria and Lagos 1958 vx).

The declining role of the federal savings bank can be seen from Table 2.7. Its role as a saving mobilizing institution has declined substantially and steadily. Its share of total assets of the nancial system is negligible. It declined from 1.4 per cent in 1962 o almost nothing in 1980. This poor performance has been attributed o the rigid rules of operations which stem from the bank's connection with the civil service regulations and the consequent inherent dministrative redtapesm, the non-competitive services and the static nterest rate.

The Federal Mortgage Bank

The federal mortgage bank, formerly the Nigerian Building Society as established in 1957 with the primary objective to finance house uilding, not necessarily home ownership. The various state Governments have their own housing corporations which make funds available to builders and developers and at times, they build on their own and lease or sell to individuals. Mortgage institutions are still at an early stage of development and this accounts for their role in the economy. In more developed countries like the UK the building societies constitute important saving mobilizing institutions and important competitors to the clearing banks in saving mobilization. The proportion of savings from the federal mortgage bank has remained below 1.0 per cent of the total institutional savings between 1962 and 1980.

2-4.1:3 Insurance and Provident Fund

Insurance Companies

Insurance companies as financial institutions have grown very slowly inspite of their early start. The first insurance company to open office in Lagos was the Royal Exchange Assurance, a leading

British insurance company. It started in Lagos in 1921. Prior to that date, insurance was transacted by agencies of European offices. Insurance business, particularly with some saving element has not been of significant importance until recently. The income of all insurance business in Nigeria by 1960 amounted only to 7 million naira. By 1974, the aggregate premium income from all forms of insurance business stood at 54.8 million naira, it rose to 134 million naira in 1976 and by 1977 it went up to 195 million naira. This is not very encouraging when compared to the growth of deposits with the commercial banks. Besides, there is a concentration of insurance business in the field of motor vehicle and other property to the neglect of life insurance business. For instance, of the 7 million naira income of all the insurance companies operating in 1960 only 0.6 million naira was in respect of the life insurance business; and out of the 195 million naira income of these companies in 1977, only 46 million naira was collected on the life insurance business.

National Provident Fund

National provident fund is a similar institution to the insurance institutions in that the principle of national provident fund is insurance but it aims at making saving compulsory. The difference between the national provident fund and the insurance company is that while insurance involves voluntary contractual arrangements, the national provident fund is compulsory contribution to social security fund.

The national provident fund was initially established by the National Provident Act 1961. It has since been reconstituted by Decree No 39 of 1974.

The fund has invested substantial amount of its resources in gilt-edged securities and Government development stocks. Its investment in 1970 was 82.7 million naira, and 200 million naira in 1975 and by 1978 it stood at 340 million naira. The fund's contribution to institutional savings has declined in recent years particularly between 1968 and 1980 when its share declined from 21 per cent in 1968 to 11 per cent in 1974 and from 8.8 per cent in 1975 to 5.6 per cent in 1980. The period 1962-67 indicated an increasing trend in the fund's share of the institutional savings. Its share in 1962 was only 2.4 per cent but by 1967 it was 24 per cent.

2-4.1:4 Development Banks

Development banks are financial institutions purposely created to provide long- and medium-term credit needs of the public and the private enterprises. There are a number of these banks; the principal ones are the Federal Government owned Nigerian Industrial Development Bank (NIDB), the Nigerian Agricultural and Co-operative Bank (NACB), and the Nigerian Bank for Commerce and Industry (NBCI).

As their names indicate, the overall objective of these institutions is to accelerate the growth and development of industry, agriculture and commerce and all other economic growth inducing activities. They are expected, for example, to play promotional, advisory and supervisory roles in aiding the private indigeneous enterprises and entrepreneurs.

The NIDB was established in January 1964 through the acquisition and re-organisation of the Investment Company of Nigeria, a private investment company incorporated in Nigeria in 1959 as an industrial development finance company. To be able to provide development finance to the industrial establishments its minimum loan investment is 50,000 naira and the maximum is 15 million naira and the maturity of its loan is fixed at 5-15 years with a moratorium of 2 years.

The NACB was established in March 1973. The main objective is to finance agricultural production and development. Unlike the NIDB, the bank can sponsor medium and large scale agricultural projects. The NBIC was established by Decree No 22 of May 1973 to ensure the success of the Federal Government indigenisation programme through making funds available to the Nigerians interested in the purchase of equity shares of businesses marked only for the Nigerians. Its principal function was therefore, to 'provide equity capital and funds by way of loans to indigenous persons, institutions and organisations for medium- and long-term investment in industry and commerce...' Decree No 22 2 April 1973).

From Table 2.7 it is observed that although the development banks and other investment companies are large in numbers, they do not have the resources to really make a significant impact on the financial system.

2-4.1:5 The Security Markets

Money Market

The Nigerian money market came into existence with the establishment of the Central Bank of Nigeria. Prior to that there existed no domestic investment outlet for financial institutions operating in Nigeria. Such institutions with temporary surplus funds had either to hold them as idle balances with the consequent opportunity cost in terms of interest income lost or place them in the London money market with the attendant inconvenience of distance, except that most of these banks were outposts of the British banks with head offices in London.

Table 2.10 Money market instruments outstanding 1960–80

(Percentages)

	1960	1965	1970	1975	1977	1978	1979	1980
Treasury bills	90.0	65.6	69.7	67.0	34.0	28.0	45.1	39.4
Treasury certificates	-	-	29.6	24.8	44.2	61.9	49.1	56.3
Commercial paper held by banks	10.0	34.4	0.7	3.5	1.3	1.6	0.5	0.9
Certificate of deposits	-	-	-	0.3	1.2	3.7	1.9	2.2
Bankers unit fund	-	-	-	4.4	18.1	3.9	2.7	0.5
Eligible development stocks	-	-	-	-	1.2	0.9	0.7	0.6
Total	100.0 (20.0)	100.0 (122.0)	100.0 (798.0)	100.0 (919.0)	100.0 (2,034.7)	100.0 (2,910.0)	100.0 (4,700.4)	100.0 (5,375.6)

Sources : CBN Annual Report and Statement of Accounts, December 1977, 1978 and 1980.

Notes : Figures in brackets are total in million naira.

To deal with this problem the CBN launched the Nigerian money market in 1960 with the issue of the first Government Treasure bills of 90 days maturity designed purposely to raise funds for the Government. Generally there are about six money market instruments in circulation including Treasury bills. These are Treasury certificates, commercial bills, certificate of deposits, and Bankers' unit fund and Eligible development stocks.

The money market has expanded significantly in recent years as shown by the value of the market instruments. It has grown from 20 million naira in 1960 to over 2,000 million naira in 1977. (See Table 2.10). Treasury bills constituted the major outstanding instruments up till 1975. As from 1976, Treasury certificates became equally important accounting from over 61 per cent and 56 per cent of the total instruments outstanding in 1978 and 1980 respectively.

The Capital Market

The capital market in Nigeria is the Nigerian Stock Exchange which was established on 15 September 1960 as the Lagos Stock Exchange. It was established on the initiative of the private business community, the NIDB and the CBN and the Federal Government. Its memorandum of association includes as its objective to provide facilities for trading in securities, supervise activities in this regard, facilitate the flow of long-term funds into commerce and industry and maintain their fair prices for securities. The Lagos Stock Exchange now operates as the Nigerian Stock Exchange with three branches in Lagos, Kaduna and Port Harcourt.

The size of the Nigerian Stock Exchange (NSE), in terms of its primary role is shown in Table 2.11. The nominal value of public sector issue has grown from around 60 million naira in 1970/71 to 415

Table 2.11 Nigerian stock exchange : new issue activity 1970-78

Year	Number of Issue			Nominal Value (Million Naira)			(Percentages)		
	Public sector	Private sector	Total	Public sector	Private sector	Total	Public sector	Private sector	Total
1970	-	-	-	40.0	8.4	48.4	82.6	17.4	100.0
1971	3	5	8	60.0	27.0	87.0	70.0	30.0	100.0
1972	3	4	7	60.0	10.6	70.6	85.0	15.0	100.0
1973	6	12	18	120.0	14.3	134.3	83.4	16.6	100.0
1974	3	11	14	60.0	16.7	76.6	78.2	21.8	100.0
1975	6	2	8	450.0	1.5	451.5	99.7	0.3	100.0
1976	2	8	10	400.0	41.3	441.3	90.6	9.4	100.0
1977	3	17	20	415.0	63.7	478.7	86.7	13.3	100.0
1978	4	6	10	220.0	20.0	240.0	88.0	11.5	100.0

Sources : 1 PNC Okigbo Nigerian Financial System, p.200

2 CBN Annual Report and Statement of Accounts - various years

million naira in 1977. Public issue of bonds as well as shares predominates. In 1978 for instance, the issues of Government stocks represented 88 per cent of the new issues of all securities.

In terms of its secondary role, as Table 2.12 indicates, Government stocks still constitute the major dealing instrument in the market. In 1973, the number of transactions in Government stocks was 282 representing 99 per cent of the total dealings. In 1980 the number and value amounted to 7,138 and 388.8 million naira respectively. In terms of mere numbers transactions in private securities continue to dominate the market, but in terms of value of transactions, Government securities retained their dominance over private securities.

On the whole, the Nigerian capital market is narrow. Apart from Government stocks and limited number of industrial shares, bonds and convertible stocks are in the present state of the market relatively unknown. The market is shallow because a single large order will immediately affect the prices.

2-4.2 The Size of the Financial System

The pioneering work carried out by Goldsmith (1969) showed that there is a statistical relationship between the financial sector and the rest of the economy, between what he called the financial super structure and the financial infrastructure. More recent work by Revell (1973, p.9) emphasized that 'the financial system is a superstructure erected on the basis of the real wealth of the community'. On the above understanding the size of the financial sector can be measured by what both authors independently called the financial inter-relations ratio (FIR) relating the superstructure

Table 2.12 Nigerian stock exchange secondary market for securities activity 1970-80

Year	Number of Transactions			Value (Million Naira)			(Percentages)		
	Public sector	Private sector	Total	Public sector	Private sector	Total	Public sector	Private sector	Total
1970	303	331	634	8.2	0.1	8.3	98.8	1.2	100.0
1971	204	748	952	16.3	1.8	18.1	90.1	9.9	100.0
1972	252	640	898	26.2	0.98	27.2	96.3	3.7	100.0
1973	282	537	819	91.9	0.53	92.4	99.5	0.5	100.0
1974	256	2807	3063	48.4	1.3	49.7	97.4	2.6	100.0
1975	193	501	694	62.8	0.9	63.7	98.6	1.4	100.0
1976	321	696	1017	111.3	0.56	111.8	99.6	0.4	100.0
1977	337	1314	1651	178.8	1.2	180.0	99.3	0.7	100.0
1978	229	2263	2492	287.2	10.6	197.8	94.6	5.4	100.0
1979	124	3099	3223	249.7	4.7	254.4	98.2	1.8	100.0
1980	220	6918	7138	380.9	7.9	388.8	98.0	2.0	100.0

Sources : 1 CBN Annual Report and Statement of Accounts - various years

2 PNC Okigbo (1981) Nigerian Financial Systems, p.201

measured by a number of indices to the national wealth or income. The idea is that the higher the ratio, the more the importance of financial institutions and instruments.

The value of FIR is determined by a number of factors: first, the extent to which economic units depend on external source of funds to finance their capital formation. Second, the degree of monetization of the economy. Third, 'since financial institutions have a multiplier effect on the volume of claims issued, the larger the proportion of financial activity which involves financial institutions the larger the volume of claims issued and conversely' (Revell 1973, p.23).

In this study the size of the financial system is measured in relation to the GDP at current market prices. This is shown in Table 2.13. Financial system accounted for 20.7 per cent and 41.7 per cent of GDP in 1960 and 1974 respectively. The ratio stood at 58 per cent in 1978 before declining to 50.8 per cent in 1980. This compares favourably with figures given by Goldsmith (1966, p.9) for 1960 in the case of India (0.35), Ethiopia (0.15), Japan (1.40) and for 1961 in the case of the UK (1.70). The figures for Nigeria indicate that the financial sector is assuming greater and greater importance in the economy as the economy develops.

As shown in Table 2.14, the annual growth rate of assets of the financial institutions was 13.2 per cent during 1960-65, 17.6 per cent during 1966-70 and 44.4 per cent and 23.4 per cent in the periods 1971-75 and 1976-80 respectively. For the entire period 1960-80, the annual average growth rate was not equally shared by the groups of institutions. Consequently there was a change in the relative size of the various types and groups of financial institutions during the period 1960-80.

Table 2.13 **Money supply and assets of the financial system as percentage of gross domestic product 1960-80**

(Percentages)

	1960	1966	1970	1972	1974	1977	1979	1980
A Money supply (1+2)	12.3	14.2	17.2	15.1	13.3	25.6	23.1	27.1
1 Money (1.1+1.2)	10.0	9.7	11.2	9.1	7.6	17.6	13.9	17.0
1.1 Currency	6.6	6.0	6.1	5.0	3.4	6.9	5.8	9.6
1.2 Demand deposits	3.4	3.7	5.1	4.1	4.2	10.6	8.1	7.4
2 Time and savings deposits	2.3	4.5	6.0	6.0	5.7	8.0	9.2	10.1
B Assets of the financial system	20.7	26.5	32.8	30.3	41.7	52.9	48.8	50.8

Sources : 1 Table 2.7

2 CBN Economic and Financial Review - various years

The relative growth rate of the monetary sector - CBN and the commercial banks - are expected to show a declining trend while the relative growth rate of other banks and non-bank financial institutions are expected to increase as the country develops. But that was not clearly depicted in Table 2.14. This is explanable by two factors : first, the 1967-70 war in the country distorted the trend and rather enhanced the relative importance of the CBN and commercial banks during the period 1966-70. Second, the windfall in the oil revenue in 1973/74 increased the resources of the Government and thus the resources of the CBN and to a less extent than of the commercial banks, hence the phenomenal increase in the growth rate of the assets of the two institutions in 1971-75 period. The CBN's asset growth rate averaged over 100 per cent during the period. The expected trend in the growth rate of the assets of these institutions showed up clearly in the period 1976-80.

Table 2.14 Growth rate of assets of the financial system annual averages

(Percentages)

	1960-65	1966-70	1971-75	1976-80	1960-80
I Monetary Sector (1+2)	10.1	20.2	48.1	22.5	25.3
1 Central Bank	7.8	14.1	100.5	18.8	35.3
2 Commercial Banks	13.4	23.2	31.8	26.8	23.8
II Other Banks (1+2)	-	1.1	81.7	43.2	31.5
1 Merchant Banks	-	8.3	98.1	44.4	33.6
2 Federal Savings Banks	...	0.0	13.4	2.1	2.8
III Nonbank Financial Institutions	28.0	10.1	17.3	32.3	21.9
Total	13.2	17.6	44.4	23.4	24.6

Source : Derived from Table 2.7

As noted above one of the factors that affects the importance of the financial sector and determines the size is the degree of monetization of the economy. Although the degree of monetization of the Nigerian economy cannot be measured accurately, the attempt gives an idea of the role and changing size of the financial system in the development of the economy. Table 2.13 shows that the relative level of money supply rose from 12.3 per cent of the GDP in 1960 to 21.7 per cent in 1976. In 1980, it increased to 27.1 per cent of the GDP.

The Table points up another basic characteristic of the monetary and financial development in the economy. The expansion in money was accompanied by a significant change in its composition. Deposits in the form of chequing accounts in the banking system rapidly increased in relative terms becoming a basic instrument of money economy. By 1960 currency was the main basic asset recording 6.6 per cent of the GDP as against 3.4 per cent for demand deposits. By 1974 their relative importance changed with demand deposits recording 4.2 per cent of the GDP as against 3.4 per cent for currency.

The increase in quasi money-time and savings deposits-with respect to the GDP attests not only to the tremendous expansion of time and savings deposits during the last 20 years but also to the volatile behaviour of such deposits. Time and savings deposits as a ratio of the GDP rose from 2.3 per cent in 1960 to 6.0 per cent in 1972; this trend was not followed in 1973 when it rose to only 6.5 per cent, thereafter declining to 5.7 per cent in 1974 before rising again.

2-5 CONCLUSIONS

The development of the Nigerian financial system and in particular the banking system has been significantly influenced by the political, industrial, foreign trade, agricultural, mining developments as well as the size and population of the country. For example the substantial drop in the share of the agriculture in the GDP in recent years is bound to have tremendous repercussions on the banking system. This is because the decline represents a big shift in demand pressures in the economy which has influenced to a large extent the operations of the financial system. As an illustration, in the 1950s and 60s the source of growth of the economy was primary product exports. This source was endogenous to the economy in the sense that the output represented the efforts of a large section of the Nigerian population. In the 1970s and 80s the momentum of growth derives from the mining sector, particularly the crude petroleum exports whose direct impact on the population is small. Consequently, while the monetization of the export proceeds in the 1950s and 60s could not lead to heavy pressures on prices, the monetization of crude oil receipts has had its impact on price level and brought as well increased national wealth with the consequent impact on the volume of banking business in the economy. In addition, as Okigbo (1981) remarked, mining industry being an enclave economy, the investment requirements of the sector are not met from the aggregate financial resources of the domestic economy. Consequently, the adjustment of the financial system to the rapid changes in this sector tends to be slow and sluggish.

S E C T I O N B

THE STRUCTURE OF THE NIGERIAN BANKING SYSTEM

CHAPTER THREE

THE EVOLUTION OF THE NIGERIAN BANKING SYSTEM : A HISTORICAL OVERVIEW

3-1 INTRODUCTION

This chapter attempts to offer a concise history of the evolution of the foreign and indigenous commercial banking in Nigeria. The historical evolution of the Nigerian banking system relates very much to its structure and hence to its performance.

The chapter is divided into six sections. The second and third sections examine the emergence of the foreign and indigenous banks in Nigeria respectively. In section four the legal and regulatory framework will be analysed. The ownership structure of the Nigerian banking system is discussed in section five. The last section is the conclusions.

3-2 THE EMERGENCE OF FOREIGN BANKS

The lucrative and fast expanding Nigerian market attracted many extra-territorial merchants from various nations in the sixteenth and seventeenth centuries. As a consequence there was a wide variety of currencies in circulation in Nigeria by the nineteenth century. Apart from such commodity currencies as cotton, gin and rum, there were in circulation various metal currencies such as Spanish doubloon, American half-eagle, eagle and double eagle, Mexican dollar, Australian Maria Theresa dollar, French Napoleon and British sovereign. The Portuguese introduced brass and copper wires and brass bracelets called manillas. The introduction of these currencies was very helpful in diminishing the barter exchange system. This is important because the need for banks cannot arise in an environment of trade by barter or of predominantly commodity currencies.

The wide variety of currencies in circulation led the British government to seek to harmonize the currencies of the British empire by introducing the shilling at the end of the nineteenth century. An important development which may be regarded as the proximate cause of the need for a bank in Nigeria was the establishment of a settled territorial government which made it imperative to harmonize the different and competing media of exchange which in no small measure confused several transactors. Thus the activities of the transnational corporations, the establishment of a settled territorial government and its consequent financial transactions, the decline of barter exchange system, and the introduction of the British silver currency - all these 'required an institution in the form of a commercial bank for safety and transmission of funds, the importation and distribution of British silver coins and the provision of credit to the government and the trading companies' (Uzoaga, 1981, p.65). For an example, the annexation of the Northern Provinces led to greater demand for coins for the payment of troops, public officials, and local labour. Consequently, silver coins imported into Nigeria increased from £24,426 in 1886 to £874,850 in 1911 - a thirty-five-fold increase. This made it favourable for the need for a bank to be felt for the growth of hand-to-hand currency. Furthermore, between 1886 and 1890 the transportation and care of the coins shipped to West Africa on order by local trading companies created nightmares for the resident representative of the shipping company. As Okigbo (1981, p.78) puts it:

> The last bit of the transportation through the Lagos bar may be romantic to the occasional voyager; it was scarifying to the shipper who had valuable cargo to deliver to the consignee on land. Besides the cargo had to be warehoused in the shipping offices, and guarded until delivery. It would be so much wiser to transfer this function from a shipping expert to another type of expert, one used to dealing exclusively with money, a banker.

The Chairman of Elder Dempster and Company, Mr Alfred Jones saw the advantage that would accrue to his shipping company if it could sponsor the establishment of a bank in Lagos. He approached the African Banking Corporation, which was then operating in South Africa, in 1891 and had no difficulty in persuading it to open a branch office in Lagos. The bank was opened in August 1891. Thus the African Banking Corporation was the first modern commercial bank to open a branch in Nigeria. Unfortunately within a year of its establishment, Lagos was hit by trade recession caused by local uprising between the ljebus and the Egbas in March 1892. The uprising and the consequent trade recession put the bank into serious distress and made its existence precarious. Elder Dempster came to the rescue by taking over the bank in March 1893, after paying £1,000 to the African Banking Corporation. Elder Dempster ran the bank as a private bank until December 1893. By December 1893, at the request of the government in Lagos through the Crown Agents, a new joint-stock bank was registered as Bank of British West Africa (BBWA). The new bank opened office in Lagos in 1894 with an authorised share capital of £100,000 of which £30,000 was called up and £12,000 paid up. The bank made tremendous progress, attested by the fact that between 1894 and 1910 it had opened three branches and in the following nine years by 1919 it opened five more branches.

The bank was given the monopoly to ship, transport and deliver all silver coins for cash transactions in West African trade. T is gave Elder Dempster an extra-ordinary advantage in West African trade over the other traders. Elder Dempster already had tremendous trade influence and advantage in West Africa being the main shipping lin that operated regularly from Britain to West Africa, and combin d shipping with inland trade. The ships served as warehouses and he officers sold out of the ships' warehouses. To add banking int e to this enormous power was to compound the advantage the company h d over the other traders.

The other British merchants of course, were not satisfied with the undue advantage enjoyed by Elder Dempster and decided to challenge it. First, they organised themselves into an association - the African Association under the leadership of Mr John Holt in 1889. Second, they decided to establish another shipping company and a second bank in order to directly and effectively compete with the Elder Dempster and Company in all aspects of the trade. Thus in 1896 John Holt and Company ordered its own ships and steamers and in 1899 the new bank - the Anglo-African Bank - was incorporated with a nominal capital of £150,000 and subscribed shares of £32,000 of which £24,000 was called up and £18,000 paid up by 1903.

The bank opened in Old Calabar instead of Lagos to avoid unfavourable competition with BBWA which had built-in advantages in Lagos. It was successful and opened more offices soon after in Calabar, Brutu, Lokoja, Jebba, Onitsha, Warri, Zungeru and later Lagos. It had in addition agencies in Bonny, Brass, Degema, Buguma and Egwanga. The bank had its support and backing from the major trading companies in West Africa such as the Royal Niger Company, the

African Association led by the Chairman of John Holt and Company, and Alexander Miller Brothers and Company and this very much contributed to its success. By 1905, it changed its name to the Bank of Nigeria, a sign of growth and confidence, and became an important competitor to the BBWA for thirteen years before a merger proposal was completed and the Anglo-African Bank was absorbed by the BBWA on 20 June 1912. With the merger, the bitter rivalry between the two banks ended, so ended too was the early attempt to introduce competition in the Nigerian banking system. The BBWA remained a monopolist in the banking scene till 1916. The monopoly granted the bank to supply, ship and deliver silver coins in Nigeria was abolished in 1912; the abolition came too late to hurt the BBWA or benefit the Bank of Nigeria because BBWA had by then absorbed the rival - the Bank of Nigeria. Furthermore, after the establishment of the West African Currency Board in the same year, 1912, the BBWA was granted another monopoly. It was appointed the sole agent for the custody and distribution of British silver currency issued by the West African Currency Board.

In 1916, a new bank, the Colonial Bank, was established. The bank which hitherto had operated only in West Indies was authorised by the Parliament in 1916 to operate anywhere in the British Empire. In the same year the bank opened office in Lagos. The coming into the Nigerian banking scene of the Colonial Bank constituted a big threat to the monopoly power of the BBWA. It was more aggressive in its competition because it had the resources and was as strong as the BBWA. This is shown by the big and striking similarities in the balance sheet of the two banks:

	Colonial Bank (pounds sterling)	BBWA (pounds sterling)
Nominal capital	2,000,000	2,000,000
Paid up capital	600,000	560,000
Reserves	150,000	220,000

The Colonial Bank was in fact so successful that within four years of its founding it established 15 branches in Nigeria. By 1925, however, it was taken over by the Barclays Bank into an integrated international bank with several entities controlling its geographical sphere: Colonial Bank, Anglo-Egyptian Bank, and National Bank of South Africa. The Bank became known as Barclays Bank Dominion Colonial and Overseas (DCO).

It has been argued that both banks - the Colonial Bank later the Barclays Bank (DCO) and the BBWA which in 1957 changed its name to Bank of West Africa, behaved as monopolists even though structurally one could talk of oligopoly in banking. Instead of competing they agreed to co-ordinate their activities and respect each others sphere of influence (Teriba, 1968). For instance, as an illustration to support this assertion, the United African Company (UAC), was in habit of offering facilities outside the banking system to customers in the form of trade credits, to government in the form of payment for customs and other duties in London and Liverpool instead of in Nigeria thus saving in transport of currency. Both banks had to offer some accommodation to the UAC in the face of new threat of competition created by the emergence of indigenous banks in the period 1925-45, to the detriment of indigenous traders and of Nigerian government Treasury. This understanding or accommodation continued until 1957 (See Okigbo 1981, p.83).

The next foreign bank that entered the scene was the United Bank for Africa (UBA). It has a French origin. The French had longed to participate in the growing trade and commercial activities in Nigeria but could not do that until some fifty years after the British banks had firmly established their control of the market. To come therefore, it had to do it indirectly through London and not directly through Paris. The Banque National pour le Commerce et l'Industrie had a London company which was nationalised in 1945 and it became known as the British and French Bank for Commerce and Industry. It was this bank that decided in 1948 after a successful trade mission in 1947 to Nigeria to establish a branch office in Nigeria. Thus the UBA started as a British and French bank for Commerce and Industry. It received its support from French enterprises and nationals and Indian traders who came to Nigeria through Hong Kong.

Its growth was rapid and in 1956 it changed its name to the British and French Bank. In 1961 it took up Nigerian incorporation as United Bank for Africa (UBA) with an authorised capital of £1.5 million. This was later raised to £2 million by shares subscribed by five other international banks: British and French Bank, Banca Nazionale del Lavoro, Monte del Paschi de Siena, Bankers Trust Co NY, and Rotterdam Bank. UBA has grown to be one of the three biggest banks in Nigeria at present.

The International Bank for West Africa was registered in Nigeria in 1959. It was a subsidiary of Banque Internationale pour L'Afrique Occidentale which is a member of a consortium of banks including citibank, Banque Nationale de Paris, Banque de Sueze et d'Indo Chine and some other French banks. Its first office was opened in Kano, and this was because its aim was to finance the movement of groundnuts from Niger where the bank had strong foundations through Kano to Apapa. The 1969 Banking Decree compelled it to take out a wider Nigerian base.

The other newcomers of foreign banks to the Nigerian banking scene include Arab Bank now Arab-Nigerian Bank, which was jointly owned by Jordan and Lebanon, the Bank of America, now the Savannah Bank which started as an American enterprise in Nigeria, the Bank of India now Allied Bank of Nigeria which was an Indian possession. Société Génerale Bank is another foreign bank and it was established in Nigeria in 1977. By April 1982 it had opened up nine branches in Nigeria.

Before the indigenisation programme in Nigeria each of these banks was a subsidiary of an international banking organisation with a head office in one of the large money market centres such as London, New York and Paris. The branches of the foreign banks in Nigeria were therefore an integral part of the commercial banking system in the native land of the international bank and the policy adopted were transmitted from the head offices in the light of the prevailing monetary conditions at home (Nevin, 1961).

Their being a subsidiary of the multinational banking firms had some implications in their mode of operation with respect to the economic development of Nigeria. From the onset they were in no doubt of what their mission was. In the words of Loxley (1971), expatriate banks 'never pretended that their raison d'etre was to cater for the needs of the African community. They were primarily established to finance credit needs of expatriate ... traders and businessmen'. (See Mensah, 1976). The expatriate banks believed that only few Nigerians were creditworthy and even those few were dealt with caution.

Furthermore, the strong link with the world money market centres means automatic dependence on these markets for liquid assets and investment of excess reserves which in effect rendered monetary policy measures ineffective, and retarded the emergence of local money and capital markets.

Table 3.1 Selected indices : indigenous and foreign banks in Nigeria 1973-75

(Percentages)

As at 31 December	1973 Indigenous	1973 Foreign	1974 Indigenous	1974 Foreign	1975 Indigenous	1975 Foreign
Number of branches	43.3	56.7	44.4	55.6	44.5	55.5
Paid up capital	49.0	51.0	48.7	51.3	45.7	54.3
Deposits	25.3	74.7	24.8	75.2	30.5	69.5
Loans and advances	38.2	61.8	35.6	64.4	27.5	72.5
Acceptances (L/credits etc)	22.7	77.3	14.9	85.1	12.8	87.2

Source : Derived from Table 2.4 of Report of the Committee on the Nigerian Banking System, p.26.

While refusing in general to finance indigenous businesses, even when as Bauer (1954) found out, their integrity were impeccable and Nigerians were prepared to pay higher interest rates, the expatriate banks brought the least risky and most lucrative export-import businesses which itself was dominated by foreign firms, and the banking business under their control. For example as Table 3.1 shows expatriate banks controlled, on the average, 56 per cent of total branch networks, 52 per cent of paid up capital, 73 per cent of total deposits, 67 per cent of loans and advances of the commercial banks in the period 1973-75. Despite this overwhelming bank power, the expatriate banks gave only a small proportion of their loans and advances to Nigerian enterprises. (See Table 3.2). As Uzoaga (1981, p.72)observed, 'the monopolistic and oligopolistic stance of foreign banks has made it unneccesary for them to show any interest in the development of African businesses'.

3-3 THE EMERGENCE OF INDIGENOUS BANKS

The reaction of Nigerians to the obvious discriminatory attitude of the foreign commercial banks manifested itself in various attempts to found their own banks. The first of such an attempt was the establishment of Industrial and Commercial Bank in 1929 by a group of Nigerians. The bank soon failed because of poor management and inadequate capital. Besides, the period was clearly not auspicious for business particularly for banks and new bank for that matter. In 1931 the Mercantile Bank was founded under the headship of the same managing director who had headed the failed Industrial and Commercial Bank. Consequently it had difficulty in attracting capital or deposits from the public. Its paid up capital never exceeded 3,400 naira and its deposits only once exceeded 4,000 naira. It steadily suffered losses until 1936 when it went into voluntary liquidation. As noted above, the period 1929-36 was a wrong time because of the collapse of the world economy, to plunge into the establishment of financial institutions and in particular it was more difficult for fledgeling indigenous commercial banks with very limited capital and untried management. Even the existing foreign banks faced hard times during this period and BBWA, for instance, had to close its branches at Opobo, Abonema, Lokoja and Gusau between 1929 and 1932 and reduce its staff from 874 to 652.

The first successful indigenous bank was the National Bank established on 11 February 1933 with the following objectives :

1 to see that every Nigerian likely to benefit from loans and advances and overdraft is encouraged by the bank;

2 to help small time as well as big time businessmen to hold their own in commercial field;

3 to help Nigerians establish industries and own property;

4 to operate in such a way as to give Nigerians confidence effectively in commercial and industrial fields.

The National Bank survived the depression because of the superior quality of management compared to the previous indigenous efforts. It however, had its difficult times. It had to face the weight of competition almost of a monopoly nature from the powerful expatriate banks with higher and better quality management drawn from the parent organisation and the close connection between the expatriate banks and the foreign businesses in Nigeria whose banking needs were more often than not arranged for them overseas. The National Bank is at present one of the biggest indigenous commercial banks.

The second successful indigenous commercial bank is the Agbomagbe Bank now known as Wema Bank. It had a very difficult start. It started as a family business in 1945 with an authorised capital of £10,000 fully paid up by its owners. The bank faced serious liquidity problem almost from its establishment which was worsened by the 1952 Banking Ordinance requirements. The Ordinance required the commercial banks to have a minimum nominal capital of 50,000 naira and minimum paid up capital of 25,000 naira. The bank was saved from liquidation by the Western State government. As at 1977, the capital of this bank was 4 million naira with 2.8 million naira paid up capital.

The success of National Bank encouraged other Nigerians to establish more indigenous banks. Thus in 1947 the Nigerian Farmers and Commercial Bank was incorporated. Its growth was very rapid and in 1951, it reported deposits of 656,576 naira and advances of 335,576 naira. Within four years of its operation it had established 30 branches in Nigeria and had a London office. But by 1952 it liquidated. The failure was of course a consequence of the risk of unguided over expansion of branch network.

The African Continental Bank (ACB) was also established in 1947. It began as a private property known as Tinubu Properties Limited, with a nominal capital of £250 of £5 fifty shares, all bought by Dr Nnamdi Azikiwe in 1944. In 1946 it changed its name to Tinubu Bank with the nominal capital raised to £5,000 and in October 1947 the name was changed again and it became known as the African Continental Bank (ACB). The capital of the bank was then raised to £250,000.

The involvement of the ACB in the politics of the Region led to the Regional government's formulation of a policy of intervention in commercial banking. The policy as stated in the Foster Sutton report was based on discouraging monetary transactions by any one bank, liberalizing credit facilities for Nigerian entrepreneurs, encouraging the development of indigenous banking, and planning for the eventual establishment of a state bank. The ACB is at present one of the big three indigenous commercial banks.

The success of the few indigenous banks: the National Bank, the ACB and the Wema Bank spurred Nigerians to venture into commercial and industrial fields. As Okigbo (1981,p.87) put it, 'To give Nigerians confidence, which was lacking from the expatriate banks is, in our view, perhaps the greatest achievement of indigenous banking in Nigeria'.

It is noteworthy that Nigeria experienced a rapid expansion in the indigenous banks during the period 1947-52. The rapid expansion was also accompanied by high rate of failure which by 1954 claimed 21 out of 25 indigenous banks with 16 of them collapsing in 1954 alone. The Pan Nigerian Bank and the Standard Bank, both incorporated in 1951 were among those that failed in 1954. The high failure rate during this period was attributed to poor management, inadequate capital, depressive economic conditions and the impact of Banking Ordinance of 1952.

The Merchant Bank was founded in January 1952, met the 1952 Banking Ordinance requirements and survived the bank failure period; but in 1961 it liquidated. It failed because of poor lending practices such as unsecured loans, major advances to the directors of the bank. Its failure and demise in 1961 ended the era of private indigenous banking history in Nigeria.

3-3.1 The State Commercial Banks

The Regional/State government's participation in the financial sector dates back to 1954 when the Federal Constitution which granted autonomy to the former regions was introduced (Nwankwo, 1979). The resulting stringent requirements of the 1952 Banking Ordinance had been, to a great extent, responsible for the collapse of the banking boom of the late 1940s and early 1950s. Consequently by 1954, the few surviving indigenous banks faced immediate liquidation because the three years' grace period allowed the banks to be licensed under 1952 Banking Ordinance was fast expiring. To save the banks from this predicament, the Regional governments had to pump in money into these banks. In addition, poor resource management, inadequate capital and unsecured loans had also forced the surviving banks to continue to depend on the state governments even after complying with the 1952 Banking Ordinance requirements.

The implication has been the demise of private indigenous banks and the emergence of state-owned banks. The then Eastern Region government took over the ACB. With the splitting of the Eastern Region into Anambra, Imo, Rivers and Cross River states, the ACB is at present owned jointly by the new states except the Cross River state government. Similarly, the Western Region government acquired the National Bank of Nigeria and the Agbomagbe bank now Wema Bank. The two banks are now owned jointly by the new states of Oyo, Ogun and Ondo. Later in the 1950s the Northern Nigeria government participated in and eventually took over the Bank of the North. The Bank of the North belongs to the six constituent states of the former Northern Region government.

With the creation of the new states and the end of the civil war, there was a renewed interest by the state governments to participate in commercial banking. Thus the other states without banks of their own felt that it was only a state bank that would meet the aspirations and financial requirements of the indigenes of the state. Accordingly, they strove to have their own banks. Bendel state established the New Nigeria Bank in 1970. Cross River state founded the Mercantile Bank, and River State, in addition to part ownership of the ACB established the Pan Nigerian Bank.

An observation with the state governments' participation in commercial banking is that the dependence of the banks on the state governments involved the banks, inevitably in the politics of the state. Of course, the involvement made good politics but bad banking because, by their ethnic and tribal alliances, they unconsciously or consciously stratified sources of private capital and sacrificed efficient and independent management. These banks are also plagued by frequent interferences by their owner governments in their management and operations. They tended to depend very heavily on government deposits which are subject to fluctuations in governments' revenue sources, thereby creating considerable instability in their operations.

However, while as Ekukinam (1976) observed, the motivation for establishing state banks may be described as parochial, it is to the credit of the state governments that the early indigenous banks survived the 1952 Banking Ordinance requirements and other financial crisis. Nevertheless, the banks should be free of the various government's interferences and permitted to be truly "national" and "continental" in their operations, in their equity investment and their recruitment of efficient management. It is only in this way that the banking system can improve its performance and contribute effectively to the development of the economy.

3-3.2 Co-operative Banks in Nigeria

A co-operative bank can be defined as a financial institution especially set up to offer greater access to saving and borrowing facilities for co-operative societies and their members at relatively cheaper costs than those provided by traditional commercial banking institutions. Thus the motto of co-operative bank in Britain is "Consumers' Bank" and in some countries like Canada, France and Germany, it is known as the "People's Bank" (Ojo and Adewunmi, 1979). It is therefore clear that co-operative banks should in ordinary circumstances be distinguished from commercial banks. They are, unlike commercial banks, known as co-operators' banks and are expected to derive their strength from co-operative movements. The questio then is; to what extent are co-operative banks in Nigeria the bank for the co-operators. Nigerian experience has shown that co-opera ive banks have tended and operated like commercial banks. For instance, Ojo and Adewunmi (1979) found in their study that co-operative banks in Nigeria had no data and information in respect of the extent to which the banks have assisted co-operative societies. The explanation was that the 'banks (co-operative banks) function in the same way as the other commercial banks, placing little or no emphasis on financing the co-operative societies and their members as such. Loans were given to all customers on more or less the same basis, with little preferential treatment for and no special attention paid to the needs of co-operatives' (p.45).

The reasons why they operated as commercial banks are obvious. First their dependence on the co-operative societies for sources of funds means a restricted and unreliable source of strength. Second, co-operative banks are subject to all commercial banking regulations in the same way as commercial banks.

There are at present four independent co-operative banks in the country. The first to be established is the Co-operative Bank Limited. It was established in 1953 as a Co-operative Bank of Western Nigeria by the Government of Western Nigeria to function as a central financing agency for the Co-operative Movements in the Region. The intentions of the government were clearly set out in its Policy Paper on Co-operative Societies of June 1952 as follows:

> Since most of the developments envisaged for the Movement will benefit the overall economy of the Region and concern persons of low income who are scarcely touched by the operations of the Commercial Banks and for whom it is the responsibility of Government to provide some form of aid, it is expected that Government will use the bank as an instrument of rural finance and pay for the services rendered in this regard:
>
> (a) by helping to create an atmosphere whereby the Ban can obtain funds to this extent from statutory bodies operating in the Region for the benefit of the producers; or
>
> (b) by guaranteeing borrowings that may be made by the Bank from other sources until adequate working capital for proposed development is acquired (Government of Western Nigeria, Policy Paper on Co-operative Societies, (June 1952 para 64).

In executing this policy the government founded the bank with an outright grant of £2 million through the Region's Cocoa Marketing Board to functionally complement the activities of five other apex co-operative institutions in the Region; namely, the Co-operative Press Ltd, Co-operative Transport Ltd, Co-operative Union of Western Nigeria, Association of Nigeria Co-operative Exporters, and Co-operative Supply Association Limited. With the promulgation of the 1958 Banking Ordinance, the bank was obliged to re-apply for registration as a bank. Accordingly it was incorporated on 14 June 1961 to perform all functions of a commercial bank. The name was later changed to Co-operative Bank Limited.

The next was the Co-operative Bank of Eastern Nigeria Limited which was founded in 1954. Unlike the Co-operative Bank Limited, the bank was established on the initiative of the co-operators in the

Region, but like the former bank was supported financially by the Regional Government. The bank started off with a paid up capital of 1,180 naira plus a Regional Government grant of 20,000 naira.

In an address presented to the Honourable Dr Okpara, Premier of Eastern Nigeria by the Board of Directors of the Co-operative Bank of Eastern Nigeria Limited on 12 May 1962, the objective of the bank wa stated thus:

> The aim and objective of the Bank is to spread all over Eastern Nigeria and to encourage and finance all registered co-operative organisations. The Bank will also encourage members of the public who operate accounts with it and will offer financial assistance when this is possible.

The objective was therefore clear. The bank should operate as strictly a co-operative bank drawing its resources from the societies and granting bulk of its loans to the members. Private individuals and the public were not allowed to operate accounts at the bank due to restrictions imposed by the Banking Ordinance. It remained strictly the Co-operators' bank until 1962, when with the promulgation of the Banking Act, it became necessary for the bank to take out an incorporation under the Companies Act and to get licensed as a commercial bank with a paid up capital of 25,000 naira. To adequately reflect its commercial role, the bank's name was changed in 1982 to the Co-operative and Commerce Bank Limited.

The two co-operative banks were the only such banks in operation until 1974 when the Kaduna Co-operative Bank was established. At the opening ceremony in November 1974 the then Commission for Trade, Industry and Co-operatives said that 'it is intended that the bank should operate fully as a commercial bank, establishing branches and correspondents, and as it develops carrying out all and every type of banking business'. It is thus clear that right from its inception, although co-operative in mane, the bank was expected to be commercial in its operations.

The next such bank was the Kano Co-operative bank which was founded in 1976. It was established with an authorised capital of 3 million naira of which the Kano state government paid 2 million na ra and the Co-operative Movements in the state paid the balance of 1 million naira. It is, to all intent and purpose, a commercial bank.

3-4 LEGAL AND REGULATORY FRAMEWORK

Much of the contribution that the financial sector can make to growth and development depends upon the legislative and regulatory arrangements devised to guide the activities of the financial institutions. Commercial banks by their operations touch on the welfare of the economy. They are not only responsible for the main part of the payment mechanism but also are the 'frontline troops when it comes to implementing monetary policy' (Eastburn and Hoskins, 1978, p.3). Since they are at the same time profit-oriented business organisations, there is the need to ensure that banks' operations comply with the objectives the authorities have set for the welfare of the society.

The formulation for the financial sector of appropriate laws that will promote development through innovation and competition is not an easy task since legislation has to reckon with balancing three considerations: cost of intermediation, allocative efficiency and safety. As Revell (1980) noted, increased safety as expressed in higher capital ratios and more provision for losses under specific headings raises the cost of intermediation. 'Neglect of safety would certainly impair allocative efficiency because it would mean that not all costs were being brought into the calculations of marginal costs. ... Safety and robust balance sheet structures are also essential for successful use of monetary policy weapons; vigo ous measures of monetary policy are impossible unless institutions ar strong enough to sustain pressures for a considerable period, alth it is equally true that extra-strong balance sheet may mean that ba k do not respond immediately to pressures from the authoriti s (Revell, 1980, p.146).

Essentially, the form of control can be reduced to two main types. First there are those designed to ensure that the banking system as a whole is economically sound. These are essentially the prudential controls which are devised to control the risk of banks becoming insolvent or losing the confidence of their depositors. Second, there are those controls designed to ensure that banks behave in what is deemed to be an economically responsible way, that is in a way conducive to the furtherance of the government's overall economic objectives. These are essentially the monetary and credit controls (Morison, 1979).

The Nigerian banking history has shown that the period 1892-1952 was a period of unregulated banking activity, and this accounted in no small measure, for the high rate of bank failure of the late 1940s and early 1950s. The alarming rate of failure necessitated the appointmentof the G.D. Paton to 'enquire generally into the business of banking in Nigeria and make recommendations to the government on the form and extent of control which should be introduced' (Paton, 1949). His findings led to the Banking Ordinance of 1952. The Ordinance stipulated minimum capital requirements, defined a system of licensing, liquidity requirements and maintenance of reserves and provided for bank supervision. With the establishment of the CBN in 1958, the Central Bank of Nigeria Act 1958 and the Banking Ordinance 1958 were enacted. The Banking Act 1969 was decreed, repealing the 1958 Banking Ordinance. The 1969 Act with its various amendments is at present the most comprehensive regulatory measures governing the operations of banks in Nigeria. The major stipulations of the Act are based on a system of regulation of capital accounts, maintenance of reserves and liquidity ratios.

3-4.1 Regulation of Capital Accounts

The regulation of capital accounts of the banks takes the form of prescribing the (i) Minimum required capital and (ii) Minimum capital reserve requirements. Regulations in the form of prescribed minimum requirements of paid up share capital and the capital reserves are summarized in Table 3.3.

The objective of regulating capital accounts of the banking system is to protect the depositors and minimise the chances of banks becoming insolvent. The requirements of 1969 Act, as those of the previous ones maintained discriminatory policy in the paid up capital in favour of the indigenous banks. In 1952 and 1958, the minimum was 25,000 naira. In 1962, the minimum was raised to 500,000 naira for the indigenous banks. For the foreign banks no minimum was stipulated before 1969. What was required of them was an evidence or an undertaking of having certain minimum paid up capital. This was probably because the expatriate banks were branches of the international banks and it was not necessary to specify different capital requirements for the branches. However, in 1969, the minimum paid up capital was specified for the expatriate banks which by the companies decree of 1968 were required to be incorporated in Nigeria, and for incorporation they were required to have a minimum paid up capital of 1.5 million naira. Indigenous banks paid up capital was also raised to 600,000 naira in 1969. In addition applications for a licence were to be made to the Colonial Financial Secretary by 1952 the Federal Minister of Finance in consultation with the CBN by 1958, and the Commissioner of Finance through the CBN by 1969.

The lower minimum capital requirements for the indigenous bank may be explained by three factors. First, it could be an attempt to minimize the cost of the initial capital required to start a banking business by interested Nigerians. However as Teriba (1969) argued, this was not so because the provisions were still beyond the resource capability of Nigerians. Second, it could be that since the indigenous banks carry out smaller volume of business than the expatriate banks, therefore assuming the insolvency of banks is positively correlated with the volume of business, the expatriate banks would be liable to higher risk than the indigenous banks and consequently should require higher capital. It should, however, be known that in Nigeria, as in most developing countries, the indigenous banks often, at the behest of the government, take on business of higher social priority that exposes them to higher ratio of risk assets, defined as total assets less government securities and cash, than the expatriate banks. The third factor is the indigenous banks close connection with the government.

The capital reserve requirements before 1969 applied only to the indigenous banks. Expatriate banks' requirements were conditional, on the Minister of Finance being satisfied with the reserve position of the banks. The policy was based on the fact that these banks relied on their head offices outside Nigeria for any reserve requirements. The reserve requirements for the indigenous banks were in respect of minimum retention ratio i.e the ratio of bank's net profits transferred each year to a reserve fund. In 1952 the ratio was 20 per cent. This was raised to 25 per cent in 1958 and 1962. The transfer was to be made each time the reserve fund was less than the paid up capital in order to bring the reserve equal to the amount or greater than the paid up capital.

In 1969, the capital reserve requirements were changed in three ways. First, there was a harmonization between banks so that the requirements would apply to both the indigenous and the expatriate banks. Second, the retention ratio of 25 per cent of net profit was maintained and banks whose reserve fund level was equal to or greater than paid up share capital were required to transfer only 12.5 per cent of their net profits. Third, a capital fund to deposit ratio of 1:10 was set up for banks. Where a bank has a ratio less, the CBN has the power to direct the banks to increase the ratio to a maximum of 30 per cent. It is however, difficult to justify the 1:10 ratio. There is always the extreme difficulty, really the impossibility of objectively deciding what is an adequate amount of capital or what is the appropriate ratio of capital to assets, liabilities, deposits or risk assets - whichever denominator is eventually chosen. This does not, however, diminish the importance of the capital ratio as an operational norm for assuring bank solvency. The ratio was later changed in 1977 to relate capital requirements to loans and advances instead of deposits in order to approximate the risk-asset ratio.

In addition to the capital requirements, banks were required to satisfy the current liquidity ratio, cash ratio and special deposit requirements as specified by the CBN. While these are necessary to ensure that the banks are always capable of meeting the normal deposit withdrawals of their customers, it must be pointed out that high liquidity does not assure a bank's solvency, and that liquidity is irrelevant once a bank is insolvent. A bank's solvency depends on its cash flows or liquidity; both of these are in turn affected by the supply-demand relationships of bank's services to its customers. (See Revell, 1973, P99-110, 1975; Hodgman, 1963).

Table 3.2 **Loans to indigenous borrowers by Expatriate banks and all commercial banks 1970-72**

(Percentages)

	1970		1971		1972	
	All Banks	Foreign	All Banks	Foreign	All Banks	Foreign
Individual	26.8	28.3	26.6	26.7	26.2	24.5
Sole Proprietor	18.1	15.8	17.5	16.2	17.0	14.2
Partnerships	12.3	8.8	12.5	9.3	12.3	8.6
Companies	42.8	47.1	43.4	47.8	44.5	52.7
Total	48.8	43.3	56.2	46.9	66.6	45.6

Source : E O Ebiefie : The performance, scope and problems of commercial banks in Nigeria as a source of financing indigenous businesses in Financial Institutions and the Business Community, E D I University of Nigeria Enugu Campus.

3-4.2 Credit Policy and Guidelines

Since 1964, credit guidelines have become far the most effective technique of control of the banking industry. The traditional instruments are unemployable because of the narrowness and ill-integrated nature of the capital and money markets. The CBN has consistently issued guidelines to the banking industry particularly in the area of loans and advances to various sections of the economy, and the share of bank loans that should be granted to indigenous borrowers. The idea has been to control the aggregate volume and expansion of credit for the effective development of the economy. The 1969 Act stipulates that unsecured loans exceeding 1,000 naira cannot be granted either the bank's directors or any firm or private company especially one in which the directors are interested (Oloyede, 1975).

3-4.3 Bank Supervision and Examination

An attempt at enforcing high standards and practices of banking in Nigeria was made possible by the 1962 bank law amendment. A banking examiner was then appointed and attached to the Ministry of Finance with the objective to examine periodically the books and affairs of all the banks in Nigeria. The Commissioner for Finance has the power under certain conditions to order for special examination and if a bank is found to be doing bad banking business, the commissioner may take steps to ensure proper management by appointing an experienced person to advise the particular bank on the conduct of its business; and/or recommending that the licence of the affected bank be revoked.

Table 3.3 Capital requirements of the Nigerian commercial banks 195 -19 0

Law	Minimum required paid-up capital		Minimum capital-reserve requirements		Other requirements
	Indigenous banks	Expatriate banks	Indigenous banks	Expatriate banks	
1952 Banking Ordinance	25,000 naira	Evidence of paid-up capital of at least 200,000 naira	20 per cent of profit to be transferred to Reserve Fund	None	Only registered companies could operate as banks
1958 Banking Ordinance	25,000 naira	An equivalent of not less than 400,000 naira	25 per cent of profit to be transferred to Reserve Fund	At the discretion of the Minister	No dividend payment of reserve level is inadequate
1962 Banking Amendment Act	500,000 naira	Assets worth no less than 500,000 naira	As in 1958	As in 1958	-
1969 Banking Decree	600,000 naira	1,500,000 naira	As in 1958 unless reserve funds is equal to or greater than paid-up capital when transfer ratio is 12.5 per cent 10 per cent minimum bank capital to bank deposit liabilities		Restriction on dividend payment as in 1958
1970 Banking Amendment Decree	No change	No change	10 per cent minimum bank capital to bank loans and advances		Unsecured loans and advances to bank employee to be related to salary and not emoluments

Sources : (1) Nigeria : Official Gazettes

(2) E C Ndekwu (1976) Central Banking and Monetary Policies PhD (unpublished) University of Wales

The 1969 Act formalised the supervision by creating the Bank Examination Department as one of the Departments of the CBN. The CBN thus had a wide range of powers under this provision which embrace:

1 the appraisal of the system of operation, procedures and control;

2 the appraisal of the management with special attention to competence and general effectiveness; and

3 assessment of the adequacy or otherwise of the capital structure in relation to the size of the business, paying some attention to the changes in the capital funds over time.

3-5 OWNERSHIP STRUCTURE - INDIGENISATION OF THE BANKING SYSTEM

As is clear from the discussions so far, the origin of the Nigerian banking system lies in the promotion of trade between the metropole and the periphery of the colonial empire. This early association with external trade created on "outward looking" policy within the banks. Unlike banking system developed through the indigenous entrepreneurship, the foreign banks maintained this myopic view of the country's economy as export-import sector.(Abdi, 1977). Consequently the foreign banks contributed very little to the development of the economy. As Gerschenberg (1972) observed, despite political independence, the continuing financial dependence has resulted in a banking system with "poor" record in assisting economic development and emancipation.

These limitations of the foreign banks had continued to attract attention of the government, hence the use of the various regulatory measures to try to improve the involvement of the foreign banks in Nigeria's economic development. Although these measures have tended to moderate the cost to the government and the economy of the movement of bank funds into foreign markets, they were deficient both in improving ownership structure of the banking system and the participation of the foreign banks in the financing of the priority sectors of the economy such as agriculture and rural development.

As shown in Table 3.2 the proportion of total loans and ad an e granted to the indigenous borrowers by all the banks increased from 48.8 per cent at the end of December 1970 to 66.6 per cent at the end of December 1972. The proportion granted by the foreign banks, whi h was less than 20 per cent in the 1960s, increased marginally from 43 per cent in 1970 to 46.9 per cent in 1971, declining to 45.6 per cent in 1972. In fact the largest component of bank loans and advan e granted by the banking system (dominated by expatriate banks) had b en in favour of general commerce which is associated with external trade and internal distribution of imports, manufacturing and construction which underscores the foreign banks' support for enterprises in which expatriate interest is dominant.

In 1972, the Federal Government in a bid to remedy this disturbing situation took a decissive step and acquired 40 per cent equity interest in the three biggest foreign banks - Barclays Bank (now Union Bank), Standard Bank (now First Bank), and United Bank for Africa (UBA). These three banks controlled the bulk of the banking activity in Nigeria. In April 1973, for instance, the three banks accounted for 67 per cent of the total assets of the banking system. They held about 70 per cent of aggregate deposits, more than 50 per cent of loans and advances, about 52 per cent of the total number of bank offices and their combined liquidity ratio averaged over 79 per cent compared with 67 per cent for the entire banking system. (Enuenwosu, 1973).

The government's objective in acquiring the 40 per cent equity participation 'is for the Government to get intimately involved in commercial banking activities so as to guide them to operate to the maximum benefit of the economy. This is as much in their inte est as it is in the interest of the country' (Budget speech 1973/74).

With a new Federal Government in office in July 1975, after a coup d'etat the indigenisation policy was reviewed and it was found that 40 per cent indigenous participation in the leading foreign b ıks was not enough to deal with the basic problem of controlling the financial system through the use of various qualitative and quantitative instruments of monetary policy available to the CBN which had been rendered unemployable by the strong link between the foreign banks and the international money market centres of London, New York, and Paris. Consequently in September 1976, the Federal Government decided to extend indigenous participation to all the expatriate banks and to increase its equity interest to 60 per cent. The idea is that the government and individual Nigerians' participation in the foreign banks must not be less than 60 per cent; this is in conformity with the recommendation of the Committee on the Nigerian Financial System which states inter alia:

> Within the framework of 60 per cent Nigerian participation, (i) public sector equity should be less than absolute majority; (ii) public sector equity should be no less than foreign equity in these banks (Report on CNFS para 243, 1976, p.25).

Table 3.4 shows that the government (Federal and state) has majority shares in 13 out of 19 banks in operation in December 1978 with just 51.7 per cent in the Union Bank. The government's share in the First Bank and the United Bank for Africa (UBA) were 47.1 per cent and 48.9 per cent respectively. Other Nigerians held the remaining 12.9 per cent and 11.1 per cent equity shares of the two banks respectively. Those banks where the government owned 100 per cent equity shares are state owned and they were the former private indigenous banks.

So far the ownership of the Nigerian banking system has been transferred, though not completely to the Nigerians. It is hoped tha with more Nigerians on the Board of Directors than foreigners, th ould influence the banks to be more involved in the development f the economy. The banks should now, as it were, be "inward look ɪg' ! nowing that their growth and development is concomitant with th growth and development of the economy.

Table 3.4 Equity ownership of commercial banks in Nigeria Dec 1978

Commercial Banks	Government	Other Nigerians	Foreign	Total
Union Bank Nigeria Ltd	51.7	8.3	40.0	100.0
First Bank Nigeria Ltd	47.1	12.9	40.0	100.0
United Bank for Africa Ltd	48.9	11.1	40.0	100.0
Savannah Bank Nigeria Ltd	60.0	-	40.0	100.0
International Bank for West Africa Ltd	60.0	-	40.0	100.0
Nigeria-Arab Bank Ltd	60.0	-	40.0	100.0
Bank of the North Ltd	100.0	-	-	100.0
Allied Bank Nigeria Ltd	60.0	-	40.0	100.0
Kaduna Co-operative Bank Ltd	100.0	-	-	100.0
Kano Co-operative Bank Ltd	99.0	1.0	-	100.0
Mercantile Bank Nigeria Ltd	32.0	68.0	-	100.0
National Bank Nigeria Ltd	100.0	-	-	100.0
New Nigerian Bank Ltd	100.0	-	-	100.0
Pan African Bank Ltd	100.0	-	-	100.0
Wema Bank Ltd	100.0	-	-	100.0
Co-operative Bank of Eastern Nigeria Ltd	46.26	53.74	-	100.0
Societe Generale Bank Ltd	-	60.0	40.0	100.0
African Continental Bank Ltd	100.0	-	-	100.0
Co-operative Bank Ltd	-	100.0	-	100.0

Source : Ade T Ojo and 'Wole Adewunmi (1982) Banking and Finance in Nigeria, p.47.

3-6 CONCLUSIONS

The historical structure of the Nigerian banking system has shown that between 1891 when the first commercial bank was established in Lagos and February 1933 when the National Bank of Nigeria was stablished the banking system was wholly foreign dominated, and was n most part uncompetitive. From 1933 to 1972, there emerged two pes of banks in the system: (i) wholly foreign banks (ii) wholly digenous banks. For the first time competition was introduced into e banking system though with the indigenous banks in a isadvantageous position, having to contend with the in-built vantages of the older foreign banks. With the coming into effect of NigerianEnterprises Promotion Decree (NEPD) in 1972 the Federal vernment acquired 40 per cent equity shares in the three largest atriate banks in the economy. Thus there emerged three types of nks in the system: (i) mixed banks; (ii) wholly foreign banks; d (iii) wholly indigenous banks. Under the second phase of indigenisation in 1976, the Federal Government acquired additional 20 p r cent equity interests in the three largest foreign banks and 60 per cent in the other foreign banks. Thus the system has gradually metamorphosed into two types of banks: (i) the mixed banks with indigenous majority interests and (ii) wholly indigenous banks mainly state Government owned.

The legal framework of the banking system has shown that effective legislation has to reckon with the various trade-offs. Generally it can be maintained that the strategy for rapid economic development is to permit the banking system a high degree of flexibility so that it might respond to the demands of both savers and investors while at the same time ensuring economically sound and responsible banking operations. As Olashore (1977) noted, the objective of the CBN in applying these regulatory measures are:

- the development of a sound banking system;
- the protection of depositors of the banks;
- the promotion of rapid economic development throughout the country;
- the provision of adequate banking services in all parts of the country;
- the allocation of bank credit in accordance with the Government economic guidelines and priorities such as the programme of industrialization and indigenisation of the economy; and
- the maintenance of internationally accepted standards and practices of banking industry.

CHAPTER FOUR

GROWTH AND DEVELOPMENT OF THE NIGERIAN BANKING SYSTEM

4-1 INTRODUCTION

We shall in this chapter analyse the assets and liabilities structure of the Nigerian banking system. Specifically, emphasis will e laid on the growth of loans and advances, investments and depo°its. A detailed analysis of the items on the balance sheet - assets and liabilities - reveals information on how effectively and efficiently esources have been acquired and organised in the portfolio of assets by the banks. The discussion will further give an insight into the ontributions of the banking system to Nigeria's economic development.

The chapter is arranged so that the development of the banking s stem is discussed in the next section. The analysis of the assets and liabilities structure of the banking system is undertaken in the hird section. The fourth section discusses the growth of branch etwork. The branch network expansion of the banks will reveal a number of useful information:

1 the problems and prospects of mobilization of saving by the banks;

2 the concentration of the banks between the urban and the rural areas; and,

3 the number of persons per bank office.

The fifth section will consider the need for and the problems of rural banking scheme in Nigeria. This will highlight the existence of a financial gap and the flourishing informal market in the economy; and in the sixth section inter-system comparison of commercial banks development is considered. The final section is by way of a conclusion.

4-2 DEVELOPMENT OF THE BANKING SYSTEM

The development of the banking system and, in fact, the development of the financial system in general, may be measured in a number of ways. It is pointed out in chapter two that the most generally accepted measure of financial development is the financial interrelations ratio (FIR) defined as the value of financial assets in existence at one time divided by the value of all tangible assets, that is, national wealth. (See Goldsmith, 1969; Revell 1973). Another measure is the ratio of financial instruments issued by financial institutions to those issued by nonfinancial units, which indicates the degree of institutionalization of savings. As pointed out earlier, these measures, their shortcomings notwithstanding, are not easily applied to the Nigerian situation. The FIR, for example, assumes the existence of detailed accounts of not only financial assets held but also the national wealth. Similarly, the measure of "new issues" of financial institutions relative to those of other economic units assumes the existence of flow-of-funds accounts. Moreover, as Abdi (1977) noted, this indicator is of limited use in economies where the banking system's closest competitors are informal money markets, where reliable data of new and old debts are impossible.

In the present study, we adopt a slight modification of the FIR, and use the ratio of banks assets to GDP. The rate of growth of the banking system over the period under review is indicated by the net changes in the value of total banks financial assets to GDP ratio. Fig 4.1 shows the trend in the growth of total banking system's assets, indicating that 1970 is more or less the "take-off" year in the banking system's growth and development.

Table 4.1 Commercial banks' assets and the national product of the economy 1960-81

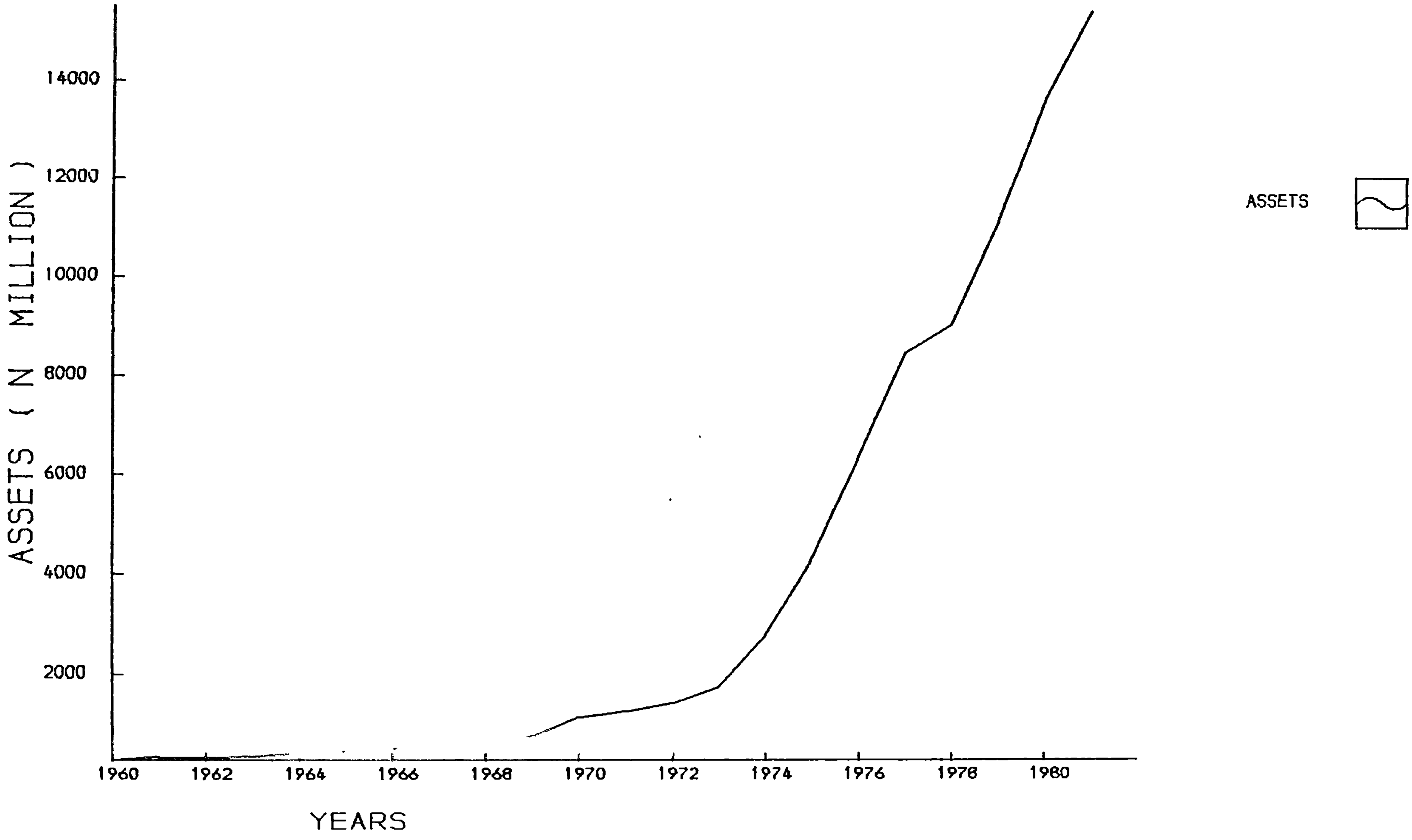
	(Million naira)		(Percentages)	
End of year	Total assets of banks	GDP	Total assets as per cent of GDP	Changes in total assets as per cent of GDP
1960	235.8	2,400	9.8	-
1961	294.7	2,378	12.4	2.5
1962	285.2	2,516	11.3	-0.4
963	325.2	2,946	11.0	1.4
964	396.0	3,145	12.6	2.3
1965	434.3	3,361	12.9	1.1
966	492.8	3,614	13.6	1.6
1967	449.0	2,950	15.2	-1.5
968	560.1	2,878	19.5	3.9
969	761.8	3,851	19.8	5.2
1970	1,152.0	5,621	20.5	6.9
971	1,275.9	7,098	18.0	1.7
972	1,437.5	7,703	18.7	2.1
973	1,772.0	9,001	19.7	3.7
974	2,811.2	16,962	16.6	6.1
1975	4,308.0	20,405	21.1	7.3
1976	6,371.4	25,449	25.0	8.1
1977	8,530.9	28,015	30.5	7.7
1978	9,105.7	28,737	31.7	2.0
1979	11,238.6	40,333	27.9	5.3
1980	13,717.4	50,599	27.1	4.9
1981	15,548.1	56,941	27.3	3.2
1960-81(average)			19.2	3.6

Sources : 1 CBN <u>Annual Report and Statement of Accounts</u> - various years

2 IMF <u>International Financial Statistics Year Book 1981</u>

3 Nigeria, Federal Republic of. <u>Fourth National Development Plan 1981-85, vol 1</u>, Federal Ministry of Economic Development Lagos, 1981.

FIG 4.1 TOTAL ASSETS OF THE BANKING SYSTEM 1960 -1981



As Table 4.1 indicates, total assets of the banking system as a percentage of the GDP rose from 9.8 per cent in 1960 to 27.3 per cent in 1981 with the highest share of 31.7 per cent being recorded in 1978. There was a moderate but steady increase in the ratio of the anking system's financial assets to GDP in the period 1963-70 The roportion fluctuated significantly between the year 1970 when it was .5 per cent and 1974 when it dropped to 16.6 per cent te taining a proportion of 19.7 per cent in 1973. Overall, the wth f the financial assets of the banking system outpaced that roduct. The long-run growth trend in the ratio of the b nancial assets to GDP as clearly shown in Fig 4.2, r flect portant development in the banking system, and also the import t le the system has played in the development of the economy.

The net changes in the banking system's financial assets as a roportion of the GDP indicate that the rate of growth of the banking system over the period 1960-81 has been unstable. This is clearly hown in Fig 4.8. The peak periods were 1968-70 and 1974-77, thus corresponding to the periods when the oil revenue surged prodigiously. The troughs in the growth rate are in the periods: 1962 which is explained by the expected impact of the new independent nation; 1967, which is the result of the war effects on the general economic activity; 1971, which may be explained by the increased demand for money balances, and goods and services without corresponding increase in production as a result of the integration of the war ravaged thickly populated areas of the country with the rest of the country; and finally 1978, the cause of which is the decline in oil revenue and the consequent effect on government spending and economic activity. The annual average change in the banking system's assets as a ercentage of the GDP for the period 1960-81 was 3.6 per cent.

Generally it is observed that specific events have a sh t-r ffect on the development of the banking system. For instar anging relationships of the world economic situation su h a terioration in terms of trade, the rise in prices of petro all in prices of raw materials and certain financial poli ies al ve been reflected to some extent in the way in which th ban g stem has developed. In some cases, these factors have aid d t velopment of banking while in others they have hindered t ample, it is noteworthy from Table 4.1 and Fig 4.2 that there a gnificant increase in the ratio of the banking system's fin n a sets to GDP in the period 1974-78. This may be explained y two ain factors. First, is the general rise of the price of crude troleum in the international market which yielded large amount of income to the Government and through Government expenditure, the general level of income in the economy rose, and hence the rise in the volume of savings and other deposits in the banking system. Second, there was the impact of inflation on commercial banks in the 1970s which could be associated with rising money value of the banking system's deposits as well as rising money income.

4-3 ASSETS AND LIABILITIES STRUCTURE OF THE BANKING SYSTEM

Economic development is accompanied by fundamental changes in the structure of the financial assets and liabilities of the banking system. In the developing countries, commercial banks are the leading mechanism through which financial resources are transferred.

The significance of the banking system's assets and liabilities as a vehicle of transmission is not very clear in the financially developed economies where they are one among an array of assets with nearly perfect substitability. In financially developing economies where financial holdings are limited to cash and bank liabilities, the growth of liabilities and assets takes an added importance. Thus the analysis of the composition of the financial assets and liabilities of the financial system reveals the development of the commercial banking and its impact on the economic and social development of Nigeria.

4-3.1 Structure of Assets

Asset portfolio of commercial banks in Nigeria can be grouped into five classes:

1 Primary Reserves:
- cash and cash items made up of vault cash and balances with the CBN
- balances with other banks

2 Secondary Reserves:
- treasury bills
- treasury certificates
- balances with call money fund

3 Investments:
- stabilization securities
- bankers' unit fund
- eligible development stock
- certificate of deposits

4 Loans and Advances:
- Overdrafts
- bills discounted

5 Fixed Assets
- Movable properties
- Immovable properties
- stocks

6 Other Assets

FIG 4.2 TOTAL ASSETS AS % OF GDP 1960 -1981

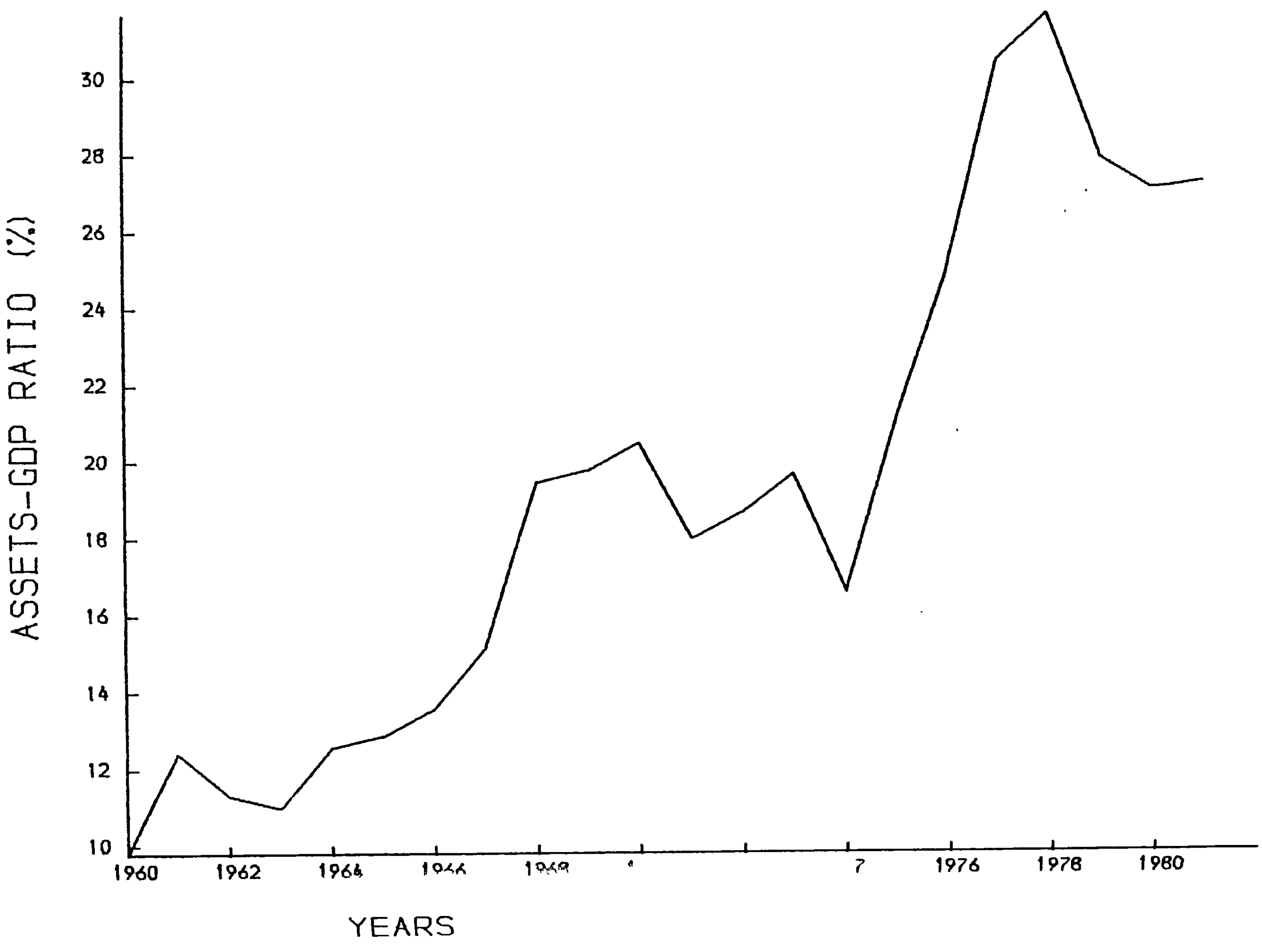


Table 4.2 Assets and liabilities structure of the Nigerian commercial banks 1960–80

(Percentages)

	1960	1965	1970	1972	1974	1975	1976	1977	1978	1979	1980
Liabilities											
Total deposits	57.4	61.0	54.2	55.2	60.3	65.9	65.4	61.4	59.1	62.3	61.5
Capital and reserves	2.7	6.8	5.0	5.3	3.6	3.0	2.5	2.4	2.9	2.9	2.4
Balances held for other banks	17.5	9.6	1.2	1.2	0.8	0.9	1.1	1.1	1.1	1.2	1.0
Loans and advances	4.6	4.4	0.5	1.8	2.0	1.2	0.7	0.2	0.2	0.4	0.6
Other liabilities	16.6	18.2	38.9	36.5	33.3	29.0	30.3	34.9	36.7	33.2	34.5
Total liabilities	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.7	100.0
Assets											
Cash and cash items	8.0	5.9	6.5	5.3	11.8	19.2	17.2	10.0	8.1	6.1	9.7
Balances with other banks	20.5	11.7	1.8	2.2	3.9	4.3	4.6	5.2	4.3	8.4	5.4
Investments	1.5	3.0	43.4	26.2	26.9	18.4	16.5	13.5	10.5	12.2	16.6
Loans and advances	47.8	62.2	30.5	43.1	33.4	35.7	33.3	36.0	45.1	40.4	40.2
Other assets	22.2	17.2	17.8	23.2	24.0	22.4	28.4	35.3	32.0	32.9	28.1
Total assets	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Sources : CBN 1 Twenty Years of Central Banking in Nigeria 1959-79 (Lagos : CBN Research Department 1979)

2 Economic and Financial Review - various years

3 Annual Report and Statement of Account - various years

Table 4.2 shows the structure of the financial assets of the Nigerian commercial banking system. To gain a deeper understanding of the structure, a brief description of each group might prove useful. Before examining each group, however, it is necessary to note the phenomenal increase in total assets of the banking system from a modest level of 235.8 million naira in 1960 to 15,548.1 million naira in 1981. (See Table 4.1 and Fig 4.1). The increase was moderate in the early years 1960-70 and significantly higher in the later period 1970-81. The petroleum wealth came in 1970 and brought with it economic prosperity, and this was reflected in the increased volume of business of the banking system.

Primary Reserves

These include cash balances held in the vault by banks. Commercial banks may deposit funds with other commercial banks as well as with the CBN. Deposits with the CBN may be part of the statutory deposits requirements in proportion to the banks' liabilities, or can be free balances deposited simply to meet immediate cash requirements. Since these funds earn little or no interest (statutory required deposits by the CBN may earn some albeit small interest income) they are held to a minimum. In addition to the above balances, commercial banks may hold funds with other banks as part of their loaning portfolio or on the contrary, they may raise inter-bank funds to cover short-term liquidity requirements and 'to exploit market imperfections' (Abdoh, 1977).

As shown in Table 4.2, the annual averages of the proportion of banks' assets held as cash and cash items on one hand, and as balances with other banks on the other hand, were 8 per cent and 8.5 per cent respectively for the period 1960-79. The proportions were highest in the period 1975-76, a period when the commercial banks were "over liquid" with no avenues to invest their funds because the Federal Government, as a result of the increase in its revenue due to the windfall earnings from crude oil exports, ceased to supply government paper except in the case of development stocks. Since the development stocks were long-term investment assets, they were not attractive to the commercial banks and consequently the Government was unable to mop up the excess liquidity in the banking system.

Secondary Reserves and Investments

These are assets that are easily convertible to cash in time of urgent need. They consist substantially of government securities and other money market instruments. Investment in private firms' securities by commercial banks are rare or non-existent. These types of investment have four origins:

- legally required investment. These are investments forced on banks by the CBN directives. Commercial banks have no control over this type of investments.

- policy oriented investments. These are investments that are made not necessarily for profit but rather which imply a policy emphasis with long-term uncertain return.

- profit motivated investments. Banks occasionally acquire corporate securities for profit purposes.

- forced investments. These stem from bank takeovers due to defacto and, or dejure insolvency of their debtors.

Table 4.2 shows that investments constitute the second single most important asset item of the Nigerian banking system. Banks applied more of their funds in investments than in loans and advances in 1969 and 1970 when they had 44 per cent and 43.4 per cent respectively of their funds in investment. There were two main reasons for this development. First, there were the periods during which loans were kept in check especially by the risk and uncertainty of the economic and political situation occasioned by the war and the aftermath of the war. Second, the banks were obliged to invest in government securities by the CBN directives - a measure designed to make funds available to the Government to enable it to prosecute the war. As Table 4.3 and Fig 4.4 indicate, investment by the banking system within the economy increased significantly; it rose over 400 times the 1960 level in 1980, and it was 5.4 times the 1970 level in 1979. The long-run growth in investment is an indication of the greater participation of the banking system in the domestic financial markets. Treasury bills constituted over 68 per cent of the total investment instruments in 1960 and with the introduction of Treasury certificates in 1968, they both constituted 93 per cent of the investment instruments in 1970, and 89 per cent in 1972. This proportion increased to 97 per cent in 1974, but declined substantially to 53 per cent in 1977. By 1980 the proportion was 92.9 per cent.

Over the period 1960-80, there have been changes in the internal distribution of the investment assets. In the period 1960-66 there were only two main instruments available to the banks: Treasury bills and Call money. By 1968, Treasury certificate was added to the list. The Call money scheme was phased out in June 1974. By 1976 four new instruments were introduced and utilized by the banks. These were stabilization securities, Bankers' unit fund, Certificate of deposits and Eligible development stocks.

FIG 4.3 CHANGE IN TOTAL ASSETS AS % OF GDP 1960 -81

Loans and Advances

Loans and advances are the most important component of the asset portfolio of the banking system. To the banks, they are the highest income yielding assets. To the economy, loans and advances are necessary to meet the investment financing requirements and current expenditure of the productive system. Total commercial banks loans and advances represented approximately 55.4 per cent of the total assets of the banking system during the period 1960-67. This ratio, however, declined in the period 1969-75 to 37.1 per cent; and in the period 1976-79 it stood at 38.7 per cent (See Table 4.2). There was a substantial decline in the proportion of loans and advances to total assets of the banking system in 1968 from 61.2 per cent in 1967 to 40.3 per cent and since then it has never attained the 1967 level up to 1980. This phenomenon may be attributed to a number of factors. First, the introduction of Treasury certificates in 1968 and four other short-term instruments (stabilization securities, Bankers' unit fund, Certificate of deposits and eligible development stocks) in 1976 met the short-term investment preferences of the banks. Second, the uncertainty of the economic and political situation created by the war held the banks loans and advances in check. Third monetary authorities introduced portfolio constraint on the banks by requiring them to invest in securities. Thus Table 4.2 indicates that the banks were paying attention to other placements such as indirect financing through investment in securities. Investments became an active avenue for banks' resources since 1968. Aside from the decline in the proportion of loans and advances to total assets of the banking system, the overall structure showed stability in the growth trend of the ratio. The long-run stability is consistent with the basic idea that lending is the natural operation of commercial banks.

Loan assets of the banking system can be classified into two broad categories. First is the overdraft, which is the privileged line of credit that enables a customer to overdraw his account up to and sometimes beyond the agreed limit. In effect, as Benston (1972) observed, a chequing account with overdraft priviledges is a combined demand deposit and demand loan accounts. When the balance is a debit the account is a loan, when the balance is a credit, it is a deposit account. Although overdraft is often regarded as unsecured line of credit, most banks in Nigeria would want a customer to guarantee his potential overdraft with negotiable or other collateral as might be the case for any loan. The ideal thing is that generally overdraft privilege is agreed to by the bank if the customer is considered a good risk, and if the customer-relationship is expected to be profitable overall. Another category of loan asset is the bills discounted. Discounting bills receivable, mainly promisory notes and trade acceptances is an important loaning instrument used by the banking system.

4-3.2 Liabilities Structure of the Banks

The liabilities side of the banks' balance sheet indicates the sources of banks funds and liabilities incurred in the banks' normal operations. It is shown in Table 4.2 that the bulk of increases in the funds of the banks has come from customers' deposits. Deposits are classified into demand deposits, that is the type of liability which is fully monetary in character, savings deposits and time deposits.

Table 4.3 **Domestic investment portfolio of the Nigerian Commercial banks 1960–80**

(Percentages)

Asset type	1960	1965	1970	1974	1977	1978	1979	1980
Treasury bills	68.6	57.8	51.8	63.4	12.6	28.5	45.2	61.1
Treasury certificates	...	...	41.8	33.6	34.4	24.5	28.9	31.8
Call money fund	...	29.1	5.3	...	...	...	...	...
Stabilization securities	...	...	...	...	11.1	15.2	1.0*	...
Bankers' unit fund	...	...	...	...	14.3	5.7	4.3	0.7
Eligible development stocks	...	...	...	...	1.0	1.5	1.1	2.0
Certificate of deposit	...	...	...	...	1.0	5.3	2.7	4.4
Others	31.5	13.0	1.1	2.9	25.6	19.3	16.7	...
Total	100.0 (5.4)	100.0 (22.3)	100.0 (534.2)	100.0 (778.3)	100.0 (2,353.1)	100.0 (1,799.0)	100.0 (2,893.8)	100.0 (2,621.2)

Sources : CBN 1 Economic and Financial Review - various years
2 Annual Report and Statement of Accounts - various years

Notes : 1 Figures in brackets are in million naira.
2 * Represents figure for the month of October

Their volume and structure determine, to a large extent, the operations of the banking system particularly in its lending activity. The growth of deposits has been phenomenal. In absolute size, it rose from 137 million naira in 1960 to 657.2 million naira in 1971 and by 1981 it was 10,667.0 million naira. The proportionate share has been relatively stable ranging from 57.4 per cent in 1960 to 61.5 per cent in 1980. The lowest proportion was recorded in 1972 when it was 51.5 per cent.

Tables 4.4 and 4.4A show a clear long-run decline in the share of demand deposits. Demand deposits which represented 60 per cent of total deposit liabilities of the banks in 1960 declined to 40.6 per cent in 1972. The proportion, however, rose to 56.9 per cent in 1977 before it started a downward trend again recording 45.7 per cent in 1981. It averaged 47.8 per cent for the entire period 1960-80. The declining proportion notwithstanding the high proportion of demand deposits and the fact that the constraint on savings and time deposits (with respect to withdrawals) is often only a formal one, give the Nigerian banking system a particularly high liquidity, which from the economic point of view may be destabilizing and tend toward inflation. But from the microeconomic point of view, Nigerian banks, for various reasons, have not felt obliged to wish for less liquid form of liability, and for that reason they have not encouraged the formation of effectively tied deposits by paying higher rates on them.

Savings and time deposits have, however, shown significant improvement over the period. Savings deposits rose from 26.9 per cent in 1960 to 30.0 per cent in 1966. It started declining thereafter and registered 18.5 per cent in 1981. The decline was more than compensated for by the increase in the proportion of time deposits from 13.1 per cent in 1960 to 32.9 per cent in 1968 and to 40.6 per cent in 1980. The expanded deposits not only demonstrate the increased confidence that could not be discerned unambiguously from changes in the demand deposits but are also preferable in terms of banks' developmental impact. The increase in time deposits allows the banks an added flexibility to lend for purposes other than working capital and short-term self-liquidating commercial transactions. Thi is particularly important in Nigeria where the policy emphasis has shifted to loans to agriculture and industrial sectors. Demand deposits may not be very reliable for such loans, because demand deposits are in most cases held primarily for transaction needs and only secondarily as portfolio assets.

As Table 4.4A further shows, the banking system has, in recent time, been more successful in attracting savings and time deposits. The ratio of demand deposits to money supply (narrowly defined) increased from 34.2 per cent in 1960 to 55.1 per cent in 1965, and after a period of fluctuating trend (1965-73) to 55.8 per cent in 1974. By 1981 it declined to 52.9 per cent. The proportion of term deposits (savings and time deposits), on the other hand, was 22.8 per cent in 1960 and 62.7 per cent in 1965. It rose to 75.4 per cent in 1974 and by 1981 it declined to 62.8 per cent. While the annual average of the ratio of demand deposits to money supply for the entire period 1960-80 was 46.4 per cent, that of term deposits was 51.5 per cent. The increased attraction of term deposits by the commercial banks is attributed to increased banking habit of the people rather than to the payment of higher interest rates.

FIG 4.4 LOANS AND INVESTMENTS OF THE BANKING SYSTEM 1960 -80

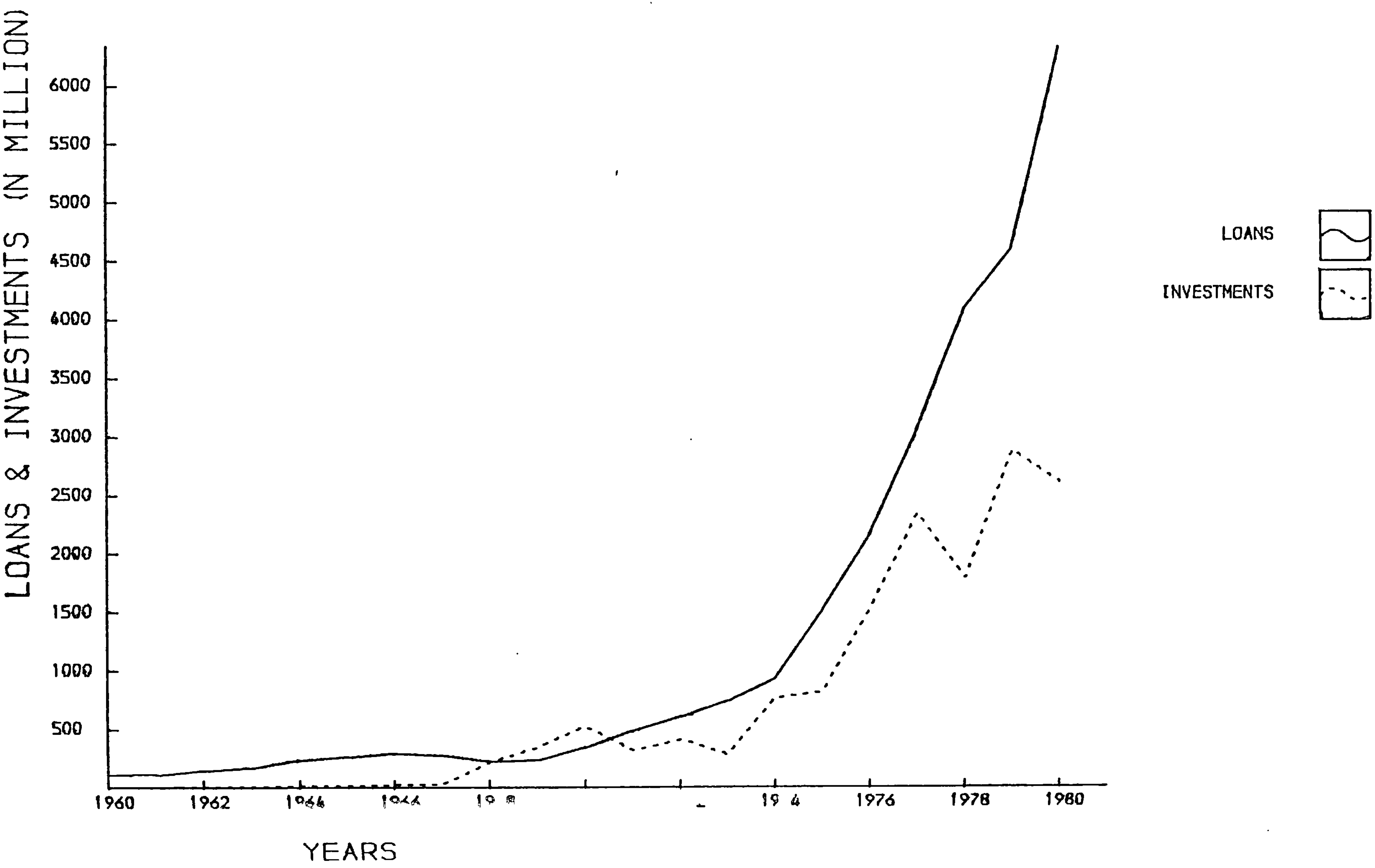


Table 4.4 **Commercial banks' growth in Nigeria : the deposit structure 1960-81**

(Million naira)

Year end December	Demand deposits	Savings deposits	Time deposits	Total deposits	Money supply (M1)	GDP
1960	82.2	36.8	18.0	137.0	240.7	2,400
1961	83.4	42.4	28.0	154.0	242.0	2,378
1962	90.6	48.4	34.8	173.8	250.2	2,516
1963	97.6	56.4	37.8	191.8	266.6	2,946
1964	115.6	70.2	46.2	232.0	313.5	3,145
1965	124.0	80.4	60.6	265.0	224.9	3,361
1966	134.6	89.4	73.2	297.2	351.8	3,614
1967	110.4	51.8	79.4	241.6	317.8	2,950
1968	147.0	74.8	108.8	330.6	330.1	2,878
1969	185.6	94.6	120.8	401.0	438.3	3,851
1970	289.0	129.8	207.0	625.8	631.3	5,621
1971	285.4	160.4	211.4	657.2	639.9	7,098
1972	315.0	205.2	256.0	776.2	700.2	7,703
1973	430.7	224.5	357.8	1,013.0	866.6	9,001
1974	720.7	286.7	686.5	1,693.9	1,290.5	16,962
1975	1,266.8	251.3	1,051.0	2,839.1	2,297.5	20,405
1976	2,185.1	709.1	1,270.0	4,164.2	3,536.3	25,449
1977	2,980.1	930.1	1,325.0	5,235.2	4,920.9	28,015
1978	2,700.9	1,075.7	1,526.0	5,302.6	4,858.1	28,737
1979	3,265.7	1,283.8	2,418.3	6,967.8	5,616.5	40,333
1980	3,730.8	1,518.4	3,593.5	8,842.7	8,598.1	50,599
1981	4,880.9	1,979.3	3,816.8	10,677.0	9,228.6	57,567

Sources : 1 CBN (i) Annual Report and Statement of Account - various years

(ii) Economic and Financial Review - various years

(iii) Monthly report, 1981

2 IMF International Financial Statistics - various years

3 Nigeria, Federal Republic of Fourth National Development Plan 1981-85. Federal Ministry of Economic Development, Lagos, 1981.

Table 4.4 A **Commercial banks' growth in Nigeria : the deposit structure 1960-81**

(Percentages)

Year End Dec.	Demand deposits (per cent	Savings deposits of total	Time deposits deposits)	demand deposits (per cent	Time + savings of money supply)	Demand deposits (per cent	Time + savings of GDP)
1960	60.0	26.9	13.1	34.2	22.8	3.4	2.3
1961	54.2	27.5	18.3	34.5	29.2	3.5	3.0
1962	52.2	27.8	20.0	36.2	33.3	3.6	3.3
1963	50.9	29.4	19.7	36.6	35.3	3.3	3.2
1964	49.8	30.3	19.9	36.9	37.1	3.7	3.7
1965	46.8	30.3	22.9	55.1	62.7	3.7	4.2
1966	45.3	30.1	24.6	38.3	46.2	3.7	4.5
1967	45.7	21.4	32.9	34.7	41.3	4.6	4.4
1968	44.5	22.6	32.9	44.5	55.6	3.8	6.4
1969	46.3	23.6	30.1	42.3	49.1	4.8	5.6
1970	46.2	20.7	33.1	45.8	53.4	5.1	6.0
1971	43.4	24.4	33.2	44.6	58.1	4.0	5.2
1972	40.6	26.4	33.0	45.0	65.9	4.1	6.0
1973	43.0	22.0	35.0	49.7	67.2	4.8	6.5
1974	42.5	17.0	40.5	55.8	75.4	4.2	5.7
1975	44.6	18.4	37.0	55.1	56.7	6.2	6.4
1976	52.5	17.0	30.5	61.8	56.0	8.6	7.8
1977	56.9	17.8	25.3	60.6	45.8	10.6	8.0
1978	50.9	20.3	28.8	55.6	53.6	9.4	9.1
1979	46.9	18.4	34.7	58.1	65.9	8.1	9.2
1980	42.2	17.2	40.6	43.4	59.5	7.4	10.1
1981	45.7	18.5	35.7	52.9	62.8	8.5	10.1
Average 1960 -1981	47.8	23.1	29.2	46.4	51.5	5.4	5.9

Sources : Same as Table 4.4

It is, however, important to note that demand deposits, though outpaced by term deposits (see Fig 4.5) increased in relative terms to become a basic instrument of money economy. In relation to the GDP the increase in the ratio is a further indication of the significant expansion in term deposits and hence in the banking habit. The proportion was 2.3 per cent in 1960; it recorded 60 per cent and 10.1 per cent in 1970 and 1981 respectively with an annual average of 5.7 per cent in the period 1960-80.

Another basic feature of the development of the banking system is the level and growth of total deposits per capita. The information is essential as it is one of the indicators of increased capture of financial resources by the banks, which is related to the more advanced stages of banking development (Rietti, 1979). Table 4.5 shows that total banking systems deposits per capita rose 55 times the 1963 level in 1981. It rose from 3.4 million naira in 1963 to 187.2 million naira in 1981. The annual average for the period 1963-80 was 36.9 million naira. Fig 4.6 shows that the long-run growth trend in the various deposits per capita has been significant and stable. There was a tremendous increase in the period 1978-81.

Two reasons can be offered to explain the increase in total deposits per capita. First, is the fact that as the economic development proceeds, the community chooses different ways of allocating its available funds primarily on the basis of the services offered by the banking system. For this reason, individuals in the economy have become aware of the new and better banking services, safety of deposits and facility of their use among other factors. Second, the rise in income level generated by crude oil exports and earnings has been a leading factor in the dynamic performance in the attraction of resources by the banking system. The dramatic increase in deposits per capita started with the period of increased crude oil prices and earnings of the 1970s. (See Fig 4.6).

A cursory look at Fig 4.6 indicates that term deposits per capita shows a higher rising trend over the period except in 1976-78, than demand deposits. If therefore, we accept the thesis that more advanced stages of banking development are identified with greater attraction of long-term financial resources, then there is thus every evidence to support our hypothesis that the Nigerian banking system has performed creditably well in mobilizing resources. The analysis so far puts up the increased use of banking facilities and reflects the long-run trend in the manner in which sources of permanent income is maintained. This is ultimately reflected in the greater soundness and strength of the banking system because it has longer-term resources to support their lending operations.

A second major source of funds to the banks is "other liabilities" which include funds in the course of collection and those credited to suspense accounts, deposits against letters of credit, provision for staff pension funds and bad and doubtful debts. The proportion of "other liabilities" in the total liabilities has increased from 16.6 per cent in 1960 to 26.7 per cent in 1967. It recorded the highest ratio of 38.9 per cent in 1970. Between 1968 and 1980 the share of "other liabilities" remained more or less stable at an average ratio of 35 per cent. The shareholders funds and reserves have not been a very significant source of bank funds. The proportion has been declining in recent times. It declined from 6.8 per cent in 1965 to 2.4 per cent in 1980.

FIG 4.5 DEPOSITS AS % OF MONEY SUPPLY 1960 - 81

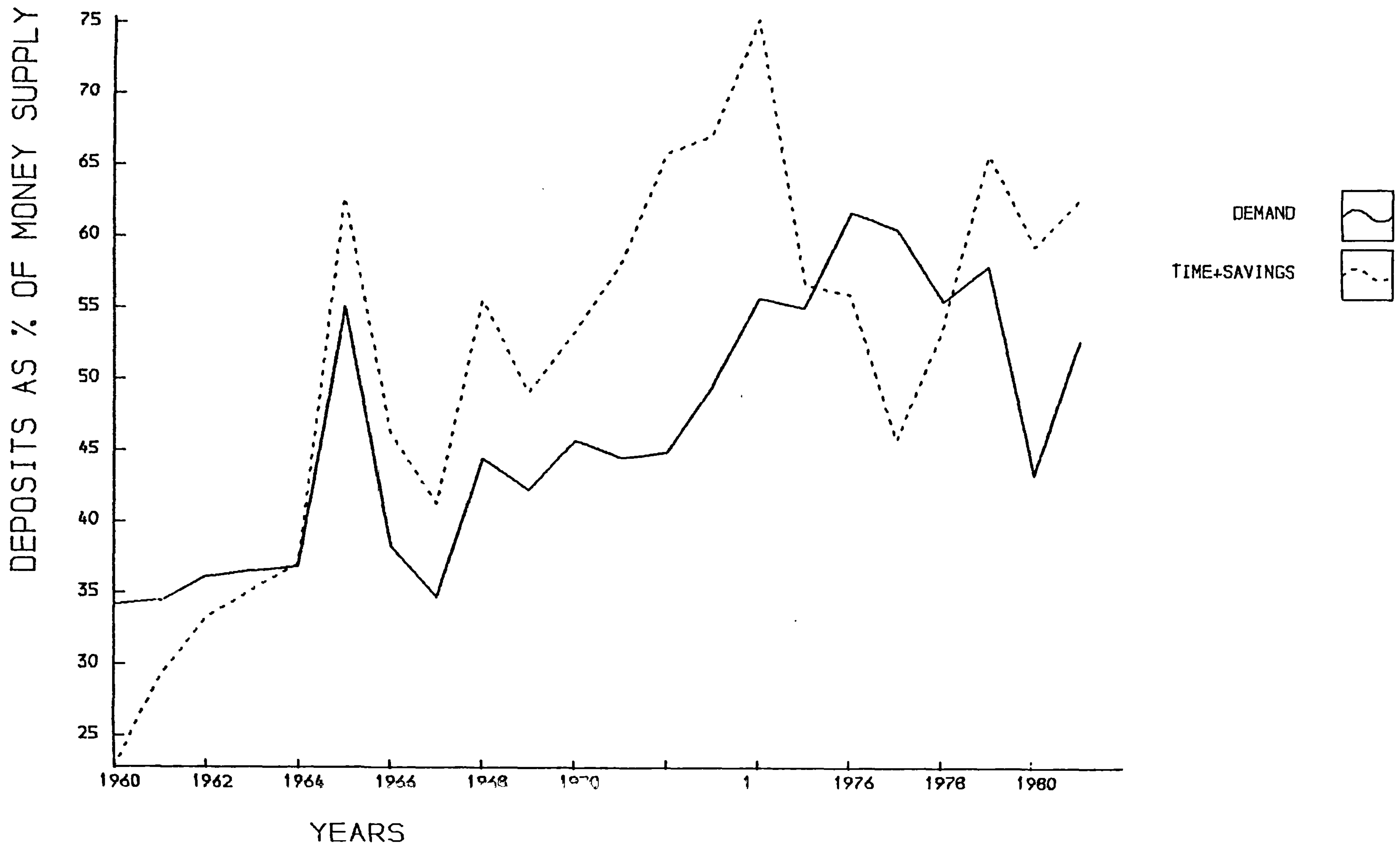


Table 4.5 Commercial banks' deposits per capita 1963-81

(million naira)

Year	Population	Total deposits per capita	Demand deposits per capita	Savings deposits per capita	Time deposits per capita	Time and savings deposits per capita
1963	55.7	3.4	1.8	1.0	0.1	1.7
1964	57.1	4.1	2.0	1.2	0.8	2.0
1965	58.5	4.5	2.1	1.4	1.0	2.4
1966	60.0	4.9	2.2	1.5	1.2	2.7
1967	61.5	4.0	1.8	0.8	1.3	2.1
1968	63.0	5.2	2.3	1.2	1.7	2.9
1969	64.6	6.2	2.9	1.5	1.9	3.3
1970	66.2	9.4	4.4	2.0	3.1	5.1
1971	67.8	9.7	4.2	2.4	3.1	5.5
1972	69.5	11.2	4.5	3.0	3.7	6.6
1973	71.3	14.2	6.0	3.1	5.0	8.2
1974	73.1	23.2	9.9	3.9	9.4	13.3
1975	74.9	37.9	16.9	3.4	14.0	17.4
1976	76.8	54.2	28.5	9.2	16.5	25.8
1977	78.7	66.5	38.9	11.8	16.8	28.7
1978	80.6	65.8	33.5	13.3	18.9	32.3
1979	82.6	84.4	39.5	15.5	29.3	44.8
1980	84.7	104.4	44.0	17.9	42.4	60.4
1981	86.9	187.2 122.4	56.2	22.8	43.9	66.7

Sources : 1 Population Bureau Office Lagos

2 CBN (i) Annual Report and Statement of Accounts - various years
(ii) Monthly Reports, 1981

Note : The population is projected at 2.5 per cent of increase per annum using 1963 census figures.

An important structural change occurred in 1967 with the dramatic reduction in the proportion of "Balances held for other banks". The proportionate share of this item was 17.5 per cent in 1960, but it has progressively declined to 1.0 per cent in 1969. Between 1974 and 1980, the highest ratio of 1.2 per cent was recorded in 1979. The explanation for the steady decline was the significant decline in the funds held for offices and branches abroad. Similarly borrowing in the form of loans and advances from the CBN and other financial institutions which constituted a very slender portion of the total liabilities of the banks has steadily declined from 4.6 per cent in 1960 to 0.5 per cent in 1970. It rose to 2.0 per cent in 1974 but by 1978 it declined to a very low level of 0.2 per cent. The explanation for this is the fact that the banks maintained a very high level of liquidity. The trend underlines the need for expanding the inter-bank market in Nigeria and for the banks to be more aggressive in seeking for investment opportunities.

The next important basic question that should be dealt with here is whether or not the growth of the banking system has contributed to higher rates of investment in the economy over the period under review. A simple definition of the contribution of the banking system to the financing of capital formation consists of the calculation of increases in the banks' credit to the public and private sectors of the economy as a percentage of gross domestic investment. The calculations are shown in Table 4.6. Although this coefficient of mobilization of bank resources can overstate the contribution of the banking system to investment because part of bank credit is allocated to investment and part to consumption expenditures, it is, nonetheless, regarded as a satisfactory indicator of that contribution. Generally, commercial banks' credit to the economy has shown a long-term upwards trend, increasing from a moderate level of 125.4 million naira in 1963 to 9066.9 million naira in 1980. (See Fig 4.7).

FIG 4.6 COMMERCIAL BANKS' DEPOSITS PER CAPITA 1963 -81

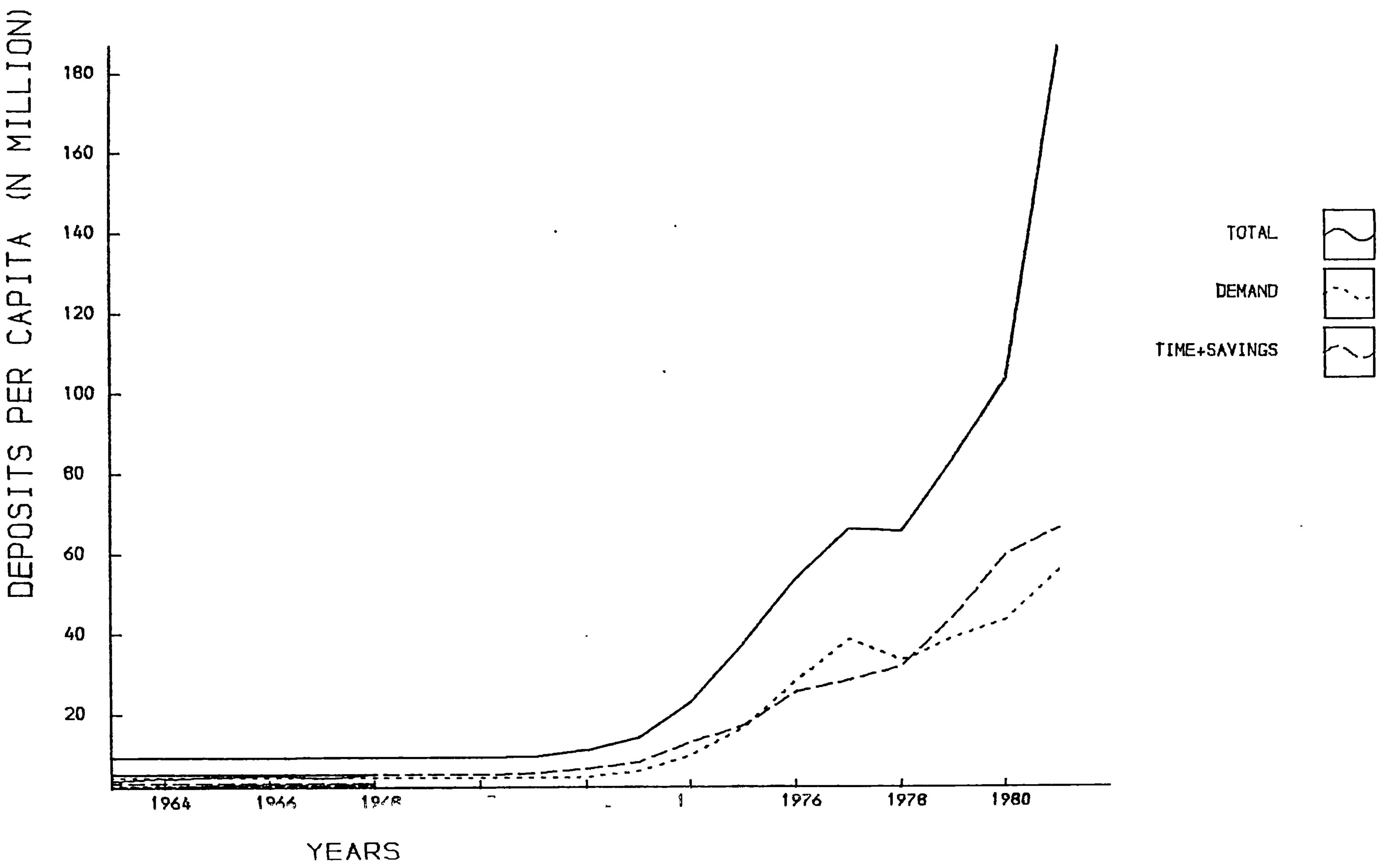


FIG 4.7 COMMERCIANKS' CREDIT TO THE ECONOMY 1963-80

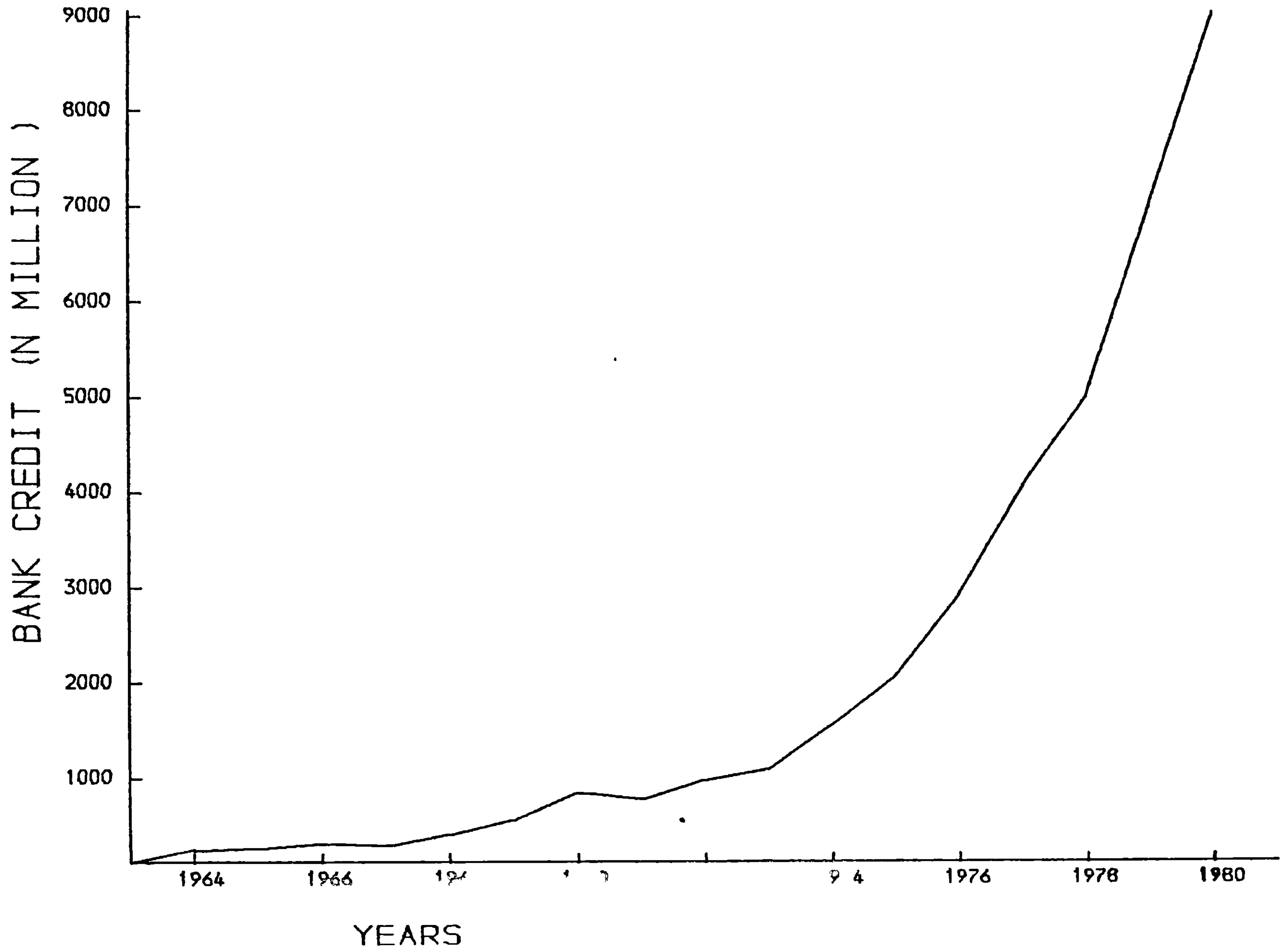


Table 4.6 shows that the coefficient of mobilization of bank resources increased from an annual average of 12.3 per cent in 1961-66 to 20.9 per cent in 1967-70. The coefficient declined significantly to 8.3 per cent in the period 1971-75. It rose again to an annual average of 13.7 per cent in 1976-80. For the entire period 1964-80, this coefficient was 13.6 per cent. As Fig 4.8 indicates, the coefficient fluctuated very much throughout the period 1963-80. The contribution of the banking system to capital formation was highest in the years 1968-70, and showed moderately increasing trend in the period 1975-80. (See Fig 4.8). The pattern of the growth rate of the coefficient can be explained by the fact that from mid 1960s to the end of the war in 1970, the Government borrowed increasingly from the banking system to enable it successfully to prosecute the war, hence the banking system's contribution to capital formation was highest in the years 1968-70.

The foregoing suggests that despite the sustained expansion of bank credit as a percentage of investment, alternative sources of investment financing continued to be dominant. Indeed such financing still depends heavily on internal savings of firms and to lesser extent on the sale of debt instruments and shares in the financial markets.

FIG 4.8 ANNUAL CHANGES IN BANK CREDIT AS % OF GFCF 1963-80

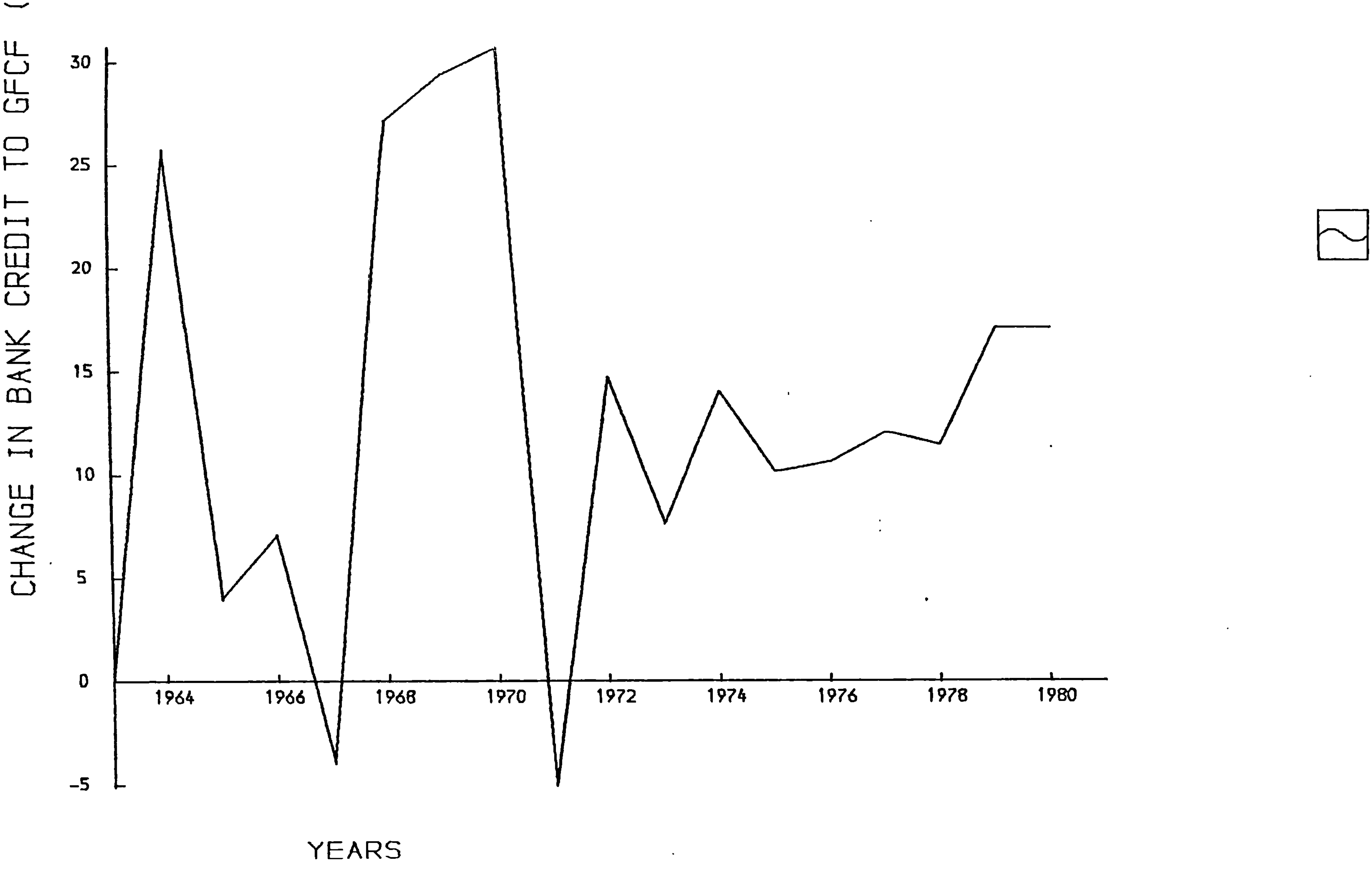


Table 4.6 **Coefficient of resource mobilization by commercial banks 1963-80**

Year	Gross fixed capital formation	Commercial banks credit tothe economy	Annual changes of bank credit to the economy	Annual changes as a per cent of gross fixed capital formation	
		(Million naira)		(Percentage)	
1963	393.0	125.4	-	-	
1964	503.0	255.0	129.6	25.8)	
1965	615.0	279.6	24.6	4.0)	12.3
1966	601.6	322.6	43.0	7.1)	
1967	483.6	303.2	-19.4	-4.0)	
1968	434.0	421.4	118.2	27.2)	
1969	527.6	577.0	155.6	29.5)	20.9
1970	911.2	858.0	281.0	30.8)	
1971	1,283.0	792.0	-66.0	-5.1)	
1972	1,401.0	999.6	207.6	14.8)	
1973	1,506.0	1,114.1	114.5	7.6)	8.3
1974	3,231.0	1,570.7	456.6	14.1)	
1975	5,019.8	2,083.2	512.5	10.2)	
1976	8,107.3	2,948.1	864.9	10.7)	
1977	9,420.7	4,098.9	1,141.8	12.1)	
1978	8,115.3	5,037.4	938.5	11.5)	13.7
1979	11,626.0	7,041.3	2,003.9	17.2)	
1980	11,781.0	9,066.9	2,025.6	17.2)	

Sources : 1 CBN Annual Report and Statement of Accounts - various years 1960-80.

2 IMF International Financial Statistics - various years

3 Nigeria, Federal Republic of: Fourth National Development Plan 1981-85, Federal Ministry of Economic Development, Lagos, 1981.

4-4 THE GROWTH OF BRANCH NETWORK

It is important to examine the growth of the banks branch network because it gives a snap shot of the structure of the banking system and it is essential in indicating the prospect for the effective mobilization of savings. One of the reasons financial developments may instigate an increase in the aggregate volume of real savings is the direct institutional effect (Abdi, 1977). This implies that the existence of financial institutions may promote higher marginal propensities to save. The institution-elasticity of priva e aggregate volume of savings would obviously depend on the existence of alternative channels. As Lewis (1970, p.229) contends, 'There is a whole range of savings institutions that can be developed ... Experience shows that the amount of savings depends partly on how widespread these facilities are; if they are pushed right under the individual's nose, to the extent of having street savings group, or factory groups, or even deductions from earnings at source, people save more than if the nearest savings institution is some distance away'.

It is also argued that the expansion of branch network will influence the mix of bank deposit liabilities. For example, the study by Weisbrod (1980) found that the convenience of branch banking permits customers to hold lower balances in non-interest bearing demand accounts, and correspondingly to hold higher balances in less liquid higher yielding assets. The greater proportion of savings and time deposits in the banks' deposit liabilities, as observed above, may be a consequence of the convenience provided to the community by branch network expansion of banks in recent years.

Table 4.7 **Commercial banks and their branches 1960-80**

Year	Number of banks	Number of branches	Growth rate of branching	Average branch per bank	('000) population	Number of persons per branch
1960	12	190	-	15.8	51,598	271,568
1961	13	195	2.6	15.0	52,921	271,390
1962	17	210	7.7	12.3	54,278	258,467
1963	17	218	3.8	12.8	55,670	255,367
1964	17	226	3.7	13.3	57,062	252,487
1965	15	240	6.2	16.0	58,489	247,704
1966	15	253	5.4	16.9	59,951	236,960
1967	14	281	11.1	20.1	61,450	218,683
1968	14	298	6.0	21.3	62,986	211,362
1969	13	302	1.3	23.2	64,561	213,778
1970	13	318	5.3	24.5	66,175	208,097
1971	16	340	6.9	21.3	68,160	200,440
1972	16	358	5.3	22.4	70,205	196,103
1973	16	383	7.0	23.9	72,311	188,801
1974	17	403	5.2	23.7	74,480	184,814
1975	17	433	7.4	25.5	76,714	177,169
1976	18	450	3.9	25.0	76,800	170,667
1977	19	508	12.9	26.7	78,556	154,638
1978	19	585	15.2	30.8	80,563	137,715
1979	20	672	14.9	33.6	82,621	122,948
1980	20	740	10.1	37.0	84,732	114,503

Sources : 1 Population Bureau Office, Lagos

2 CBN (i) Annual Report and Statement of Accounts - various years
(ii) Monthly Report, August 1976, p.9

3 Okigbo PNC (1981) Nigeria's Financial System, p.101

A look at Table 4.7 shows that there has been a remarkable increase in the number of banking offices, although the number of operating banks has remained more or less the same. In 1960, there were only 190 bank branches owned by 12 banks. By 1964, the number of banks and branches were 17 and 226 respectively. In 1969, the number of banks declined to 13, but the branches increased to 302. There were 20 banks with 740 branches in 1980. In his last budget speech, the president of Nigeria, Alhaji Shehu Shagari (1982), stated that the Government has granted licences to five new banks and approval has also been given to nine others which will start operations as soon as they have complied with the laid down conditions. He further stated that 48 new branches have been opened bringing the total number of branches to 917. (See Daily Times, 5 November 1982, p.27-8). The growth rate of bank offices has been positive with the highest rate of 15.2 per cent being recorded in 1978. This phenomenal increase in bank offices was due to the first phase of the Rural Banking Scheme which lasted for three years, July 1977 to June 1980. By the end of December 1980, for instance, a total of 200 bank offices have been established.

Apart from the period 1960-64, the average branch per bank has been increasing over the period, rising from 16 in 1965 to 24.5 in 1970. In 1975 it stood at 25.6 and rose to 37 branches per bank in 1980. Since the branches are not equally shared among banks, it is observed that the biggest three banks - Union bank, First bank and United Bank for Africa - which before 1972 were foreign banks controlled 66.8 per cent and 60.4 per cent of branches in 1960 and 1966 respectively. Their share of branch offices has declined to 56.0 per cent and 46.7 per cent in 1970 and 1978 respectively. The National Bank of Nigeria and the African Continental Bank (ACB) both wholly indigenous had together 25.3 per cent and 27.0 per cent share of branches in 1960 and 1966 respectively. Their share also declined to 26.4 per cent and 19.3 per cent in 1970 and 1978 respectively. (See Table 4.8).

An important feature of the Nigerian banking system is the inadequacy of the banking facilities. The tremendous increase in branches notwithstanding, Nigeria is still grossly under-banked with a ratio of one bank office to 114,503 persons in 1980. This does not compare favourably to other countries such as the United Kingdom with a ratio of 1:40,000; the United States with a ratio of 1:6,000 and a ratio of 1:52,000 in India (Okigbo, 1981). The implication of the low bank density is that a lot of saving is not being mobilized within the economy and that there is a good prospect of increasing branches profitably to tap idle financial resources in the economy.

The extent of inadequacy of banking facility in the country can be discerned from examining the state distribution of branches. Table 4.9 shows that by 1978 only four out of 19 states had 50 and above bank offices. These are Anambra (50), Bendel (51), Lagos (111), and Oyo (62). These states together had a total of 274 branches. This means that with only 23 per cent of the country's population, the four states controlled over 46 per cent of the bank offices. There is a concentration of bank offices in Lagos. For example, Lagos had 22.6 per cent of the branches in 1970. By 1976 it declined to 20.7 per cent. Its share of offices was 19 per cent in 1978. This is because Lagos is the nerve centre of business, the national capital, and the headquarters of the Central Bank of Nigeria. It is, however, noteworthy that the share is declining. This is because of the shift in the emphasis by the Government to rural banking. All the 19 banks in operation in 1978 had offices in Lagos. Thirteen of the banks had offices in Kano. Oyo state ranked third with 12 branches, followed by

Imo state (9), Rivers (9), Bendel (8). Sokoto state which is the third largest populated state in the country had only 4 banks with a total of 14 offices.

Table 4.8 Commercial banks' branches 1960-78

Bank	1960	1966	1970	1976	1978
Union Bank of Nigeria Ltd	62	62	86	94	108
First Bank of Nigeria Ltd	56	64	68	97	111
United Bank for Africa Ltd	9	13	24	33	54
Savannah Bank (Nigeria) Ltd	-	2	2	4	7
International Bank for West Africa Ltd	2	4	5	11	20
Nigerian-Arab Bank Ltd	-	2	2	4	7
Allied Bank of Nigeria Ltd	-	1	1	3	5
African Continental Bank Ltd	20	30	37	38	50
Bank of the North Ltd	3	5	12	33	36
Kaduna Co-operative Bank Ltd	-	-	-	2	5
Kano Co-operative Bank Ltd	-	-	-	1	3
Co-operative Bank Ltd	-	8	11	18	20
Mercantile Bank of Nigeria Ltd	-	-	-	9	13
New Nigerian Bank Ltd	-	-	-	15	23
Pan African Bank Ltd	-	-	-	7	13
Wema Bank Ltd	10	7	8	13	19
Co-operative Bank of Eastern Nigeria Ltd	-	-	15	12	24
Societe Generale Bank Ltd	-	-	-	-	4
Bank of Credit and Commerce International	-	-	-	-	-
National Bank of Nigeria Ltd	28	32	47	56	6
Totals	190	230	318	450	585

Sources : 1 Ojo and Adewunmi (1982) Banking and Finance in Nigeria, (Graham Burns UK), p.52
2 CBN Annual Report and Statement of Accounts, 1980

Note : The table excludes banks that have been closed down for various reasons.

Table 4.9 State location of commercial banks' b an i

States	1970	1971	1972	1973	1974	1975	1976	1978	Number of banks 1978	('000) Population by states 1978	Bank density by state one branch per
Anambra	23	23	26	31	31	32	34	50	7	5,190	103,800
Bauchi	4	4	4	6	6	6	7	13	4	3,508	269,846
Bendel	30	36	39	40	41	44	49	51	8	3,551	69,627
Benue	4	4	5	5	5	7	9	7	6	3,502	500,286
Borno	4	5	7	14	14	15	15	20	7	4,325	216,250
Cross River	11	9	10	13	14	16	17	18	4	5,019	278,833
Gongola	1	1	1	1	3	5	5	6	3	3,759	626,500
Imo	21	21	21	21	22	24	27	42	9	5,299	126,167
Kaduna	19	20	21	22	25	28	28	32	6	5,914	184,813
Kano	12	13	13	14	17	18	20	33	13	8,333	252,515
Kwara	9	10	13	14	14	14	14	18	6	2,474	137,444
Lagos	72	77	80	84	85	93	93	111	19	2,319	20,892
Niger	2	3	3	3	5	5	6	7	3	1,724	246,286
Ogun	13	13	13	13	14	15	15	19	6	2,238	117,789
Ondo	18	19	19	19	19	21	22	33	5	3,939	119,364
Oyo	37	41	42	44	46	48	50	62	12	7,516	121,226
Plateau	9	10	10	10	11	11	11	16	6	2,924	182,750
Rivers	22	23	21	21	21	21	21	28	9	2,482	88,643
Sokoto	7	8	10	10	10	10	10	14	4	6,549	467,786
Total	318	340	358	383	403	433	450	585		80,563	137,714

Sources : 1 CBN Monthly Report, Lagos, August 1976, p.9
2 PNC Okigbo (1981), Nigeria's Financial System, p.101
3 Populations Bureau Office, Lagos

Generally, the concentration of bank offices is biased in favour of urban centres. This is because the major urban centres provide the easy basis and sources of commercial banking business and profitability, so that banks follow the business instead of leading business. Secondly, the banking system was until 1976 dominated by foreign banks which tended to establish their branches where there is a concentration of expatriate businesses of few urban merchants and traders. Third, most of the indigenous banks are state-owned and tend to concentrate first, on the state capital.

Another observation is that although there is no restrictions on branching, a few of the banks operate in more than a small number of the states. By 1976, for instance, only Union Bank operated in all the 19 states, while, apart from Bank of the North (12 states), National Bank of Nigeria (14 states), First Bank (17 states), UBA (10 states), ACB (8 states), International Bank for West Africa (7 states) and Co-operative Bank (5 states) all the others operate in at most three states.

Finally, most of the state owned banks have a greater proportion of their branches in their home states. For example, the Mercantile Bank has ten of its thirteen branches in Cross River state, New Nigerian Bank has 17 of its 23 branches in Bendel state and Pan African Bank has nine of its thirteen branches in River state.

4-5 RURAL BANKING PROGRAMME

Having identified financial resources as a key factor in economic development, the Government has since realised that no meaningful development can be achieved without the development of the rural sector. Since the rural economy represents a substantial proportion of the country's human and natural resources, a large amount of capital is needed to help transform and modernise the sector. The funds needed can be mobilized and channelled to productive investment in agriculture and small-scale industries in the rural areas by the banks. Unfortunately, commercial banks in Nigeria are concentrated in the urban areas to the utter neglect of the rural community. As a consequence, the Federal Government devised a programme of making banking facilities available in the rural community.

In its report on the financial system, one of the recommended objectives of the commercial banks by the Committee on the Nigerian Financial System which was accepted by the Government is:

> The banks should actively facilitate the transformation of rural environment by promoting the rapid expansion of banking facilities and services and banking habit in the rural and near rural communities. They will thus serve as paying and receiving stations for hand to hand currency and provide facilities for remittances to and from rural areas. They will provide savings deposit facilities for their customers and thereby help to mobilize rural savings. Most important of all, they will serve as vehicles for the creation of credit in the rural areas. This credit will take the form of equity and loans for small scale farmers and entrepreneurs. (Government White Paper on the Report of the Committee on the Nigerian Financial System. Lagos 1977)

The next important factor necessitating the establishment of rural banking is the existence in the economy of the "financial dualism". There is undeniable evidence that a significant constraint on the integration of rural and urban sectors has been the dualism of the financial markets. There are two parallel markets in the economy with distinct characteristics. As Abdi (1977) observed, these markets are often geographically separate and only rarely does arbitrage take place between them. The smaller and more organised market utilizes bank deposits and other financial institutions' liabilities besides currency. The unorganised or informal market, which embraces a large proportion of the country utilizes, in the main, currency. The two markets differ in their sources and terms of credit granted. The only type of loans available outside family, traders and friends in the unorganised money market may well be from professional money lenders and produce buying agents. The informal money market has persisted despite the exploitative interest rate. Many rural entrepreneurs have depended on it to finance their small scale enterprises. For example, Miller (1977) in his study of 302 farmers in West and Kwara states showed that about 82 per cent of the available credit came from friends and relatives and 24 per cent came from money lenders. Commercial banks and other institutional sources did not contribute anything.

There is, therefore, the need to integrate the two sectors of the economy and thereby eliminate the progress-retarding financial dualism. One important way of integrating the two sectors is by provision of modern financial institutions and instruments in the rural areas. This is why the Government has embarked on the policy of rural banking. Implicit in this policy has been the belief that the level of savings in the rural areas is constrained by the absence of assets that are attractive in terms of safety, yield and liquidity. It is further expected that the integration of the financial markets would reduce, if not eliminate, the distortion in resource allocation between the rural and the urban areas. In addition equal access to resources mobilized by financial institutions is expected to lead to more equitable distribution of the growth dividend as the process of capital formation is spread across all sectors of the economy and across all strata of the population. Besides, the extension of banking services to the rural areas encourage some basic structural transformation.

One of the objectives of rural banking is to mobilize rural savings. It is generally agreed that financial problem at any stage is closely tied up with savings problems. There is often the argument that since the rural economy operates at or near subsistence level, there is very little that can be squeezed out of income and consumption. Consequently, it has not been realised that large volumes of idle funds, though in small units per individual, exist in the rural areas. The fact is that these reserves of productivity do exist somewhere in the rural areas; the prime problem of developm nt is to gather them and utilize them efficiently. This is why the rural banking policy is necessary.

The volume of these reserves in the rural areas can be gleaned from the amount of financial resources that the various traditional credit societies or associations can mobilize. Bauman and Harteveld (1977) in their study of Indian states of Tamil, Nadil and Kerala showed that the deposits made through credit and savings associations were equal to 20 per cent of the total commercial banks' deposits. In Ethiopia, the 1968-73 Development Plan estimated the annual savings volume through rotating savings and credit associations to be 8 to 10 per cent of the country's GDP. Furthermore, the review of small holder credit in Kenya undertaken by the African Rural Development Study points out that the deposits by small farmers under the Co-operative Thrift Scheme reached the quite unanticipated figure of US $2 million by 1973 which was the Scheme's third year of operation. (World Bank, 1975).

These studies point up the fact that there exist huge reserves of financial resources in the Nigerian rural economy seeking to be productively mobilized. These resources are either underutilized or unutilized because of lack of banking services in the rural areas. An effective way of, first, making much of the reserves assume financial form, and second, mobilizing the savings and investing them into productive ventures is through the establishment of banks in the rural communities.

Finally, there is the genuine need to increase the rural cultivator's income and savings which will enable him to build up physical as well as financial assets, and this in its turn, will increase his credit-worthiness, reduce the risk premium on interest rates and lower rural interest rates (Ghatak, 1975). But the growth of financial assets may be hindered, particularly in leading agricultural sector if there is a dearth of financial institutions which could offer prospects for savings and investment. In such cases as Ghatak (1977) rightly contends, the extension of financial institutions such as commercial banks, may be useful in bringing about greater diversification in the nature of accumulation of financial assets in the rural sector.

The Federal Government, through the CBN, applied various measures to get the existing commercial banks to expand to the rural areas. It was not an easy task because the rural areas do not provide the necessary business environment of lucrative ventures that can attract commercial banks. It was then obvious that the CBN had to use its powers to persuade, coerce and direct the commercial banks to open up offices in the rural areas.

The first measure resorted to was to invoke section 4 of the 1969 Banking Act. Under this section of the Act, banks were obliged to obtain the prior approval of the CBN before they could open a new branch. Such an application was rejected if it is not matched by concrete plans for opening rural branches. Dubiously enough, the banks utilised the approval for the urban areas without making good their pledges to open rural branches. The CBN was therefore, forced to place an embargo on branch expansion of major banks in the urban areas in the hope that the banks would in the alternative seek expansion to the rural areas. But that expectation failed; some of the foreign banks were making so much profits in the few urban branch locations, that they considered opening new offices even in the urban centres unnecessarylet alone bothering themselves with expanding to the rural areas. Thus the banks refused to expand to the rural areas by the simple device of refusing to open new urban branches.

Having failed with this strategy, the CBN resorted to persuasion. The banks were persuaded to adopt a new approach to the rural development and to extend credit to the agricultural sector. At the 1976 Annual Dinner of the Nigerian Institute of Bankers, the governor of the CBN, for instance, stated:

> Closely related is the need for a conscious policy on your part to open branches in the rural areas. This itself will afford you the opportunity to move to more challenging, but in the long-run, more rewarding ventures in the rural areas from the stand-point of economic and social development. This is the contribution we have to make to the development of the neglected rural areas and any short-term sacrifice we have to make will eventually prove to be worthwhile for the banking community and the nation at large. (CBN : Economic and Financial Review, June 1976, p.8)

Despite the appeal and persuasion, the banks remained unyielding in their determination not to expand to the rural areas.

Table 4.10 **Communities without banking facilities in 1977**

Population ranges	Number of settlements
over 100,000	14
50,000 - 100,000	28
40,000 - 50,000	37
30,000 - 40,000	47
20,000 - 30,000	96
10,000 - 20,000	208
below 10,000	696
Total	1,126

Source : CBN Bullion, 20th Aniversary, Edition July 1979, p.52

A more realistic and definite approach was devised by the CBN in 1977. The first step was to identify "unbanked" areas through a survey which showed the need to provide 1,126 rural branches (See Table 4.10). To distribute equitably the burden of rural expansion among the banks, the CBN decided to allocate the identified rural centres to the banks on a basis of a formula which relates the number of each bank's rural branches to its total branch network throughout the country (Oloshore, 1979). To facilitate the execution of the programme, the CBN decided to phase the scheme. The first phase was the period July 1977 to June 1980. Under the first phase, 200 rural centres were identified and allocated to the banks for opening branches (See Table 4.11). In identifying these centres priority was given to local government headquarters so as to ensure that each local government headquarters had at least one bank office. The second phase started in August 1980 and it is expected to end in December 1983. Under the second phase 266 bank offices have been allocated to the banks. The allocation is based on the relative size and branch network of the various banks, except that no bank is allocated less than six branches.

In appraising the first phase, it is necessary to note that it is a success to the extent that of the 200 branches allocated to the banks, 194 branches were opened by the end of December 1980. It is, however, not enough to open these branches, the operations of the branches with respect to the roles they are expected to play are of crucial importance and must be monitored by the CBN. The stiff resistance put up initially by these banks should serve as enough warning to the CBN that unless their rural branch activity is carefully and constantly monitored that they are bound to play a negative role in the development of the rural areas by merely serving as profit centres for their head offices, mobilizing rural funds for investment in the urban centres. This will rather perpetuate the financial dualism and leave the rural areas poorer.

Rural banking is a concept, and thus a rural bank is a bank located in a predominantly subsistence agricultural community for the purpose of mobilizing and relending idle funds with the ultimate aim of modernising and uplifting the living standards of the rural areas as a preliminary step to economic "take-off" of the national economy. Unfortunately, in Nigeria rural banks are not separate entities but are branches of old established banks subject to the rules, traditions and policies of their individual headquarters. The implication of this is that rural branches are very much likely to be influenced by the parent banks and as such are not going to adhere to the ideals for which they were established.

Table 4.11 **Rural banking programme : allocation of identified centres to the commercial banks**

Banks	Allocation under first phase	Completed at the end of December 1980	Allocation under second phase
African Continental Bank Ltd	16	16	19
Allied Bank Nigeria Ltd	6	6	7
Bank of Credit and Commerce International	-	-	6
Bank of the North Ltd	6	6	19
Co-op Bank Ltd	5	5	8
Co-op Bank of Eastern Nigeria Ltd	7	4	8
First Bank of Nigeria Ltd	40	39	37
IBWA Limited	11	10	13
Kaduna Co-operative Bank Ltd	3	3	6
Kano Co-operative Bank Ltd	6	6	6
Mercantile Bank Nigeria Ltd	3	3	6
New Nigeria Bank Ltd	4	4	9
Nigeria-Arab Bank Ltd	7	7	6
Pan African Bank Ltd	5	5	6
Savannah Bank of Nigeria Ltd	7	7	11
Societe Generale Bank Nigeria Ltd	-	-	6
Union Bank Nigeria Ltd	27	27	36
United Bank for Africa Nigeria Ltd	27	27	32
Wema Bank Ltd	5	4	6
National Bank of Nigeria Ltd	15	15	19
Total	200	194	266

Sources : CBN <u>Annual Report and Statement of Accounts</u> - December 1980, p.38

For the scheme to succeed, each rural bank branch should see itself failing if the community which it serves is financially handicapped in its attempt to modernize and develop. In other words, rural banks should participate actively in all aspects of rural development because the failure of any project will constitute a threat to the very basis of their existence. This implies that rural banks should lead development and not merely follow it because there is no development to be followed in the rural communities. De elopment projects should be initiated and guided actively by the ban s.

Another important observation is the slow rate of implementing the scheme. At the rate of 200 branches in three years, on the ave age, it is going to take approximately 15 years to establish 1,126 bra hes. This slow pace is unacceptable. It is true that care must be aken not to overstretch the resources of the banks by compelling the to expand at an unbearable rate because the failure of a bank cou d spell economic doom for the country. Nevertheless, the Gove nment should see that the scheme is fully implemented in time. In a dition to encouraging commercial banks to expand to the rural area , the Government should participate actively by establishing its own odel rural banks. This will not only establish the Government and the banks' presence in the rural areas, but also act as models for the commercial banks' rural branches in their operations.

4-6 COMPARATIVE ANALYSIS

The growth and development attained by the Nigerian banking system can further be clear if an inter-system comparison is undertaken. The comparison here is restricted to the degree of financial deepening attained by selected developing countries which are in a comparable stage of economic development. The selected countries - Ghana, Kenya and Tanzania - share similar economic characteristics with Nigeria. In 1978, for instance, their per capita

GNP were as follows: Nigeria had the highest with (US) $560 followed by Ghana with $390, Kenya $330 and Tanzania $230. Gross domestic savings as a proportion of GNP was also highest in Nigeria where it recorded 28 per cent. It was 18 per cent in Kenya, 7 per cent in Tanzania and 6 per cent in Ghana. But the growth rate of real GNP in the 1970s had been highest in Kenya with average rate of 6.7 per cent followed by Nigeria with 6.2 per cent, Tanzania registered 5 per cent while Ghana had a low of 0.4 per cent, an indicative of the economic stagnation which has gripped the country in the 1970s (Kwarteng, 1982).

Table 4.12 shows that the total assets of the banking system relative to GNP averages 23.3 per cent in Nigeria for the period 1970-80. The average ratio was 17 per cent for Ghana in 1970-77; and it was 28 per cent and 29.4 per cent for Kenya and Tanzania respectively. The demand deposits to money supply (narrowly defined) ratio was highest in Kenya with an average of 71.4 per cent, and with a fairly high ratio of term deposits - savings and time deposits - money supply of 47 per cent on the average, Kenya may be said to have a fairly high level of financial intermediation. In Nigeria, the demand deposits to money supply ratio averaged 53.2 per cent over the period (but with above average ratio during 1974-79). The ratio of term deposits to money supply was highest in Nigeria with a ratio of 60 per cent. The combined ratios indicate a higher degree of financial intermediation than in the other countries. The corresponding ratios for Tanzania were 57 per cent and 31.5 per cent for demand deposits - money supply and term deposits - money supply ratios respectively. Ghana had a low average demand deposits - money supply ratio of 47.3 per cent and also an average term deposits - money supply ratio of 37.4 per cent, an indication of lower level of financial intermediation.

Table 4.12 Comparison of banks development and growth

Country	Period	Time and savings deposits (per cent of money supply (M1))	Demand deposits	Total bank assets (per cent of GDP)	Change in bank assets
Nigeria	1970-80	60.0	53.2	23.3	5.1
Kenya	1970-79	46.9	71.4	28.0	4.7
Tanzania	1970-78	31.5	56.6	29.4	5.2
Ghana	1970-79	37.4	47.3	17.0*	5.0*
United Kingdom	1970-80	118.2a	66.8	103.4c	17.3c
Japan	1970-80	156.5	76.7	103.9c	11.7c

Source : IMF International Financial Statistics, 1981

Notes : * Figures are for the period 1970-77
a Includes deposits in foreign currency
c Figures are for 1973-1980 period

The comparison is restricted to selected countries at a comparable level of economic development because comparison with developed economies can mislead. For example, the ratio of term deposits tend to be low in developing countries due to lack of financial sophistication, and perhaps, lack of people in positions to save. In the developed countries, however, the major determinant of the proportion of term deposits is whether the banks are considered the major savings medium. In the United Kingdom, for instance, they are not. The Building Societies dominate the short-term savings market and the insurance companies the long-term market. In Japan and Germany, for instance, the banks are the major savings medium and consequently term deposits are boosted. (See Forrest, 1974, p.612). Thus as can be seen from Table 4.12, the ratio of term deposits to money supply is higher in Japan than in the United Kingdom. If this consideration is not taken into account, it would mean, for example, that Kenya attained more financial sophistication and deepening than the United Kingdom and operates at the same level of financial development as Japan or that Japan's banking system is more developed than that of the United Kingdom.

4-7 CONCLUSION

In the foregoing, it has been shown that the Nigerian banking system has experienced tremendous growth and development. It has in the process contributed significantly to the development of the economy through savings mobilization and capital formation. However, a comparison of the Nigerian banking system's level of growth with those of advanced industrial countries like the United Kingdom and Japan reveals that the Nigerian banking system is still at the rudimentary stage of development. However, when the comparison is restricted to some selected countries at similar stage of economic development, it is observed that the Nigerian banking system has attained a high degree of financial intermediation.

For greater contribution of the banks to the development of the rural sector, the rural banking scheme should be pursued with greater vigor, the objectives clearly defined, and the activities of banks constantly monitored.

S E C T I O N   C

PERFORMANCE ANALYSIS OF THE NIGERIAN BANKING SYSTEM

CHAPTER FIVE

FINANCIAL INSTITUTIONS AND ECONOMIC DEVELOPMENT

5-1 INTRODUCTION

There is a growing acceptance of the assumption that financial institutions and in particular commercial banks contribute significantly to economic development. As Porter (1966, p.347) put it, 'The visible correlations in the world (between financial and real development) are indeed commanding. Whether one relates the development of the nation's financial system (however measured) to its per capita income across countries at a moment of time or across time for a particular country, the relationship between real and monetary variables is undeniable'.

The objective of this chapter is to review the literature and various hypotheses put forward to explain the relationship between financial and real development, and examine their relevance to Nigeria's economic development. The chapter will put into proper perspective our analysis in chapter four and the subsequent chapters of this study.

The chapter is divided broadly into eight sections. The next two sections review the literature put forward to explain the relationship between financial development and real development. In section four, the assumption that sustained increase in capital formation is essential for real growth is discussed; while section five examines alternative hypotheses on the role of commercial banks. The next two sections examine the relevance of these hypothese and concepts to the Nigerian banking system and economic development. The last section is the conclusions.

5-2 FINANCIAL STRUCTURE AND ECONOMIC DEVELOPMENT

The assumption that the development of financial institutions matters at all for real development has raised many varying opinions among economists. Some economists are inclined to attribute an important and implicit causal role to financial institutions, primarily commercial banks, while others are doubtful about such influence or deny it. Cameron and Patrick (1967) concluded that, 'most economists regard financial institutions as a passive factor'. The differing opinion aside, the positive view of financial institutions in real development is held by many economists.

The economists who attribute a positive effect to financial institutions in the development process are led by Schumpeter (1949). Schempeter in his analysis of capitalist economic development argued that two factors are essential for development namely financial institutions and the availability of entrepreneurs. He contended that in the process of development a new class of entrepreneurs is necessary and 'financing as a special act is fundamentally necessary in practice and theory'. Other corroborators of Schumpeter's view include Adelman and Morris (1967), Cameron et al (1972), Gerschenkron (1962), Goldsmith (1969), McKinnon (1973), Patrick (1966), and Shaw (1973), though with differing emphasis on the relative magnitudes of the impact attributed to financial institutions in development.

Adelman and Morris in their study which covered over 70 developing countries evaluated the relative impact of a number (39) of socio-economic and political variables on the capacity of these nations to develop. They showed that financial development had been associated fairly closely, compared to other economic and non-economic factors, with differences in the level and rate of growth of real national product per head. Out of the 14 purely economic variables explored, they found the level of financial institutions' development to be the best indicator of a country's development potential.

In his inspiring study of 35 developed and developing countries Goldsmith asserts that financial institutions' development matters for real development. He contends, 'The financial superstructure in the form of both primary and secondary securities accelerates economic growth and improves economic performance to the extent that it facilitates the migration of funds to the best user, i.e. to the place in the economic system where the funds will yield the highest social return'. This conclusion is based on his calculations of the financial interrelations ratio (FIR), that is the value of financial instruments outstanding divided by the value of national wealth, (physical assets plus the net foreign balance) for each of the 35 countries. The FIR indicates a direct though, not proportional relationship between financial and real development. He found the ratio to be in the range of one to one and a half in the developed markets or mixed economies and two thirds to one for developing economies. He also found that the FIR increases over the course of industrialization up to a certain level and then remains fairly stable, that the importance of financial institutions in the financing process is similarly linked to the development of an economy and that among financial institutions the share of commercial banks falls after the early stages of industrialization. Thus he considers the relationship between financial and real development as direct and visible and contends, 'The evidence now available is more in favour of the hypothesis that there exists only one major path of financial development, a path marked by certain regularities in the course of financial interrelations ratio, in the share of financial institutions in the total financial assets, and in the position of the banking system, ... a path from which (countries) have deviated only to a minor extent' (p.40).

Cameron et al observed that financial institutions have specific roles to play in development. Their study postulated the functions of the banking system as intermediation, furnishing part or all the means of payment or money supply and the provision of entrepreneural talent and guidance for the economy as a whole. Cameron summarised their view thus:

> The way in which banks perform these functions may well determine the degree of success of the development effort. As intermediaries, they may vigorously seek out and attract reservoirs of idle fund which will be allocated to entrepreneurs for investment in projects with high rate of social return or they may listlessly exploit their quasi-monopolistic position and fritter away investment possibilities with unproductive loans. (p.5).

Contrary to the view held by Schumpeter and others, Gurley (1967) held a negative view of the contribution of banks and other financial institutions to development. Gurley unlike Goldsmith, who argued that there exists only one major path of financial development associated with economic development, argued that, depending on the nature of the economy, one could envisage alternative path. He explicitly expressed doubt and challenged the prominance attached to financial development in economic development. His argument rests on the premise that there are alternative techniques of mobilizing savings and channelling them into investment such as centralization techniques, fiscal or tax subsidy technique and transfer of savings. However, Gurley did not question the central issue of the debate, the role of financial institutions in real development. He argued that the technique of finance through the financial institutions flourishes where there is a decentralization of savings and investment and heavy emphasis on external rather than internal financing of investment. The more negative attitude of Gurley derives from his focus on socialist countries.

5-3 DEMAND-FOLLOWING AND SUPPLY-LEADING FINANCE

Both "schools of thought" on the relationship between financial and real development - those who hold positive view and those who hold negative view of the contribution of financial institutions to development - failed to resolve the central issue of the controversy, viz, whether the development of financial institutions precedes real development and therefore plays an active role in economic development or whether it passively adjusts to the growth of the real sector.

The controversy is part of the continuing debate concerning the role of money in determining the pace of economic activity between two schools of economic thought which in recent years have been characterised by the labels "Monetarist" and Post-Keynesian" economics. Since the intensification of the debate, there have been two extreme views to it, ranging from "money does not matter" to "money is the determinant factor". In recent times the debate has centred on the extent to which money matters. Each of these schools puts up a number of arguments to support its claim. The monetarist school contends, for instance, that the rate of monetary expansion exerts a strong influence on nominal magnitudes such as GDP and price level. The school, however, recognises that money variation is not the exclusive determinant of these nominal and real magnitudes, that such factors as fiscal, productivity, technology and organisational innovations, factor endowment and those which change the demand for money, exert significant influence on economic activity. (See Keran 1969, 1970; Anderson and Jordan 1968). Though these forces operate to influence the pace of economic activity simultaneously, the impact of monetary forces and the speed with which the economy absorbs the impact exceeds that of those other factors. Thus while fiscal and these other factors exert little net influence on the aggregate spending, output and price level, a change in the growth rate of money supply, on the other hand, exerts a strong independent impact on total spending and hence on economic activity.

The Post-Keynesian school, on the contrary, has persisted to accord money a secondary role. One reason given by Anderson (1973) for the Post-Keynesian school's continued denigration of the influence of money in its analysis is 'because of the rather weak or long delayed response of aggregate demand to changes in interest rates'. Some Post-Keynesians maintain that money creation in any economy does not necessarily reflect creation of wealth and therefore, money does not exert much direct influence on aggregate demand, thus money was confined to a "passive permissive role".

The continuing debate has given rise to empirical tests, but inspite of the large amount of research, the issue is far from being resolved particularly the issue of causal relationship between money and economic development. Sims (1972), for instance, provided evidence of unidirectional causal relationship running from the money supply to nominal income with US data. Using a statistical test now called Sims' test he came to the conclusion that the 'hypothesis that causality is unidirectional from money to income agrees with the post-war US data, whereas the hypothesis that causality is unidirectional from income to money is rejected'. Using Canadian economy and data, Barth and Bennett (1974) reached a different conclusion. They concluded that 'although Sims' result for the United States supports the monetarist view of the role of money in the economy, our finding for Canada offers no such support' (p.310). Auerbach and Rutner (1975), on the other hand, in another study on the US economy, using quarterly detrended data for the period 1921-73, found that the direction of causality is bidirectional indicating a feedback. They concluded that for the 'period 1921-73, a weak but significant relationship between money and income was found with the presence of feed back indicated' (p.19). Komura (1982, p.26) in a recent study supports Auerbach and Rutner's finding. Using Japan's data Komura found that for the period 1955-77 there is a bidirectional causal relationship between money and income, 'the largest effect of M2 on GNP is felt in one year while the largest effect of GNP on M2 is realised in two years'.

Patrick's (1966) analysis of the role of finance in developing countries introduced a new dimension to the debate by delineating two types of financial development which could be "demand-following" or "supplyleading". He defined the former as 'the phenomenon in which the creation of the modern financial institutions, their financial assets and liabilities and related financial services is in response to demand for these services by investors and savers in the real economy' (p.174). A supply-leading phenomenon is the 'creation of financial institutions and the supply of their financial assets, liabilities and related financial services in advance of demand for them especially the demand for entrepreneurs in the modern growth-inducing sector' (p.175).

Demand-following is a case of demand creating its supply and as such its contribution to economic development is minimal. As Patrick puts it, 'The demand-following approach implies that finance is essentially passive in the growth process'. Its contribution to growth is through the support and sustenance of the leading sectors in the process of growth. Such demand-following phenomenon is often associated with the banking system of late eighteenth and early nineteenth centuries Britain and those modelled after it.

Supply-leading is associated to positive growth-inducing of developing economies through its allocative efficiency and i s encouragement of enterprise. The supply-leading finance performs two main functions in inducing economic growth, namely, the transfer of resources from traditional non-growth sectors to high-growth modern sectors and the promotion of entrepreneurship.

> New access to such supply leading funds may in itself have substantial, favourable expectational and psychological effects on entrepreneurs. It opens new horizons as to possible alternatives, enabling the entrepreneur to "think big". This may be the most significant effect of all, particularly in countries where entrepreneurship is a major constraint on development. (Patrick, 1966, p.176).

Supply-leading finance is usually associated with Germany and Japan where enterprises receive both financial and non-financial assistance from banks and where banks participate actively in seeing the successful operations of enterprises.

Patrick realised that these phenomena are not rigid to a country overtime and noted that there is likely to be interaction of supply-leading and demand-following phenomena, with supply-leading dominating at the early stages of development, becoming less important as the process of growth progresses, and then demand-following becoming dominant.

Although the supply-leading and the demand-following argument did not conclusively settle the debate, it shed more light on it. Patrick did not deny the basic assumption of this analysis that financial development matters for real development, whether it is of the demand-following or the supply-leading finance.

5-4 FINANCIAL INSTITUTIONS IN THE SAVING-INVESTMENT PROCESS

Mobilization of savings for investment is one of the most important pre-conditions for accelerated economic development. Development institutions and planning authorities in developing countries tend to focus excessively on investment without giving due attention to savings formation and mobilization. In a well balanced economy, however, the two phenomena are really two sides of the same coin. While investment generates savings, it is not possible to sustain a sound investment effort without adequate savings mobilization (Ragazzi, 1981).

We are therefore interested in the role of the banking system in the savings-investment process and hence capital formation in the development process. Bhatia and Khatkhate (1975, p.133) have outlined this role of banks thus:

> In essence three main issues exist regarding the influence of financial intermediaries: first, their impact on growth of savings, especially of the household sector; second, their role in the financialization of these savings (that is savings in the financial form); and third, their ability to ensure the most efficient transformation of mobilized funds into real capital.

Since in most developing countries, government savings - that is the excess of current revenue over current expenditure - rarely exceeds 2.3 per cent of GDP and often is negative, and corporate savings too, is limited because of the smallness of the sector, it is the savings of the non-corporate sector (household) that is of crucial significance in these countries because it is the only surplus sector in the sense that its savings exceed its investment (Bhatt and Meerman, 1978). We shall therefore, in this section base our analysis on the generally accepted assumption that sustained increase in capital formation is essential for real growth.

5-4.1 Capital Formation and Growth

That physical capital formation exerts a strategic influence n the path and pace of economic development is well founded in econo ic thought. The vital role of capital accumulation in developing countries has been accepted by many schools of economics. It is however, observed that economic development is commonly discussed in terms of wealth, labour force, output and income. These real or "goods" aspects of development have been the centre of attention of economic literatures to the comparative neglect of financial aspects. Yet as Gurley and Shaw (1955) rightly contended, development is associated with debt issue at some point in economic system and corresponding accretions of financial assets elsewhere. Consequently capital formation is one of the crucial variables in formulating any development programmes. In other words, while it is clear that planning must start on the "real" side in terms of the availability of factors, successful plan implementation cannot be achieved without adequate finance (Hicks, 1966).

Various theories of economic growth from the classical, Marxist, Keynesian, Neoclassical to the present have emphasised albeit in varying degrees, the significant role of capital in economic development. Mathias (1973, p.122) summed the classical view thus:

> A long intellectual tradition emphasized that capital was the critical factor of production and that shortage of savings, and hence capital was a critical constraint upon the growth of an economy. This certainly was the main emphasis of classical economists led by Adam Smith who emphasized that expansion was limited by the powers of "accumulation", and that capital was created by parsimony sparing resources from consumption.

In the works of Marx capital accumulation was at the centre of his analysis. Although the accumulation of capital leads to the destruction of the capitalist economy, the investment of capital leads to positive growth. In the Keynesian theory, not only did capital investment play a central role in the capacity of production, expansion and labour productivity, but also was found to be the most volatile component of the aggregate effective demand of the economy.

The Harrod-Domar theory of growth, which is an important conceptual extension of the Keynesian model, relates a country's rate of growth of income to its saving/income ratio and marginal capital/output ratio. In other words, growth rates are almost entirely determined by capital formation. In emphasizing the important role of capital in developing countries, Lewis (1954, p.155) contends that:

> The central problem in the theory of economic development is to understand the process by which a community, which was previously saving and investing 4 or 5 per cent of its national income or less, converts itself into an economy where voluntary saving is running at about 12 to 15 per cent of national income or more. This is the central problem because the central fact of economic development is rapid capital accumulation.

In analysing the stages of economic growth, Rostow (1960) adopted Lewis' view and defined the "take-off" stage into selfsustaining growth as requiring, among other things, a rise in the rate of productive investment from say 5 per cent or less to over 10 per cent of national income. In framing any development plan, it is currently common practice to calculate the amount of additional capital required to increase output by one unit per annum in each sector of the economy and for the economy as a whole.

While it is argued that if any one scarce factor associated with underdevelopment should be singled out, it would be capital (Sharma, 1978), it cannot, however, be seriously argued that availability of capital alone would lead to accelerated development. Other things are necessary. For instance, the investment absorption capacity of the economy such as the availability of entrepreneurial capacity, technical and managerial skills, other natural resources and the existence of a political, social and institutional framework which exploits the impulses of expansion. But these other things are seldom possible without some increase in capital formation.

5-5 ALTERNATIVE HYPOTHESES ON THE ROLE OF COMMERCIAL BANKS

The hypotheses put forward on the role of commercial banks in the savings-investment process may be classified into (1) the financial repression hypothesis and, (2) the structuralist hypothesis. These will be discussed in turn.

5-5.1 Financial Repression Hypothesis

The financial repression hypothesis is associated with the studies of Cameron et al (1972), McKinnon (1973), Shaw (1973). The hypothesis concludes that financial development contributes significantly and most to economic growth if it is unfettered by the pervasive interference of the authorities in the operations of the financial institutions. The poor performance of banks and other financial institutions is therefore attributed to interest rate regulations, ceilings on deposit and loan rates and sectoral guidelines on loan operations. Such ceilings, which are in nominal terms, result in low and often negative real rates of return on financial assets and, therefore in low amount of savings mobilized and channelled into investment projects.

The proponents of this hypothesis advocate a positive real interest rate policy for the effective mobilization of savings and their efficient allocation to alternative investment projects. According to them, free market forces and financial liberalization would bring about an optimum financial structure and development. It would eliminate the fragmentation of markets, that is financial dualism, and all the attendant distortions of full operations of the market mechanism.

5-5.2 The Structuralist Hypothesis

The structuralist hypothesis is associated with Gerschenkron (1962) analysis of the role of banking systems in the early industrialisation of Western European countries and the Soviet Union. The approach emphasizes imperfections in the banking systems and deficiencies in the demand side of financial services at the initial stage of development. Gerschenkron argued that as the relative backwardness of an economy increases, the role of the banks in industrial capital formation declines. Using questionable criteria the structuralist categorised European countries on the basis of the degree of their backwardness with Britain coming first in the list as the most developed, Russia the last as the most backward and Germany coming mid-way in the classification. In the more developed economy of Britain the role of the banks in financing development was minimal because of the availability of alternative sources of finance. In a moderately backwards economy the banks play a prominent role as a prime source of capital and entrepreneurship to stimulate industrialization. In the case of extreme backwardness, the structure of the economy is such that not even the banks could supply the necessary capital and entrepreneurship required for industrialization. Gerschenkron cited Russia industrialization as depicting the extreme backwardness and contends:

> The scarcity of capital in Russia was such that no banking systemcould conceivably succeed in attracting sufficient funds to finance a large-scale industrialization; the standards of honesty in business was so disastrously low, the general distrust of the public so great, that no bank could have hoped to attract even such small capital funds as were available, and no bank would have successfully engaged in long term credit policies in an economy where fraudulent bankruptcy had been almost elevated to the rank of a general business practice (p.22).

5-6 RELEVANCE OF THESE HYPOTHESES TO NIGERIA'S BANKING SYSTEM AND DEVELOPMENT

1 Demand-Following

The Nigerian banking system very much depicts the features of demand-following finance development as enunciated by Patrick. For one thing, it is modelled on the British banking system which is often cited as a case of a demand-following banking system. Furthermore, the Nigerian banking system adheres to the form of banking that became prevalent after the industrialisation of the UK of the eighteenth and early nineteenth centuries which was "commercial" with the sole accent on short-term credit to trade and industry, the underlying theory being that credit should be self-liquidating. The implications of this are that banks normally refrain from explicitly financing fixed capital formation because it would lock up bank funds contrary to the tenets of "sound" commercial banking as reflected in the unjustifiable "golden rule of banking", and also because it would reduce borrowers' interest in the prosperity of their enterprises. These reasons are, however untenable.

An examination of the deposit structure of the Nigerian banking system reveals that an important percentage of financial resources usually considered short-term can be used for longer-term lending without endangering the liquidity of the banking system. The fundamental principle on which the whole banking business is based makes it safe for banks to borrow short and lend long in a prudent manner. Such transformation of short-term funds into medium-term and long-term financial assets is one of the useful functions of a financial intermediary in the saving-investment process (Ojo, 1976). It is necessary to cite in this connection the early adoption of the "sedimentary theory of banking" in Germany which contrasted with the "golden rule of banking" or "real bills doctrine". The sedimentary theory is based on the assumption that a certain core of funds always remains with banks over longer periods of time (Khatkhate and Riechel, 1980).

Another evidence of demand-following financial development in Nigeria is the fact that banking facilities are concentrated in the urban centres where there are already well established and flourishing businesses that demand the services of the banks. It required extra exhortation by the government and the CBN to "force" the banks to expand into the rural areas. One of the ways in which the banks can enhance their savings mobilization function and therefore contribute more to real development of the economy is not only to extend their services to the rural areas but also to take active part in investment in the rural communities. In other words, their role in the rural areas need not be restricted to that of purveying credit and deposit mobilization; the banks can and should also provide entrepreneurial and managerial guidance to agriculture and small-scale industries (Bhatt and Meerman, 1978).

2 The Financial Repression Hypothesis

To a great extent the basic tenets of the financial repression hypothesis reflect the features of the Nigerian banking system. Since according to the proponents of the financial repression hypothesis, the repressions manifest their effects on the limited savings generated because of interest rate ceilings on deposits, limited loan resources because of loan rate ceilings, the hypothesis is ultimately reducible to interest rate policies. It is, however, recognised that other forms of financial repression might result from other factors such as portfolio regulations and oligopolistic financial markets (Galbis, 1982).

The interest rate structure in Nigeria is institutionally determined and administered. Interest rate structure is consequently not a good indicator of the scarcity or availability of capital in the economy. The 1969 Banking Decree (section 14) gave the CBN the power to prescribe minimum and maximum interest rates chargeable by banks.

Thus in March 1970, the CBN directed all commercial banks to link their interest rates with the minimum rediscount rate. The minimum and maximum rates and advances on loans were to be 2.5 per cent and 7.5 per cent respectively above the rediscount rate, with 1.5 per cent above the minimum rediscount rate as the minimum and maximum respectively on interest-bearing deposits.

Generally these interest rates have been maintained at a very low and static level for a number of reasons: first, to enable the government to borrow from the public at a very cheap price. As stated by the CBN; 'the Central Bank has also been concerned to see that the Government should obtain the finance it requires on the most economical basis. These considerations have necessarily conditioned the rate at which Federal Government loan operations have been undertaken and Treasury bills issues made' (CBN Annual Report, Dec 1960, p.19). A second reason that has been advanced to justify the policy of low and stable interest rates regardless of economic circumstances is the Keynesian postulate that a low interest rate implies a high rate of investment. As Galbis (1982, p.119) rightly observed, the justification is based on a misinterpretation of Keynesian investment theory which is not necessarily applicable under full employment with inflation. There are other less plausible justifications for low and static interest rate policy. There is, for instance, the argument that low and stable interest rates can help to strengthen the stability of financial institutions because low interest rates on their liabilities help to protect their earnings. There is also the influence of the well known "usury law" which limits the payment of interest rates on moral grounds.

Fig 5.1 Implications of financial repression: Savings and Investment

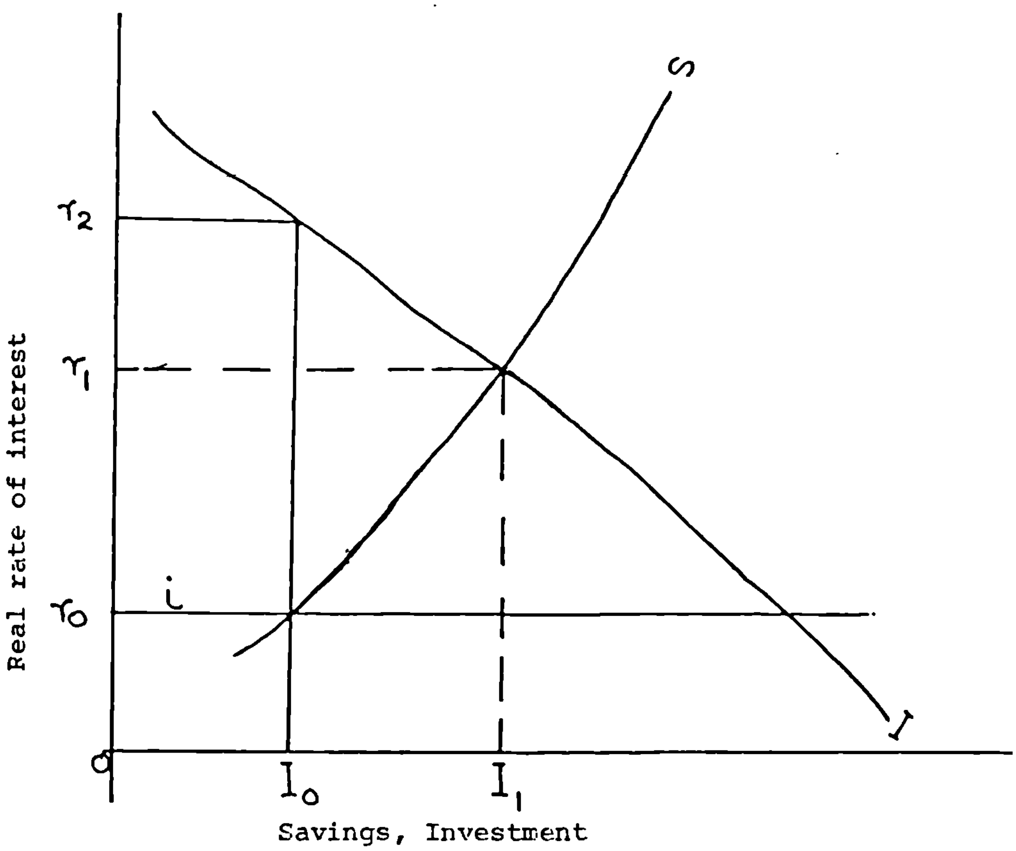


Table 5.1 **Interest rate structure 1970–80**

(Percentages)

Year end of month	Minimum rediscount rate	Treasury bill rate	Time Deposits 3 - 6 months	6 - 12 months	over 12 months	Savings	Loans and Advances First class advances	Produce advances	Other advances	Index of savings deposits 1970=100	Index of aggregate credit 1970=100
1970	4.5	4.0	3.0	4.5	3.5	3.0	7.0	7.75	8.0	100.0	100.0
1971	4.5	4.0	3.0	3.5	4.0	3.0	7.0	9.0	10.0	123.5	142.8
1972	4.5	4.0	3.0	3.5	4.0	3.0	7.0	10.0	10.0	154.8	176.3
1973	4.5	4.0	3.5	3.5	4.0	3.0	7.0	10.0	10.0	173.0	214.4
1974	4.5	4.0	3.5	3.5	4.0	3.0	7.0	10.0	10.0	221.0	267.0
1975	3.5	2.5	3.0	3.0	4.0	4.0	6.0	9.0	9.0	401.9	437.6
1976	3.5	2.5	2.5	3.5	3.5	4.0	6.0	8.0	10.0	546.8	604.2
1977	4.0	3.0	3.0	3.0	2.0	4.0	6.0	6.0	6.0	717.1	875.2
1978	5.0	4.0	5.0	5.25	5.5	4.0	7.0	11.0	11.0	829.4	976.7
1979	6.0	5.0	5.5	6.0	6.5	5.0	7.5	9.0	11.0	989.1	1,032.1
1980	6.0	5.0	5.5	6.0	6.5	5.0	7.5	9.0	11.0	1,169.8	1,256.4

Sources : 1 CBN i Economic and Finance Review - various years

ii Annual Report and Statement of Accounts - various years

2 PNC Okigbo (1981) Nigeria's Financial System:Structure and Growth, p.71.

The implications of the financial repression of holding institutional deposits and loan rates of interest below their equilibrium level is illustrated in Fig 5.1. Following the classical view of the determinants of the hypothesis, saving, s, is a function of the real interest rate. Therefore ceteris paribus the higher are the rewards, the more will be the volume of financial assets offered in the market. i, represents the administratively fixed institutional interest rate which holds the real rate, r, below its equilibrium level. Actual investment is limited to Io, the amount of saving forthcoming at the real rate ro. If the ceiling applies to savers interest rate only e.g only to deposits, the investor/borrower w uld face an interest rate r2, the rate which clears the market by equating demand for funds (investment) with the limited supply (saving). With loan rate ceilings, non-price rationing of loanable funds must occur. This typically takes place on the basis of quality of collateral, political pressures, "name", loan size and covert benefits to the responsible loan officer (Fry, 1979a).

The implications include also the fact that the non-price rationing criteria discriminate inefficiently between investment opportunities. Indeed there will be preference for traditional, low yielding investments because these appear safest, simplest and cheapest to finance. Loan rate ceilings discourage risk taking by banks; risk premia cannot be charged when ceilings are effectively imposed. In addition, there is no direct feed back from investment to saving. The volume of saving and investment is determined soley by conditions of supply i.e. by the savings function. This is the case so long as real rate of interest is held below r1. Lastly, a decline in real deposit rate of interest reduces real money demand and real credit supply. In turn the real credit squeeze lowers both the rate of new fixed investment and also investment in working capital. The rate of capacity utilization of the entire stock of capital falls hence the growth rate declines (Fry 1979b).

Since financial repression hypothesis focuses attention on the level of interest rates on savings instruments available to the public in relation to the rate of inflation, a test of the hypothesis can be undertaken by an examination of the behaviour of interest rates relative to the rate of inflation over time. If the real rates of interest, that is the nominal rates deflated by the appropriate price index have been positive over time, then it could be said that there has been no financial repression; rather that would imply financial deepening.

Table 5.1 shows a spectrum of interest rates covering various types of financial assets and loan instruments. These range from official rediscount rate - the CBN minimum lending rate - to various deposit rates, borrowing and lending rates for the period 1970-80. A cursory look at the Table reveals the static nature of the interest rate structure over time. For example from 1970-74 interest rate on savings deposits remained low and static at 3 per cent; it rose marginally in 1975 to 4 per cent and remained stable until 1978. The same is true of the various time deposits rates and the minimum rediscount rate.

There would have been nothing worrying about the static and low interest rates, if the rate of inflation had been stable over the years. But it was not. Inflation has become a permanent feature of the Nigerian economy since 1970, and there is bound to be an adverse effect of inflation on real return on savings with return falling with high rate of inflation.

Table 5.2 Estimated real rates of interest* on over 12 months time deposits, and savings deposit 1970-80

(Percentages)

Year end of month	Change in consumer price index 1975=100	Nominal interest rate on over 12 months time deposits	Nominal interest rate on savings deposits	Real interest rate on over 12 months time deposits	Real interest rate on saving deposits
1970	13.8	3.5	3.0	-9.1	-9.5
1971	16.1	4.0	3.0	-10.4	-11.3
1972	2.6	4.0	3.0	1.4	0.4
1973	5.7	4.0	3.0	-1.6	-2.6
1974	12.5	4.0	3.0	-7.6	-8.4
1975	33.7	4.0	4.0	-22.2	-22.2
1976	24.0	3.5	4.0	-16.5	-16.1
1977	19.5	2.0	4.0	-14.6	-13.0
1978	24.4	5.5	4.0	-15.2	-16.4
1979	11.2	6.5	5.0	-4.2	-5.6
1980	6.3	6.5	5.0	0.2	-1.2

Source : Derived from Table 5.1

Notes : * The real rate of interest is defined as the nominal rate of interest adjusted by the change in the consumer price index. The real rate is equal to $[(1+i)/(i+p)] - 1$, where i is the nominal interest rate, and p is the change in prices during the year.

Table 5.2 shows the rates of inflation and the real rate of return on time and savings deposits rates with the banking system. It is shown that the real rate of return on over 12 months time deposits was negative for the entire period 1970-80 except in 1972 and 1980 when positive returns of only 1.4 per cent and 0.2 per cent respectively were recorded. Real rate of return on savings deposits was positive only in 1972 and negative for the rest of the period. It is thus clear that there is a great measure of financial repression in the Nigerian economy and it has been shown that the level of financial repression through negative real rates poses important macroeconomic questions concerning an economy's ability to accumulate financial assets in real terms, the volume of national savings and domestic investment, the efficiency of investment and the allocation of resources. It has been argued that one of the reasons for the reluctance of savers to use banking institutions is that they offer relatively lower returns (Ragazzi, 1981).

A more general framework for testing the hypothesis of financial repression is offered by the concept of the real demand for financial assets held by the public. In this framework, financial repression is the decrease in the real volume of the financial sector liabilities to the public in relation to its determinants such as the real GDP and the real rates of interest. McKinnon (1973, p.59) postulated the following model:

$$(m/p)^d = f(Y,\ r,\ d-p^*/p) \tag{1.1}$$

where : $(m/p)^d$ is the demand for financial assets by the public in real terms

Y is the real GDP

r is the average rate of return to capital

$d-p^*/p$ is the expected real rate of interest

All the explanatory variables have a positive effect on the real demand for financial assets under repression.

In testing the hypothesis for the Nigerian banking system a modified version of the model is adopted thus:

$$(m/p)^d = f(Y, p_t/p_{t-1}) \tag{2.1}$$

where : Y is the GDP at current market prices

p_t/p_{t-1} is the rate of inflation; and it represents the opportunity cost of holding money relative to alternative real or financial assets

Interest rate variable is not included as an explanatory variable because as noted above the rates have been more or less static over the period. The test is to determine whether the demand for money over a period of time is inflation-elastic or not. The inflation inelasticity of demand for money may be evidence of financial repression. The two determinants Y and p_t/p_{t-1} are expected to have positive and negative impact respectively on the demand for money. Both the narrow definitions of money (M1) (currency in the hands of the non-bank and public plus demand deposits with commercial banks) and the broad definition (M2), (M1 plus savings and time deposits), have been used in the analysis. Annual data for the period 1960-80 were used in the test.

It is common practice in the literature to take the logarithm of equation (2.1) and since this suits the present analysis because it enables the interpretation of the coefficients as elasticities, the logarithm form of equation (2.1) yields:

$$\ln M1d/p = \ln a_{11} + a_{12}\ln Y + a_{13}\ln p_t/p_{t-1} + a_{14}u \tag{3.1}$$

$$\ln M2d/p = \ln a_{21} + a_{22}\ln Y + a_{23}\ln p_t/p_{t-1} + a_{14}u \tag{4.1}$$

Where the ai becomes the various elasticities and u the error term.

The test results are presented here.

$$\ln M1d/p = -2.3449 + \underset{(0.0247)^{*}}{0.5358\ln Y} + \underset{(0.0575)^{*}}{1.006\ln p_t/P_{t-1}}$$

$R^2 = 0.964 \quad DW = 2.1$

$$\ln M2d/p = -2.4732 + \underset{(0.0276)^{*}}{0.5941\ln Y} + \underset{(0.0644)^{*}}{1.126\ln p_t/P_{t-1}}$$

$R^2 = 0.963 \quad DW = 1.6$

Below each coefficient is its standard error.

* Statistically significant at the 1 per cent level.

From the test results above it is seen that a considerable proportion of the dependent variable is explained by the explanatory variables. The Durbin-Watson statistics (DW) of 2.1 and 1.6 for the estimates of equations (3.1) and (4.1) respectively indicate the absence of first order positive and negative auto-collinearity in the data used for the regression analysis. All the coefficients are statistically significant at less than 0.01 probability.

Of particular interest to this analysis is the coefficients a_{13} and a_{23}, the inflation elasticity of demand for money. Theoretically the coefficients have an unexpected signs, indicating that increases in the rate of inflation lead to increases in the demand for money. In fact the coefficient of a_{13} indicates that an increase in inflation leads to almost proportionate increase in demand for money. Theoretically, this ignores the opportunity cost of holding money. The explanation that may be offered for this is that perhaps, because of the future expectation of further inflationary pressures people held more money, especially when there are no alternative assets that can serve as hedge against inflation.

More importantly, the coefficients of a_{13} and a_{23} indicate elasticities of 1.01 and 1.13 respectively. This implies that the narrow and broad definitions of money are inflation-elastic. This finding rejects the hypothesis of financial repression in the Nigerian banking system. However as Kwarteng (1982, p.261) in a similar analysis contends, 'the inflation elasticity of the demand for money in Nigeria may be due not so much to the non-existence of financial repression in that economy, in fact there is some evidence of financial repression in Nigeria as per the low levels of the real return on deposits, but rather to the higher increases in export revenues from oil and thus in income during the 1970s'.

The assumption so far is that saving and investment are respectively interest elastic. The question is whether a free and positive interest rate policy advocated by the proponents of financi l repression hypothesis would lead to higher savings and investment than hitherto. Admittedly, the policy whereby the banks pay a very low interest rate of about 4 per cent on interest bearing deposits and at the same time charge as high as 7-11 per cent on their loans and advances is discouraging enough to savers. It is likely to have a negative effect on the performance of the banking system's savings mobilization and investment role.

An examination of Table 5.1 shows that saving is interest inelastic. For example, from 1970-74 the interest rate remained static at 3 per cent and for the period 1975-78 it was also static at 4 per cent rising to 5 per cent in 1979 and 1980. Over the same period the savings index continued to rise steadily with spectacular increase of 81.9 per cent in 1975 of 1974 level. An explanation usually offered by bankers for this trend is that the small savers do not undertake saving with an objective of earning interest income from such savings, but rather as a mere safe custody of their savings for an unexpected contingencies. As if to give credence to this view Hitiris and Wiseman (1981, p.16) contended that for the few undeveloped countries in which it was possible to study the relationship between saving and interest rate, the net impact of the real interest rate on aggregate savings was found to be insignificant or even negative, suggesting that higher rates of interest are associated, if anything, with lower real saving (see also Williamson, 1968). Furthermore studies by Tomori (1972), Ojo (1974a), Ajayi (1974), Teriba (1974) support the view that saving is interest inelastic in the Nigerian economy.

However, plausible these arguments and findings are, saving is not as non-responsive to real interest return as has been generally portrayed. The banking system could therefore attract more deposits and thereby mobilise more savings that could have remained idle or channelled into less productive ventures if it could offer more attractive interest rates. It is believed that because of the non-availability of simple intelligible and convenient financial instruments yielding a positive real return, potential saving is frustrated and largely used for consumption. Thus to raise the savings rate and ensure rational allocation of resources, it is essential to evolve financial instruments of positive real interest rates that are consistent with savings performances and motives of households.

On the investment side, how an increase in interest rate will deter investment is dependent on the expected return on investment. Take for instance, the period 1970-74 when the return being declared by industrial and commercial enterprises in Nigeria were of the order of 100 per cent on capital invested, first class prime advances rates remained static at 7 per cent (See Table 5.1). Other advance rose by 2 percentage points from 8 to 10 per cent. This type of increase is hardly likely to be decisive in the investors' plans and decisions to invest if the expected return will be reduced not so significantly or may in fact,inspite of the resultant increase in costs go up even more. It follows that what was important for Nigerian investors seeking funds in the boom conditions of 1970-76 was not so much the rate of interest but whether or not credit would be available (Okigbo, 1981). To corroborate this assertion, Ragazzi (1981) further observed that the popularity of the informal sector, despite the usurious rates of interest underlines the importance of availability rather than cost in determining the demand for and supply of rural credit. This explains why, as Table 5.1 shows, the index of loans continued to show a rising trend despite the rise in the produce and other advances rates in the period 1970-74. In 1978 when both rates were 11 per cent, the index of loans rose by 9.76 times the 1970 level when the rates were 7.75 per cent and 8 per cent for produce and other advances respectively.

The above analysis raises an important question : whether the assumed repressive measures are indeed repressive. This is because the proponents of financial repression hypothesis failed to appreciate the perculiar financial structure of developing countries such as Nigeria. As Adewunmi (1981, p.33) rightly observed:

> ... they all (proponents of the financial repression hypothesis) based their studies in advanced countries and went on to interpret the results without sufficient qualifications for the developing countries with entirely

> different environments. The environments differ not only in variety and volume of financial instruments and institutions but also in the interrelations of the different subsectors and sophistication of activities and operations.

If it is realised that the Nigerian banking system was until recently dominated by foreign banks which maintained strong oligopolistic bank market structure, it will be fully appreciated that competitive market structure does not exist in Nigeria. Consequently, interest rates management may not be regarded as a substitute for the determination of interest rates by competitive market forces, but as necessary alternatives when conditions for the existence of a competitive market are not present and cannot be readily established (Galbis, 1981, p.5). In the absence of competitive market structure, therefore, positive interest rate policy, 'could potentially destabilize financial markets, increase the power of oligopolistic financial firms to exploit market imperfections by increasing the interest spreads between loan and deposit rates, and simply perpetuate the existence of a financial environment with rather low deposit rates of interest. Intervention by the authorities would, in this setting, be required to aid the market in establishing an adequate level and structure of interest rates' (Galbis, 1981, p.6).

Furthermore, financial institutions may conceive their functions only narrowly or they may be greater risk avoiders than is socially desirable. In addition, because of the market deficiencies or imperfections of developing economies two problems may arise. First the equilibrium volume of investment may fall short of the volume of investment compatible with the full employment of the community's resources. Second, the volume and direction of investment may be considered inadequate for the long-run growth-potential of the country (Hitiris and Wiseman, 1981, p.10). These two problems usually call for intervention by the government. Besides, credit flow within the economy is so politically sensitive that no government in both the developing and the developed countries would allow it to be manipulated to its detriment. It is therefore necessary that the government through the CBN should direct the flow of bank credit to the economy to meet its development objectives. There would have been no serious government intervention had the banking system adapted right from the onset to the local conditions and been prepared to promote local development.

3 The Structuralist Hypothesis

Gerschenkron's hypothesis is to a very limited degree applicable to the Nigerian banking system and economy. To the extent that Gerschenkron emphasizes the supply side of financing industrial capital, this hypothesis may apply to Nigeria's experience. The idea that there is deficiency in effective demand for bank financing in Nigeria because of the difficulty of locating productive viable projects argument is untenable. The fact is that the banks may not be performing their functions effectively. Financiers in Nigeria do not have to sit in their offices and wait for a few depositors and borrowers, as might be the practice in places where the financial habits are relatively better developed; otherwise it might be difficult to break the "vicious circle" of low income, low volume of profitable business (or no viable projects), no adequate security, no creditworthy customers (Ojo, 1976).

As Cameron (1972) observed, the way the banks perform their functions may well determine the degree of success of development effort. If the banks listlessly exploit their quasi-monopolistic positions in developing countries, and fritter away savings and investment possibilities, these economies will remain industrially backward and Gerschenkron's description of the situation in Russia of his study will adequately apply to these economies.

According to the structuralist argument, the mobilization and allocation of savings in the backward economies would have to be accomplished through a substitute institution such as the State since the role of the banks is limited. This assertion is questionable in many developing countries. It is observed early that government saving in the developing countries rarely exceed 2-3 per cent of GDP and that corporate saving is very limited too. The only surplus units are the households, and their savings could be mobilized either through fiscal measures or through the banks. It is observed that resources mobilization through fiscal measures - taxation - in Nigeria is less than 30 per cent of the GDP (Onaderu, 1978). If therefore the role of banks in savings mobilization is discountenanced the only important source open to developing countries for capital formation will be foreign and however following the collapse of the worldwide optimism generated during the "development decade" of the 1960s about the possibilities of massive foreign aid from the rich to the poor countries, it was inevitable that many of the latter would come to the realisation that in their desperate quest for economic development they would have to rely much more on their own efforts than they had supposed (Obi, 1979). Besides capital inflow from abroad serves more as a catalyst and as a factor in easing the foreign exchange constraint than as a major factor in supporting rising levels of investment. In this situation the banking system emerges as the most important medium for mobilising domestic savings; and the government has long realised this hence much emphasis is placed on the role of banking system in mobilizing and allocating savings for the development of the economy.

5-7 MONEY AND CAPITAL IN DEVELOPMENT IN NIGERIA

To complete this analysis of the role of the finan ial institutions in real development we examine the eviden e complementary relationship between money balances, capital accumulation and economic development in Nigeria. Table 5.4 which is derived from Table 5.3 shows the correlation among real growth rate of GDP, investment, bank assets, money supply and price level in the period 1960-80. It provides evidence of the positive relationship between money, capital and economic development in Nigeria. The high correlation of 0.76 between the real growth rate of investment and the GDP supports the generally accepted hypothesis that more rapid economic development requires not only an adequate labour force and appropriate technologies but also sustained momentum in capital formation. This is also supported by the significant correlation coefficient of 0.65 between the real growth of money supply and the real growth of product (GDP), and the significant degree of statistical association found between the growth of investment and increase in money supply with a coefficient of 0.48. Furthermore, the positive and significant statistical correlation between the real growth of banks' financial assets and the real growth of the GDP of

0.57 and between the real growth of banks' financial assets and investment of 0.59 confirm the close relationship between economic development and financial assets.

Table 5.3 Real rates of increase of GDP, investment, bank assets, money supply and consumer prices 1961-80

(Percentages)

Year	Bank assets	GDP	Money supply	Price level 1975=100	Investment
1961	17.9	-7.0	-5.8	6.6	-6.7
1962	-7.6	0.6	-1.5	5.1	13.0
1963	16.4	20.1	9.4	-2.6	32.1
1964	21.2	6.0	15.7	0.7	27.2
1965	4.9	2.6	0.0	4.2	16.8
1966	-9.3	-2.0	-1.2	9.7	-10.5
1967	8.2	-17.9	-6.3	-3.9	-16.8
1968	25.5	1.5	4.0	-0.4	-8.8
1969	23.3	21.3	20.5	10.2	14.4
1970	32.9	28.3	27.7	13.8	40.3
1971	-4.6	8.7	-13.3	16.1	25.1
1972	10.1	5.8	6.7	2.6	6.7
1973	16.2	10.5	17.1	5.7	1.3
1974	41.4	67.5	33.1	12.5	91.2
1975	14.6	-10.0	32.9	33.7	14.4
1976	19.3	0.5	23.9	24.0	3.4
1977	12.1	-7.9	16.5	19.5	8.8
1978	-14.2	-17.5	-20.5	24.4	-11.9
1979	10.9	-3.4	3.8	11.2	9.6
1980	15.0	55.9	44.2	6.3	22.1

Sources : 1 FOS Annual Abstract of Statistics - various years

2 IMF International Financial Statistics - various years

3 CBN i Annual Report and Statement of Accounts
ii Economic and Financial Review - various years

4 Federal Republic of Nigeria i Fourth National Development Plan, 1981-85
ii Third National Development Plan, 1975-80

Ther is a negative correlation between the rise in price level nd investment, and between the rise in price level and the real rowth of the GDP of -0.04 and -0.14 respectively. This is perhaps, a onsequence of the fact that the set up in inflation in recent years as tended to reduce the return on savings captured in the form of avings and time deposits and has impeded the accumulation and hannelling of investment funds.

It should be added that while it is difficult to demonstrate nequivocally that there is a direct statistical relationship between nancial and monetary development on one hand, and economic velopment on the other, there is a strong indication that economic owth has been rapid to the extent that monetary and financial sources have expanded in real terms in Nigeria.

ble 5.4 Correlation among real rates of increase of GDP, investment, bank assets, money supply and consumer prices

	GDP	Investment
nk Assets	0.57	0.59
ney Supply	0.65	0.48
nsumer Prices 1	-0.14	-0.04
vestment	0.76	

urces : Same as in Table 5.3

te 1 : Consumer price incex is the best known and widely used proxy for measure of cost of living in Nigeria. The other indices such as the wholesale price index, implicit price index are not available in any systematic regular official publications.

5-8 CONCLUSIONS

In the words of Schumpeter, the capacity of the commercial banks and other financial institutions to create credit makes them essentially a phenomenon of development. In analysing development finance, it is convenient to recall that the need to develop domestic financial market institutions and patterns of behaviour necessary to generate and mobilise scarce capital funds as a key condition for economic development originated in the classic works of late Schumpeter in the 1930s and has since been unfolding in the studies of a small but growing band of economists such as Gurley and Shaw (1973), Gerschenkron (1962), Goldsmith (1969), Adelman and Morris (1968), Cameron (1972), and McKinnon (1976). Of course there is no arrangement of a financial system which can guarantee the attainment of a country's development objectives. Still it is fairly certain that financial markets can materially influence the climate and create the condition necessary to reach these goals. To again quote Rostow (1960):

> Virtually without exception, the take-off periods have been marked by the extension of banking institutions which expanded the supply of working capital; and in most cases also by an expansion in the range of long-term financing done by a central, formally organised, capital market (p.48).

In essence, the penultimate conclusion is that finance is highly relevant for development. But it is also evident that its more basic causal links are not so much through the number and variety of financial institutions and instruments as in the adoption of appropriate policies, notably the adoption of positive interest rate policy. This is the fundamental challenge facing the Nigerian financial system and the monetary authorities: whether after having helped set up the requisite financial institutions, they have the necessary insight and courage to adopt appropriate economic policies.

CHAPTER SIX

MEASURES OF ECONOMIC PERFORMANCE OF THE NIGERIAN BANKING SYSTEM

6-1 INTRODUCTION

The present chapter attempts to analyse the realised economic performance of the Nigerian banking system. The chapter is divided into five sections. The second section analyses the output performance of the Nigerian banking system as measured by surrogate such as deposits, earning assets and number of cheques processed. The profits and profitability analysis of the banking system as reflected in the magnitude of profits earned, profits after tax to asset ratio, and profit after tax to capital ratio are analysed in section three. Section four examines the intermediation activity of the banking system as measured by loans and advances to deposits ratio and loans and advances to assets ratio. The last section presents the conclusions.

6-2 OUTPUT ANALYSIS OF THE BANKING SYSTEM

6-2.1 Problems of Measurement and Concept

A long debated issue in banking theory is the identification and measurement of bank output. 'Despite the strategic role that banks play in monetary theory and in real world, there is little agreement on what it is that banks produce' (Gorman 1969, p.155). Various, sometimes conflicting, output measures serve researchers especially in estimating banks' production function. (See Benston 1965 and 1972, Bell and Murphy 1968, Greenbaum 1965)

Banking is characterised by certain features which set it apart from other industries and which have important implications for the measurement of bank output. Banking is a service industry. In micro-economic theory of the firm, for instance, the same output variable performs many diverse roles. Production of output absorbs factor inputs and is functionally related to cost. Output is also that item which is sold by the firm, thus making revenue and profits dependent upon output. Finally, the volume of output measures the size of the firm (Fry, Harper and Stansell, 1982).

The theory of the firm cannot be applied without modification to the bank and other financial institutions, because there is no readily quantifiable single physical output as there is in the non-service industry, that can adequately perform these many roles. In a financial institution, for instance, factor inputs are used in the processing activities inherent in financial intermediation. Following micro-theory, therefore, output legitimately can be defined as the volume of processing. Revenue for a financial institution, however, is not obtained by directly selling this processing output. Revenue is related to volumes and types of loans and investments which are limited by the volume of deposits. Since no particular naira amount of loans and investments need be associated with a particular volume of processing, revenue cannot simply be written as a function of processing output. The implication of these observations is that if one defines output to be processing activities, then the impact of changes in output on revenue, profits and the size of the financial institution will differ from the impact of changes in output on the firm of micro-theory. Conversely, if one defines output to be the volume of loans and investments one cannot simply assume that output s a y direct functional relationship to factor input usage. Clearly th r approach can lead to semantic difficulties and sincerpretations (Fry, Harper and Stansell, 1982).

Banking produces what is technically termed a "multiproduct" tput, (see Alhadeff 1967, Greenbaum 1967, Heggestad and Mingo 1967), th ugh the case for analysing bank as a single product firm is gued by Hodgman (1973). The output includes among other things positing and safekeeping, making loans of various types, giving vice, performing trust services and transferring and collecting nds. Attempts to measure bank output, therefore, should ideally ke cognisance of this range of services, their interdependence and mplementarity, as well as contribution of each of these to aggregate tput, however defined.

Aside from the difficulties of measurement and concept of output rticular to commercial banks and other services, output measurement these services shares most of the problems inherent to output asurement generally. For instance, in conventional method of antity measurement the unit selected is that which is observed: a ble, a car, number of cheques handled and so on. Differences in ality are either not taken into account at all or gauged on the sis of differences in the resources required to produce alternative alities at a given moment in time. This involves the recognition at utility derived from a good is seldom unidirectional; most goods present a cluster of characteristics that are sought by the stomers. As Kravis (1969, p.51) argued:

> The more successful we are in selecting units that represent the characteristics really sought by buyers (and the less enmeshed we become in the intertemporal matching of purely physical specifications), the more successful we will be in

> catching the quality changes that are increases in output from a welfare standpoint but which elude present measures.

Revell (1980, p.20) corroborated this view and added another twist when he contended:

> It is commonplace that the output of services cannot be satisfactorily measured, and it is therefore impossible to say whether the services for which payment is being made has changed in quality. The discussion of this point usually omits an equally important consideration: one of the fundamental services of financial institutions is to remove from the shoulders of their customers a large part of the risk associated with financial transactions. Risk is even less susceptible to objective measurements than quality of service.

In reality banks operate in a world of uncertainty and they produce additional services by pooling risks for their customers and individuals with funds to invest. However, important as such concepts as risk and uncertainty are, they are rather tenuous and what could best be done is to take note of the risk as such especially in the Nigerian experience where the banks do not cooperate enough to supply even the necessary basic data and information.

Another observation is that a bank's output is received far more directly than in most manufacturing industries by its customers or clients so that the direct relationship between employee and customers comes into play far more in the case of banks than in most other industries. All these make it difficult to fix rigid standards or norms of output for a number of services rendered by banks (Kinsella 1980, Report on Indian Banking Commission, 1972).

Furthermore, bank output being a service is intangible and is often sold as a package (Treadway 1969, Mackara 1975, Speagle and Kohn 1958). In estimating provision for certain services and their contributions to final output, the jointness of the services should, if possible, be taken into account. Unfortunately it is empirically impossible to isolate the various elements of the package and measure each component directly for the purpose of determining aggregate output. The high degree of jointness in the output profile of commercial banks makes the application of cost accounting technique of limited value, because the cost methods measure output as equivalent units produced from cost introduced in the production process (Horngren, 1972).

Complicating the situation further is the existence of an "input-output" dilemma in commercial banking. An example to illustrate this dilemma is money placed in a deposit account. The deposits receive the banking services of protection and bookkeeping. These services may be considered as the output of the banks. The banks can also use the deposits for supporting loans and investments and, therefore, services provided to attract and maintain deposit accounts may also be regarded as bank inputs to produce income generating output of loans and investments.

The other feature which characterises commercial banks and other financial institutions and which affect, to a large extent, their performance and output, however measured, is that commercial banks are subject to regulations by the monetary authorities. The control takes many forms in Nigeria such as the use of various instruments of monetary policy to influence the cost and volume of bank credit, prescription of interest rates for deposits and advances. Thus the volume of commercial banks' output is influenced to a significant extent by the actions of the monetary authorities.

Finally commercial banks, like most service industries, are labour intensive 'and not profiting from the same continuous gains in productivity as manufacturing industry' (Revell 1980, p.94). Output of goods and services grows through one of two ways: the use of more inputs, or the way in which inputs are combined is changed, thereby affecting efficiency. The most important input in the production process is labour. Changes in other inputs and changes in the way these inputs are combined influence the volume of output that a unit of labour can produce. This is called labour productivity. Labour productivity can, therefore, be a measure of output in non-service industry but labour productivity cannot be easily measured nor cost be used as an adequate measure of output in service industries such as commercial banks. This is because service industries suffer from "Baumol's cost disease". As observed by Baumol the productivity of labour in services does not grow as fast as that of labour in goods production (See Baumol and Oates, 1972). This would present less problem as long as labour in each of the lines of production is rewarded in proportion to its productivity. The fact, however, is that wages and salaries increase at much the same rate in all sectors of the economy. Labour in services receive almost equal reward as labour in goods production eventhough productivity in services has not matched productivity in other sectors.

6-2.2 Output Measures Used in Literature

'Attempts to measure and compare bank productivity are bedevilled by the absence of any coherent yardstick of output, changing economic conditions and valuations in bank's mix of business' (Frazer 1982, p.103). As a consequence, therefore, various approaches have been adopted by various researchers. Two factors have seemed to determine the approaches adopted by various researchers in this field. First, the particular approach depends on the object of the study. For instance, Powers (1969) noted that while Benston's (1963) measures of bank output namely the number of deposit accounts or loans and the average account of loan balance for various services suited his study of banking operations, such measures were not appropriate for his (Powers's) study of branch versus unit bank efficiency; Powers thus defined bank output as level of lending and non-lending services, using loans and investments as the measure of the former and deposits as the measure of the latter. The second determinant of the measure of bank output is the availability of data. As Kinsella (1980) observed, the availability of data has forced some researchers to use pragmatic definition of output.

Most of the relevant previous studies in this field were undertaken in the United States. Public concern and regulation of banking structure in the United States have probably made cost and output and the issue of optimal banking structure more important topics of discussion than in the United Kingdom. Most of the studies used balance sheet items as proxies for output. Alhadeff (1954) and Horvitz (1963) used loans and investments in their study. Schweiger and McGee (1961) used total deposits while Gramely (1962) used total assets. Gramely was interested in the real value of output and was the first to relate bank output to social values of the services provided. Greenbaum (1964 and 1967) also recognised the need for defining bank output in social terms. Greenbaum's measures divide output into two components: lending and non-lending. Lending output was defined as the gross yield weighted sum of diverse earning assets in the bank's portfolio. He computed yield weight for each of his sixteen classifications of earning assets which he then multiplied by their year end amounts. To this he added the non-lending gross operating income which gave him the "social value" of bank output for each bank.

Gorman (1969) in his lucid paper emphasised the need for a definition of bank output consistent to overall approach to national accounts. He developed two approaches to measure bank output: the liquidity and transaction approaches. Comparing the two approaches he found that they yielded different results. The principal argument for the liquidity approach is that it is directly related to the decision to hold deposits; in other words, the liquidity approach determines output on the basis of the volume of liquidity desired by the depositors. The transaction approach is based on the volume of transactions handled by the banks. The two approaches differ only as velocity or turnover differs. When velocity rises the transactions approach yields more increase in output than does the liquidity approach. Gorman argued that monetary policy has considerable effect on bank output and productivity when measured by liquidity approach, but does not seem to have much effect when measured by transaction approach.

Benston (1972) attempted alternative measures of bank output. In his approach bank output is classified into six relatively homogenous services; demand deposits, time deposits, mortgage deposits, instalment loans other loans and investment services. Benston used two types of measures of the quantity of output of each service: the number of deposit accounts or loans and the average account of loan balance. The procedure enabled Benston to provide estimates of individual bank's services from which estimates of marginal cost and economies of scale from contraction or expansion of specific services can be estimated by the authorities. The rationale of this approach is that output is best defined in terms of what it is that banks do which causes them to incur operating costs. Benston's contention is that operating costs are related to the number of documents handled and customers served rather than to the pound of deposits, loans or assets.

Sealey and Lindley (1977) attempted to untangle the confusion about bank output. They regard bank output as comprising a set of financial services accruing to depositors and borrowers. These services are input absorbing and therefore comprise the technical output of financial institutions. They, however assume that since production and cost require measures of these services in physical units, the monetary volume of various types of earning assets is the physical units of output of the banking firm which is analagous to the physical units of output of non-financial firm.

The problem of bank output measurement was approached in somewhat different manner by Millineaux (1978). Rather than attempting to define a financial institution's output in terms of processing activities or any other balance sheet items, Millineaux used duality relationship between production and profit functions to develop a set of tests for both technical and economic efficiency in a study of scale economies in commercial banking.

In a more recent study Goldschmidt (1981) used "moneyness" as a measure of bank output. According to Goldschmidt, 'An integration of the role of banks in monetary process with their behaviour as profit maximising producers, lead us to suggest "moneyness" as the measure of bank output'. He defined moneyness as a flow of services derived from bank deposits. The identification of the level of moneyness embodied in bank deposits measures the output of banks, and this can be done, he argued, by adopting one of two approaches: first using various financial assets including bank deposits as independent variables in equations that try to explain variation in GNP. The regression coefficients serve as moneyness weights for the corresponding assets. The second approach focuses on consumers' demand for characteristics rahter than goods and therefore bank deposits are viewed as goods employed by consumers to produce some common characteristics. Goldschmidt started by concluding that his definition and measurement of bank output provides a link between the "micro" view of bank as producers and the "macro" view of banks as financial institutions that were granted the power to create money. Goldschmidt's approach seems a variant of Gorman's liquidity approach to measurement of bank output.

Finally, in another very recent study, Fry, Harper and Stansell (1982) assume that output consists of processing of financial transactions. According to them this processing is primarily devoted to maintaining loans and share accounts. They expressed one type of processing, the dollar volume of loan processing as a function of factor inputs and other "factor absorbing" processing activities and obtained a relationship between loan volume and employment of factor inputs.

6-2.3 Measurement of Output of Nigerian Banks

A survey of the past measures of output of banks and other financial institutions and a search for measures to reflect the activities of commercial banks statistically have revealed that there exists no single valid measure of bank output. Instead there are a number of possible series each revealing a special facet of bank business. The characteristics of these various measures make their aggregation impossible. In consequence, therefore, the measurement of the Nigerian banking system's output is approached through a series of surrogates showing the different characteristics of the Nigerian banking system's output. The growth pattern in these series during the period 1960-80 is analysed.

The selection of the surrogates used here is dictated very much by the availability of data and information and other constraints. There are no data on many balance sheet items including net income, costs (apportioned between wages and salaries and deposit interest), nor is there information on the number of accounts. The bank data problem in Nigeria is inherent in the force of traditional belief in respect of secrecy in bank as well as the issue of "confidence" alleged to be invested in presenting true bank returns especially the various items of bank costs, revenue and profits. Furthermore there is no known study of bank market structure in Nigeria.

It is pertinent to point out right away that the choice of the various surrogates used does not deny the multiproduct nature of the Nigerian banks. Services provided by the Nigerian banks include the acceptance of current, savings and time deposit accounts, transmission of monies, provision of credit, safekeeping facilities, giving advice, transferring and collecting funds and provision of loans of various kinds. Ideally, we would like to derive production functions for the main categories of the services and indeed refine such measures by attaching appropriate weights based on their contribution to final output. This is not possible because of lack of adequate data and information.

Furthermore, an important development in recent years in the provision of services by banks in Nigeria is the strong customer relationship. It is very hard to obtain certain services from banks other than one in which one maintains an account. For example, it is very difficult for one to obtain travellers' cheques from banks other than "one's bank". Commercial banks have encouraged this customer relationship by selling comprehensive package of financial services.

Since banks provide liquidity, safety and monetary changes, deposits as a measure of output reflect the degree to which these functions are being performed. Goldschmidt (1981) contends that as the macro view of banks is concerned with that financial asset (deposits or loans) supplied by the banks which is more directly related to the policy targets, the question of what items should be included in the definition of bank output should be answered by looking for those items that are closely related to longrun changes in income, prices and so on. Campbell (1978) found that in the long-run, neither securities, nor loans make a significant contribution to the explanation of changes in the level of GNP when they are used as independent variables alongside various definitions of money stock. This evidence supports the view that deposits which are part of money stock are relatively more important than bank assets in explaining variations of some of the major policy targets. Accordingly a measure of bank output that is designed to capture the role of banks in the monetary process might be based on bank deposits rather than assets.

However, as far as micro view of banks (i.e. banks as producers) is concerned, asset activity is not less important than deposit activity since banks incur real costs in supporting the level of both activities. Nevertheless, the important question here is whether asset servicing adds to bank output. As Goldschmidt argues, if each and every asset mix corresponds to a specific deposit mix then the asset activity supplies no service in addition to that supplied by bank deposits; if, however, changes in the asset side of the balance sheet are independent of changes in the structure of bank deposits, then asset servicing contributes additional output.

The level of deposits also determines the intermediation ability of the banking system. The high input utilization resulting from deposit management constitutes yet another justification for using deposits as output measure. Bell and Murphy (1976, p.3) found that 5.7 per cent of employment in a typical bank in the United States is absorbed by services associated with deposits. This is particularly more so in Nigeria because of the labour intensive, low technology nature of banking operations in the country.

Deposits as a measure of output have important social welfare implications because they determine the ability of the banks to finance industrial and agricultural activities and thus affect the rate of the economy's economic growth. To further support the use of deposits as one of the proxies of bank output, Revell (1980, p.84) has this to say:

> Strictly speaking it is best to measure increases in bank business by the growth in deposits and other funds business forlending, but the incompleteness of some of the balance sheet information makes it more convenient to use volume of business as a proxy. Since the capital ratios are low, the difference is only marginal.

As Table 6.1 indicates the volume of deposits held by the Nigerian banking system registered a sixty-four-fold increase during the period under review, increasing from 137 million naira in 1960 to 8,842.7 million naira in 1980. It recorded an average annual growth rate of 20.5 per cent. The growth rate was higher in the period 1970-80 when the average annual growth rate recorded was 32.5 per cent than in the period 1960-69 when the average annual increase was 13.6 per cent (See Fig 6.1). This pattern of the growth in bank output can be explained by two factors. The period 1970-80, witnessed a tremendous increase in Government earnings as a result of the emergence of the crude oil exports. The increase in Government wealth and expenditure led to a general rise in the level of income in the economy; and since there is a positive relationship between the rise in income and the level of saving the level of deposits with the commercial banks, the major avenue for institutional savings in the country, had to rise during this period. Second, the period 1970-80 marked the implementation of the Federal Government rural banking programme which involved the banks in opening branches in the rural areas. As we noted in Chapter Four, large volume of funds in the rural areas tend to remain idle or dissipated owing to the inadequacy and inefficiency of institutional channels, and that these funds are substantial and what is lacking is the speed and efficiency by which these funds are translated into savings available for productive investment. As a consequence, with the expansion of banks in the rural areas and the opening of 200 branches between 1977 and 1980 the level of bank deposits increased. However, as Table 6.1 and Fig 6.1 depict, the growth in deposits both at current and constant prices dropped to a very low rate of 1.2 per cent and -18.6 per cent respectively in 1978.

This was the impact of the decline in Government expenditure as a result of the fall in revenue from the crude oil exports in 1978 and the consequent fall in general income level in the economy.

Table 6.1 Deposits of the Nigerian banking system at current and constant prices 1960-80

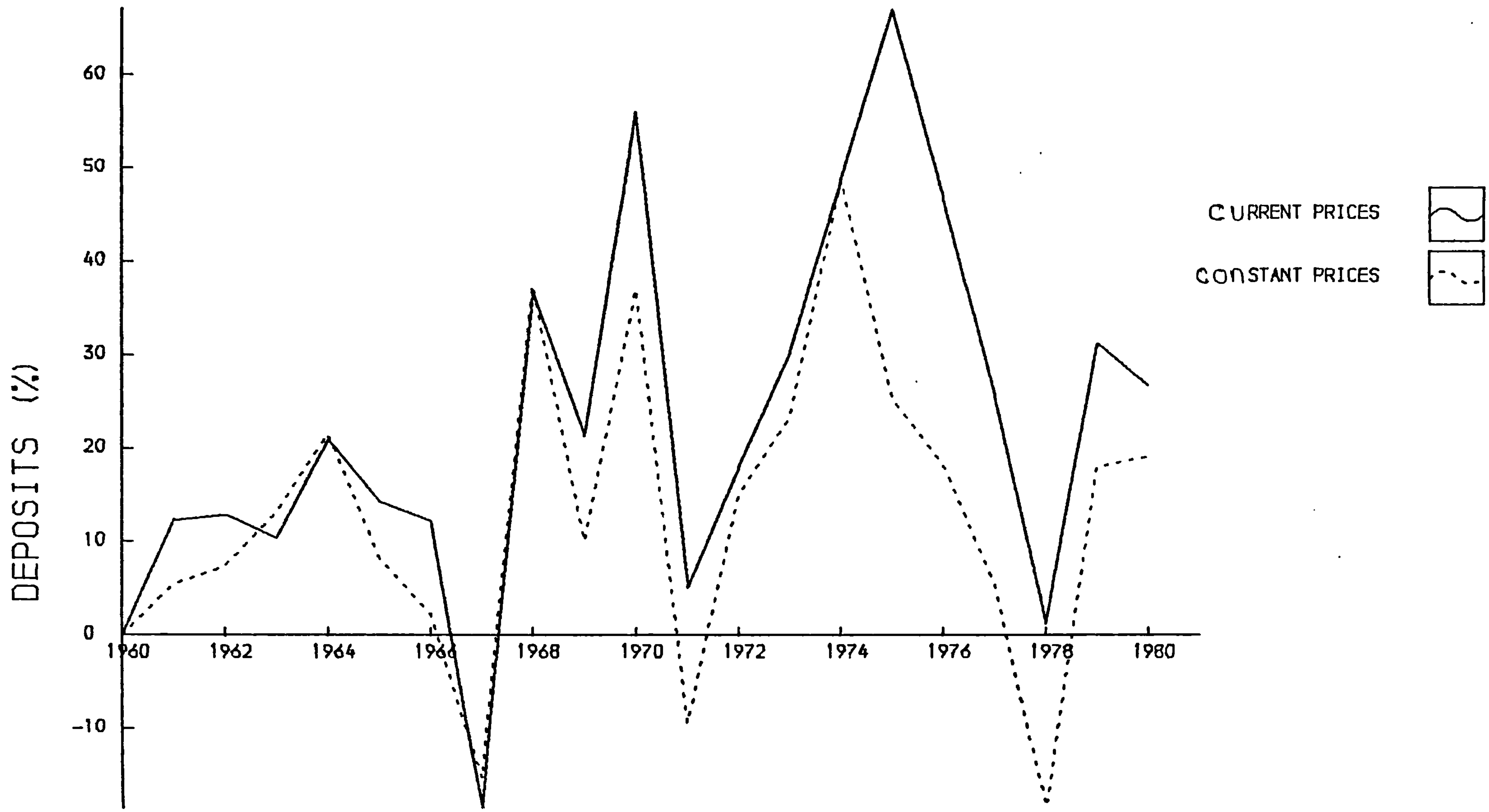
	(Million naira)		(Percentages)	
Year	Deposits at current prices	Deposits at 1975 constant prices*	Growth Rate of of deposits at current prices	Growth Rate of deposits at constant prices
1960	137.0	391.4	-	-
1961	154.0	412.9	12.4	5.5
1962	173.8	443.4	12.9	7.4
1963	191.8	502.1	10.4	13.2
1964	232.0	610.5	21.0	21.6
1965	265.0	660.8	14.2	8.2
1966	297.2	675.5	12.2	2.2
1967	241.6	571.2	-18.7	-15.4
1968	330.6	785.3	36.8	37.5
1969	401.0	864.2	21.3	10.0
1970	625.8	1,185.2	56.1	37.1
1971	657.2	1,072.1	5.0	-9.5
1972	776.2	1,234.0	18.1	15.1
1973	1,013.0	1,523.3	30.5	23.4
1974	1,693.9	2,264.6	48.7	48.7
1975	2,839.1	2,839.1	67.2	25.4
1976	4,164.2	3,358.2	46.7	18.3
1977	5,235.2	3,532.5	25.7	5.2
1978	5,302.6	2,877.2	1.2	-18.6
1979	6,967.8	3,400.6	31.4	18.2
1980	8,842.7	4,058.1	26.9	19.3
Average Annual Growth Rate			20.5	12.5

Sources : CBN i <u>Annual Report and Statement of Accounts</u> - various years

ii <u>Economic and Financial Review</u> - various years

Note * : Computed with Consumer Price Index (1975=100)

FIG 6.1 GROWTH RATE OF DEPOSITS AT CURRENT & CONSTANT PRICES 1960-8



It is noteworthy that the amount of deposits outstanding recorded a 18.7 per cent decline in 1967. This may be attributed to the economic, political and social disturbances which culminated in a civil war in 1967. The high recorded growth rate of 36 per cent in 1968 which was one of the war years can be explained by the Government's decision to change the form of currency in circulation in order to make the existing currency unusable by the Biafran Government, the secessionist part of the country which was the other side to the conflict. This decision forced many people to deposit their cash balances with the banks in 1968.

Deposits and growth in deposits are not an unambiguous measure of bank output, because changes in the level of deposits may not always reflect the same directional changes in output. Inflation produces an automatic increase in bank deposits, so that deposit outstanding may increase because of inflation without any increase in the quantity of services provided by the banking system. Left to itself the process would result in a fairly steady increase of deposits in line with inflation, at least in the short-run, but the efforts of the Governments to control inflation by operating on the money supply lead to rather more spasmodic growth of bank deposits (Revell 1980). It is, therefore, necessary to distinguish between inflation induced increase of deposits and real growth of deposits.

To correct the current price deposits series of Table 6.1 for price effect, the index of consumer prices was used as price deflator. Consumer price index, the implicit price index or the gross domestic product deflator and the wholesale price index are usually used in measuring price movements. Of the three, only two: the consumer price index and the implicit price index are currently in use in Nigeria.

Of the two in use, there is no systematic regular official publication of the implicit price index. Thus the consumer price index is the best known and widely accepted proxy for the measure of the economy's cost of living.

As shown in Table 6.1 the price deflated deposits series exhibited a ten-fold increase during the period 1960-80. It rose from 391.4 million naira in 1960 to 4,058 million naira in 1980. The average annual growth rate is 12.5 per cent.

The influence of other distorting factors on the deposits series was examined to establish the validity of this series as one of the measures of the banking system's output performance. Deposit-mix changes, affecting deposit activities, influence bank output without changing the level of total deposits outstanding. The time plus savings deposits to total deposits ratio indicates the directional effect of deposit mix changes on output.

There are, however, differing views about the directional effect of the proportion of time plus savings deposits to total deposits. Time and savings deposits use fewer bank services because of their lower turnover. Consequently an increase in the proportion of time and savings deposits to total deposits implies a lower level of real output of the banking system (Bhatia, 1978). On this Pritchard (1965, p.40) argues:

> ... because in their time deposit function the commercial banks are neither intermediaries nor creators of loan funds; they are simply custodians of stagnant money. The commercial banks do not loan out time deposits nor the "proceeds" of time deposits.

While this may apply very much in the developed countries where there are alternative sources of long term finance, it may not be so in a developing country like Nigeria. The longer the term of bank deposits, the longer the banks should be confident and willing to part with the funds by way of loans. Since a large proportion of time and savings deposits represents the resources that can, in crisis-free business periods, be lent on a longer term basis, the bigger these deposits are as a proportion of total deposits, the better placed are the banks to make term loans. Thus as Adewunmi (1981) argues, given the right development-conscious and risk-accepting attitude to lending on behalf of these bankers it can be hypothesized that the bigger the time and savings deposits available to them the more efficient lending and therefore services they will provide.

Table 6.2 and Fig 6.2 show the absolute amount of time and savings as well as their proportion to total deposits. The absolute level of time and savings deposits increased steadily during the period 1960-80. It rose from 54.8 million naira in 1960 to 5,111.9 million naira in 1980, thus registering an average annual increase of 25.6 per cent. The ratio of savings plus time deposits to total deposits also showed an increasing trend between 1960 when in recorded 0.40 and 1968 when it stood at 0.56, but fluctuated in the period 1969-80, reaching a level of 0.58 in 1980. Fig 6.3 emphasises the expansion in time and savings deposits as well as the volatile behaviour of these deposits over the period 1960-80. The conclusion thus far, is that the output of the Nigerian banking system as measured by deposits had been increasing in the period 1960-80.

An important criticism which may be levied against the use of deposits represents the capacity rather than the output of the banking system. The divergence between capacity and the output level is not serious for service industries like the banks because inventory accumulation is not possible and excess demand exists in such industry as the banking, therefore capacity measure can serve as the proxy for bank output.

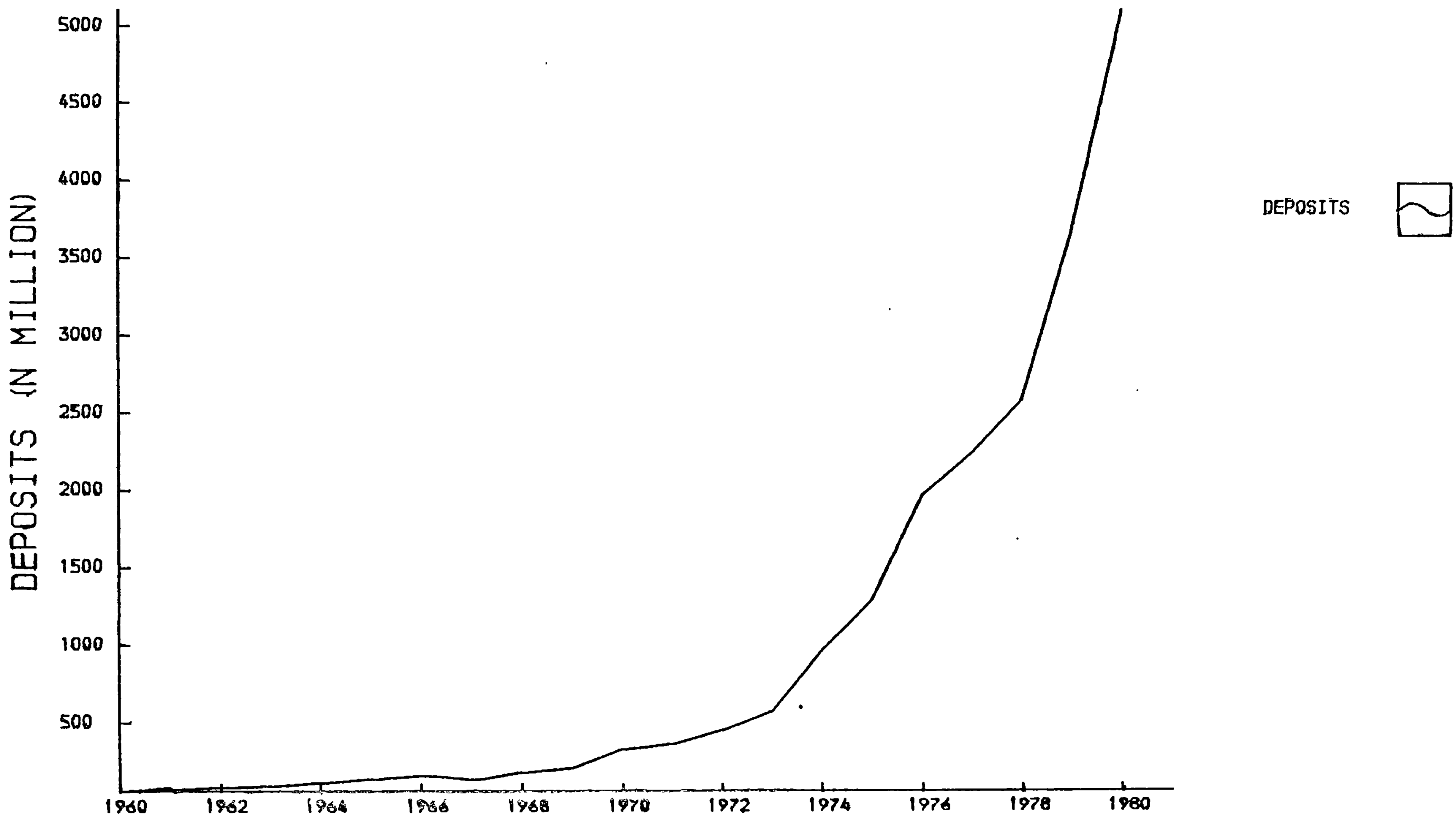
Table 6.2 Time and savings deposits of the Nigerian banking system 1960–80

Year	(Million naira) Time and savings deposits	(Ratio) Time and savings deposits/ total deposits	(Percentage) Growth rate of time and savings deposits deposits
1960	54.8	0.40	-
1961	70.6	0.46	28.8
1962	83.2	0.48	17.8
1963	94.2	0.49	13.2
1964	116.4	0.50	23.6
1965	141.0	0.53	21.1
1966	162.6	0.55	15.3
1967	131.2	0.54	-19.3
1968	183.6	0.56	39.9
1969	215.4	0.54	17.3
1970	336.8	0.54	56.4
1971	371.8	0.57	10.4
1972	461.2	0.59	24.0
1973	582.3	0.57	26.3
1974	973.2	0.57	67.1
1975	1,302.3	0.46	33.8
1976	1,979.1	0.48	52.0
1977	2,255.1	0.43	13.9
1978	2,601.7	0.49	15.4
1979	3,702.1	0.53	42.3
1980	5,111.9	0.58	38.0

Sources : CBN i Annual Report and Statement of Accounts - various years

ii Economic and Financial Review - various years

FIG 6.2 TIME & SAVINGS DEPOSITS OF COMMERCIAL BANKS 1960 -80

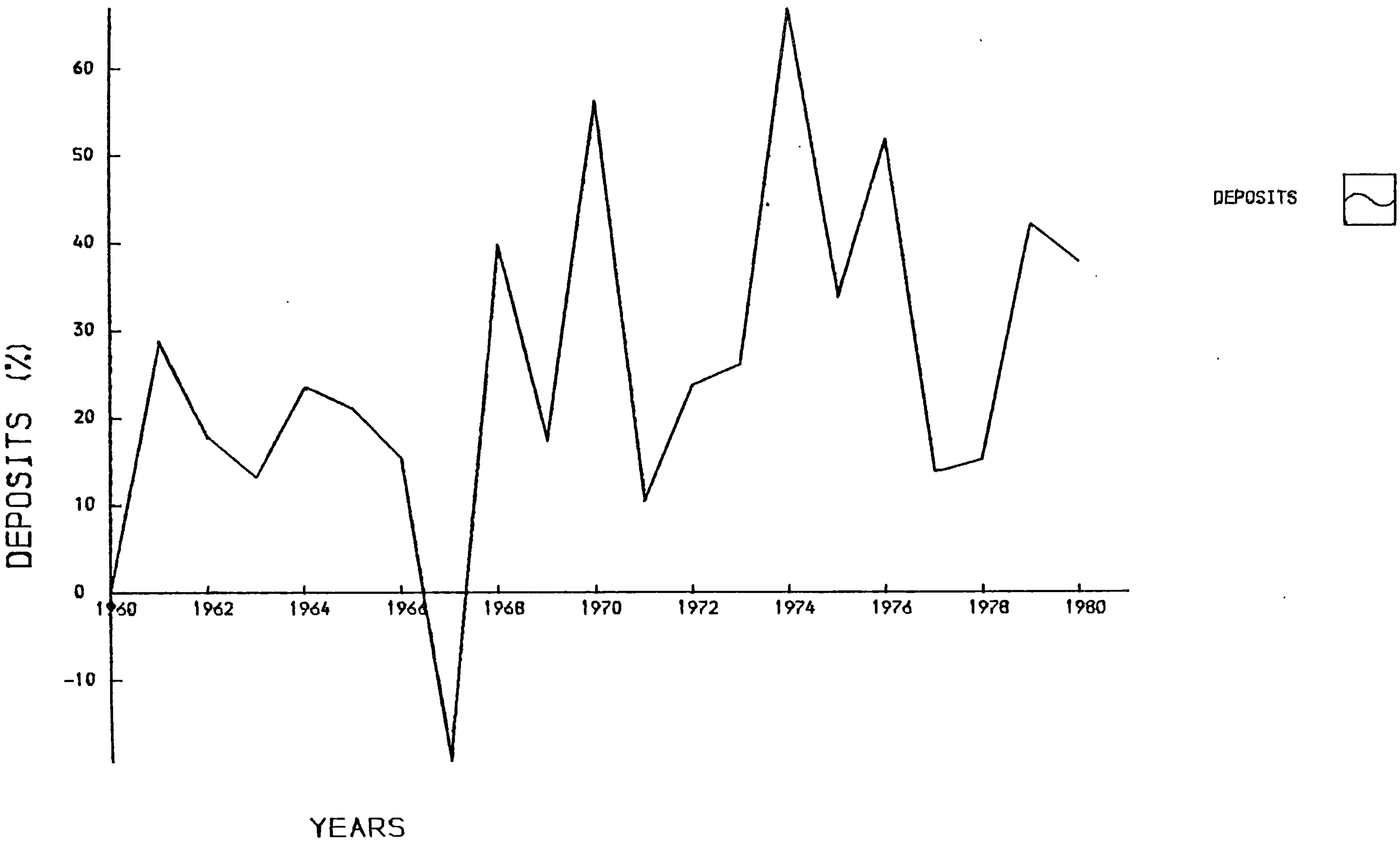


An alternative approach taken to measure output is the use of earning assets. This approach rests on the promise that output of financial institutions, particularly commercial banks are viewed as financial services provided to depositors and borrowers, and that since output generates revenue, earning assets, by far the most important source of bank revenue may serve as the yardstick of banking output. Thus as Altman (1980) contends, despite the proliferation of banking services, the basic commercial and industrial lending and investment process remains the life blood of commercial banks. To support the use of earning assets as a measure of bank output, Sealey and Lindley (1977) states that the use of dollar volume of various types of earning assets as a measure of financial firm's output is analogous to the physical units of output of non-financial firms.

The fact that the output of a financial firm is viewed as a service flow and the physical units of this flow are measured by earning assets which are generally thought to be a stock variable may at first seem inconsistent. The view that earning assets and certain other balance sheet entries are a stock is an implication of portfolio approach to bank behaviour. However, as Pesek (1970) stated the view that bank balance sheet entries are stock does not accurately reflect economic realities since, 'by its very nature bank money is constantly sliding into the abyss of non-existence, either as it is returned to the banks for conversion into currency or as rentals ("or loans") of it expires' (p.360). The continuing existence of earning assets and deposit entries on the banks' balance sheet requires continuing activity on the part of the banker to prevent the "ever changing stock or rather, flow" of these entries from being destroyed. To further quote Pesek, if balance sheet entries are to be considered as a stock, they are 'not comparable to a stock of Rembrandt paintings but rather to a river, constantly renewed in the mountains and constantly disappearing down the valley, with the banker controlling the sluice' (p.360). Therefore, commercial banks and other financial institutions can maintain a stock of earning assets or deposits on their balance sheet only be constantly incurring costs.

In objecting to the use of earning assets as a measure ofbank output, Mackara (1975) contended that viewing earning assets as bank output is analagous to viewing inventories as output for the manufacturing firm. He argued that looking at the firm's stock of inventories yields little information about the firm's production activities without information such as the net change and turnover of inventories over a specified period of time. MacKara is referring, and correctly so, to the problem associated with the use of earning assets as a measure of bank output. Conceptually, however, there are distinct differences between inventories which are held by the manufacturing firm and earning assets held by the bank. First, as noted above, most balance sheet items are "perishables" in the sense that cost must be constantly incurred to maintain a given level of earning assets. Second, and equally important, is the fact that inventories yield no direct revenue to the manufacturing firm while earning assets are the banking firm's primary source of revenue. Therefore the behavioural process involved in making inventory decision on the part of manufacturing firm is distinctly different from the bank's decision making process concerning the production of services of what the earning assets are the physical measure (Sealey and Lindley, 1977).

FIG 6.3 GROWTH RATE OF TIME & SAVINGS DEPOSITS 1960 -80



The earning assets of the Nigerian banking system consist of Government securities such as Treasury bills, Treasury certificates, Call money fund, stabilization securities, Bankers' unit fund, Eligible development stocks and Certificate of deposits; and loans and advances and bills discounted. Table 6.3 shows the earning assets of the Nigerian banking system. Fig 6.4 also shows the trend in the growth of each component of the earning assets. Bills discounted though increasing has not been significant. The total earning assets exhibited an increasing trend rising over 79 times the 1960 level in 1980. It increased from 119.7 million naira in 1960 to 9,471.5 million naira in 1980. The average annual increase is 24.4 per cent as compared with 20.5 per cent average annual increase registered by the deposit series. The difference in the two series may be attributed to the monetary policy measures of the Central Bank with regard to liquidity ratio requirements. For example, the widening of the choice of instruments between 1970 and 1980 (see Chapter Four) had led to the relative decline of cash and Treasury bills as instruments for satisfying the CBN rules of liquidity.

It is important to note the significant average annual growth of 36 per cent in the period 1972-77. The increase is connected with two parallel movements: the promulgation of Nigerian Enterprises Promotions Decree (NEPD) 1972 and 1976, compelling alien companies to sell part of their equity holdings to Nigerians. Much of the purchases were financed by the banking system thus raising the level of banks' loans and advances. The second movement is seen through the rise in the transactions on the Nigerian Stock Exchange - a considerable number of public issues also connected with NEPD 1972. Most of the issues were financed by bank loans, the securities issued being used as security by the borrower. The procedure was encouraged by the Government which tried to apply moral suasion to induce the banks to finance these transfers of shares and issues of new issues (Okigbo, 1981). It is also necessary to note the sudden and tremendous increase in investments in the periods 1968-70. This is 'as a result of the Government's wartime needs for funds' (CBN Annual Report, 1971). With improved Government revenues, the growth in the Government money market instruments slowed down in 1971.

The earning assets series of bank output suffer from the same shortcoming as deposits series, that is, changes in the mix of earning assets may affect the physical output of the banking system without changing the naira volume of assets owned by the banking system. It is, therefore, necessary to correct for this shortcoming. To ignore the distortion would imply that all forms of bank credit are perfect substitutes to the bank and the community. For example, it would imply that 100 naira of Government securities, Treasury bills, for example, is equivalent to 100 naira of business loan which is the same as 100 naira of consumer loan in terms of the amount of bank services associated with their creation. Such an implication is difficult to defend because bank assets differ widely in terms of services required to generate them.

To correct for this distortion, weights were deduced to make our measure of each earning asset of the banks reflect not only the money value of assets outstanding but also the expected yield of the assets. All earning assets have an average expected yield that must be considered in the evaluation of the bank output. In this study, an easily measured quantity that can serve as proxy for the average expected yield of each type of earning asset is the rate of interest actually paid for each earning asset (Powers, 1969). Thus interest rate is used as the weight, and the form of the measure is the interest rate times the amount of individual earning assets outstanding. The formula is of the form:

$$Q_i = \sum_j rij\ Xij$$

where

Q_i is the total output of the ith bank;
rij is the interest rate charged by bank i for jth type of earning assets;
Xij is the amount of the jth type of earning assets outstanding during a given year by the ith bank.

It might be reasoned that greater disaggregation of the earning assets data with loans and advances divided into sub categories could have refined the weighting process. For the Nigerian banking system, loans and advances represent a fairly homogenous category of short-term business loans because consumer finance in the country is still at its infancy and banks are not active in mortgage lending. Only a small proportion of the asset portfolio of commercial banks consist of real estate loans in Nigeria. For these reasons loans and advances were treated as a single broad category. Investments could have also been divided between Government securities and other investments such as Bankers' unit fund and certificate of deposits. But because Treasury bills and Treasury certificates constituted over 90 per cent of all investment instruments, it was felt that classifying investments into categories was not necessary. The earning assets were, therefore, classified into three main categories: (i) Loans and advances; (ii) Bills discounted; (iii) Investments. This is shown in Table 6.3.

FIG 6.4 EARNING ASSETS OF THE COMMERCIAL BANKS 1960–1980

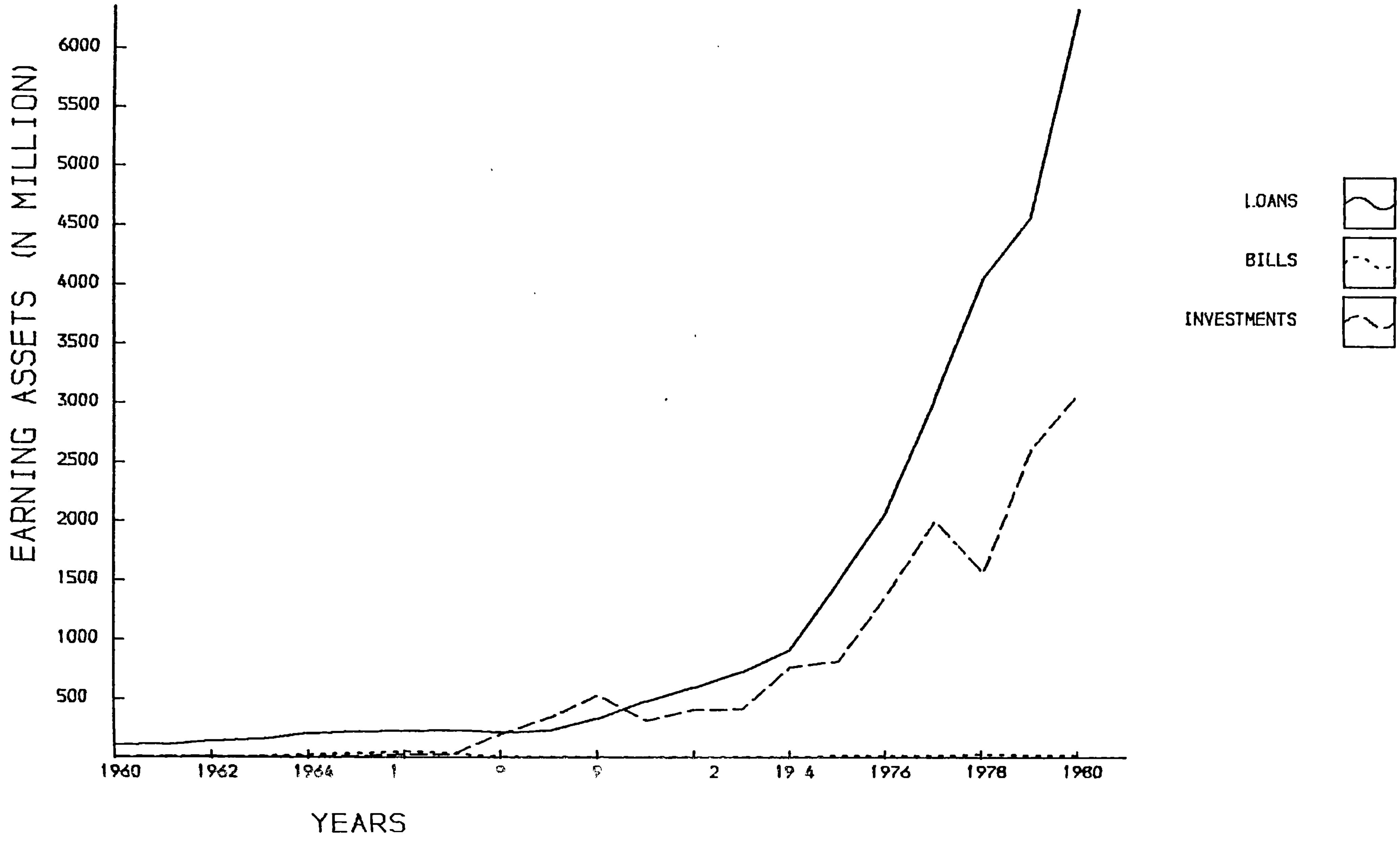


Table 6.3 **Earnings of the Nigerian banking system 1960-80**

(Million naira)

Year	Loans and advances	Bills discounted	Investment	Total earnings assets unweighted	Total earnings assets weighted
1960	111.5	2.5	5.7	119.7	10.5
1961	117.7	2.2	8.7	128.6	11.6
1962	147.9	6.2	10.0	164.1	12.7
1963	164.0	14.9	4.7	183.6	14.4
1964	214.7	30.1	14.0	258.8	21.0
1965	228.0	42.1	15.9	268.0	23.3
1966	238.0	60.1	35.4	333.5	26.3
1967	238.6	36.4	35.8	310.8	24.6
1968	220.6	5.1	206.2	431.9	27.3
1969	238.2	4.5	349.0	591.7	33.3
1970	345.5	5.9	534.0	885.4	47.7
1971	492.0	10.0	324.8	826.8	58.0
1972	611.5	8.0	418.6	1,038.1	78.5
1973	742.4	11.1	424.5	1,178.0	92.0
1974	924.1	14.0	778.3	1,716.4	124.5
1975	1,509.1	28.2	832.0	2,369.3	158.3
1976	2,099.1	23.8	1,391.1	3,514.0	204.1
1977	3,050.8	23.8	2,016.5	5,091.1	245.0
1978	4,070.0	39.7	1,573.5	5,683.2	513.4
1979	4,596.1	22.6	2,628.4	7,247.1	546.8
1980	6,356.5	...	3,115.0	9,471.5	727.8

Sources : CBN i Economic and Financial Review - various years

ii Annual Report and Statement of Accounts - various years

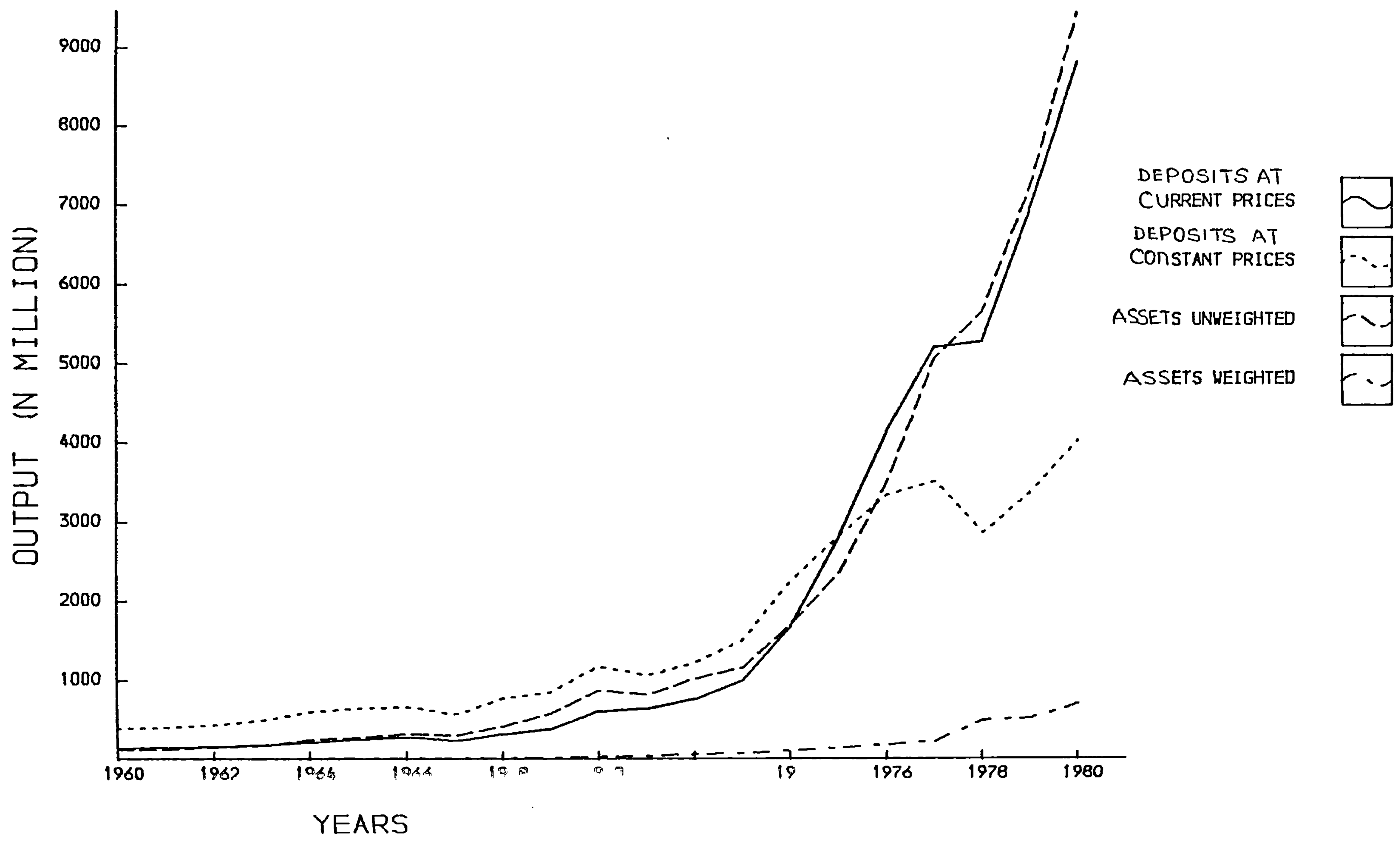
The weighted earning assets series exhibited almost equal rate of average annual growth with the unweighted series. The weighted earning assets average annual growth rate was 24.2 per cent compared with 24.4 per cent for unweighted earning assets series. The very low level of the weighted series can be accounted for by the low level of interest rate structure of the banking system as institutionally determined and administered by the monetary authorities as a deliberate policy to enable the Government to borrow at a low cost.

> The Central Bank has also been concerned to see that Government should obtain the finance it requires on the most economical basis. These considerations have necessarily conditioned the rate at which Federal Government loan operations have been undertaken and Treasury bills issues made (CBN Annual Report 1960, p.19).

For a closer examination of the low output measures so far discussed we refer to figure 6.5. The figure clearly indicates that an upward trend existed in the Nigerian banking system's output performance during the period 1960-80. For the series used, the figure shows that 1972 was the turning point in the increased output performance of the banking system. One may be tempted to explain the tremendous increase in these measures between 1972 and 1980 as a consequence of the indigenisation of the banking system which started in 1972. As a consequence of this policy, the foreign banks which hitherto were less interested in the economic development of Nigeria were brought under the Government and Nigerians control and ownership and thus were made to become actively involved in the development of the country. Furthermore the expansion of bank branches to the rural areas gave impetus to the upward trend in the output measures so far used. If these reasons are correct and accepted, it follows then that banking structure - physical and ownership - matters for bank performance and hence economic development.

The next measure of bank output as an indication of Nigerian banking system's performance employed in this study is the number of cheques processed by the banks. As a volumetric measure of output, it

FIG 6.5 OUTPUT OF THE BANKING SYSTEM 1960 -80



is fairly insensitive to price level changes and it is superior to the other measures in this respect (Bhatia, 1978). On this Hodgman (1969, p.161) agrees with Gorman's (1969) observations that:

> The vast bulk of observable activities in commercial banks relate to the processing of cheques and other transactions: banks would need a very small labour force indeed if nobody ever spent their deposits. Therefore, on this view the function of a bank is to help depositors spend money, and the volume of commercial bank output is proportional to the volume of transactions handled.

This measure, however, fails to capture all the monetary asp cts of banking system's performance and is in large part indicative of only the mechanical workload in the banking system (Speagle and Kohn, 1958). The Nigerian banking system is still highly labour intensive, and cheque-related transactions absorb a significant amount of labour and other inputs. The number of cheques can thus be one indicator of the banking system's output performance.

Table 6.4 shows that the number of cheques processed by the Nigerian banking system had an average annual rate of increase of 14.5 per cent. It was thus consistent with the increasing trend exhibited by the other two measures of bank output - deposits and earning assets. However, the large scale transfer of funds within the system, resulting from a significant increase in the average size of the cheques processed may create banking services which remain unrecognised in this output measure.

The clearing efficiency was also measured as the ratio of the monthly average number of cheques cleared in a year to the monthly average number of working days in a year for the period 1960-80. This is the average clearing efficiency and is shown in Table 6.4. The average clearing efficiency recorded an increasing trend. It rose from 2,425 in 1961 to 19,688 in 1979. There was a drop in 1967 as a result of the civil war when the banking activity was equally disrupted. The increasing trend (the civil war period decline aside) may be explained by increasing large transfers of funds within the banking system as people's banking habit increased and partly by the increasing number of clearing houses located in most of the state capitals. The number of clearing houses, for instance, rose from one located in Lagos in 1961 to eleven in 1980.

Table 6.4 Nigerian banking system: number and amount of cheques processed 1960-80

Year	(Million) Number of cheques cleared	(Million naira) Amount of cheques cleared	Average clearing efficiency
1960	-	-	-
1961	0.5	360.7	2,425
1962	0.8	604.2	2,762
1963	0.9	681.0	3,539
1964	1.2	899.9	4,635
1965	1.5	1,177.5	5,090
1966	1.7	1,318.1	6,444
1967	1.6	1,295.0	6,173
1968	1.6	1,485.3	5,477
1969	1.9	1,944.3	6,660
1970	2.3	2,892.8	7,909
1971	2.9	3,848.3	9,719
1972	3.3	4,580.6	12,228
1973	3.5	5,465.0	14,061
1974	4.1	7,512.3	16,418
1975	4.7	12,381.4	18,582
1976	5.0	18,650.9	19,869
1977	4.9	26,551.8	20,034
1978	5.6	30,312.1	22,235
1979	4.9	18,582.4	19,688

Source : CBN Economic and Financial Review - various years

6-3 PROFIT PERFORMANCE ANALYSIS

The role of profits and profitability in banking is crucial for a number of reasons. First, profits are the foundation upon which rest two main pillars of banking strength - adequacy of capital and competence of management (Crosse and Hampel, 1980). A good level of published profits reassures depositors that the business is competently managed, and 'it is recognised that retained profits will need to make a substantial contribution to the maintenance of appropriate capital base, particularly in an inflationary situation' (Bank of England Quarterly Bulletin Sept 1975, CLCB 1978).

Second, bank profits provide the first line of defence against the risk inherent in banking and therefore reassures not only depositors but also the stockholders of the safety of their investment particularly in times of economic adversity. In the words of Bhatia (1978, p.54) 'profits perform many useful functions in an economic system. They allocate capital, compensate investors for risks assumed, reward operating efficiency resulting from price-output decisions and provide for future expansion'. As observed by the Committee of London Clearing Bankers (1978, p.174) 'unless the banks can earn an adequate return on the resources they employ their ability to play their role in the economy fully and effectively will be prejudiced'. Banks whose profitability is below par are less likely to accept the risk of venturing into new markets, initiating new programmes or convenience-orientated services for their customers or developing innovating credit packages for both businesses and consumers. Contrary to the belief of some writers e.g. Adewunmi (1981), there is a direct link between profits performance and service to the public. Profits are the tangible reward which the market-orientated economies bestow on those businesses which identify and answer the demand of the consuming public (Rose, 1981).

Since these functions are the essential element of economic performance, profits and profitability ratios may be employed as indices of banking system's economic performance. As Rose (1981, p.152) puts it; 'still one performance goal must stand out, head and shoulders above the others if a bank is to be viable in the long run. This is the goal of satisfactory profits. American industrialist Charles Abbott once observed that "businesses without profits is no business any more than a pickle is candy"'. Stockholders, depositors and management are interested in this aspect of banking system's economic performance. Rose (1981, p.56) emphasised this when he wrote; 'Increasingly management, regulatory authorities, the stockholders and the investment community at large are looking at the "bottom line" - profitability -as a measure of how well a bank is performing'.

Adequate profit performance is also required to generate new capital and maintain capital. Banks' capital is essential for their prudential strength and its main purpose is to act as a potential cushion against unforeseen and severe losses. As Gardener (1982, p.42) observed, 'Retained earnings are the main source of this cushioning in the capital account. Not only do profits feed the capital account in this way, but also losses to be absorbed in bank capital can be written off only against accumulated (retained) profits and earmarked reserves generated through accumulated profits in the capital account'.

In measuring bank profits and profitability, a number of methods have been developed by different financial analysts. Probably the most comprehensive and significant modern study relating to bank profits and profitability was carried out by Revell (1980). The study investigated trends in interest margin and cost of intermediation in 80 series of aggregated operating accounts of banks and savings banks in 18 OECD countries. Considerable efforts were made to standardize the accounts and other statistical data used, although caution was expressed in comparing banks in different countries. Revell concluded that the best single indicator of the cost of intermediation is the gross earning margin (GEM) because it represents what the customers have to pay for the services provided. The GEM is the total revenue of the institution (apart from abnormal items) less what it has to pay customers and holders of debt capital for the use of resources employed in financial intermediation. It differs from interest margin (IM) in that GEM includes all non interest charges levied for ancillary services rendered by the bank. The main profitability indices used in the study were GEM/VB; IM/VB and profit before Tax/VB where VB is the volume of business i.e. balance sheet total. The study showed that the general trend in GEM/VB was upwards through time, although there were exceptions.

Revell's methodology cannot be usefully applied to the Nigerian case because of the paucity of data and information on some of the necessary and useful balance sheet items.

Rose (1981) in a recent study used the two most widely known profit indicators: Return on assets and Return on equity but strongly emphasised the importance of another set of profit ratios similar to

Revell's. These are: (i) Net interest margin (NIM) which he defined as the ratio of total income from loans and investments less interest costs to average total assets; (ii) Net operating rate of return (NOR) which is also defined as the ratio of total operating revenue less operating expenses to average total assets.

Still in another recent study on bank performance Fanning (1981) noted that the two fundamental measures of bank performance are growth in total asset size and the growth in the operating profits before taxes, interest and extraordinary items.

Thus it is widely accepted that profits would be a satisfactory measure of a firm's performance since it provides a good indication of the efficiency with which the firm uses the resources available to it (Papps 1982); and as Bhatia (1978) observed, although profits may be sensitive to environmental factors and regulatory constraints, over the long run, however, the trend in profitability reflects the prudence with. which the resources are being managed in an industry.

The use of accounting profits data for economic analysis creates conceptual problems. In the banking industry, however, the divergence between accounting and economic profit is not substantial because of the relative insignificance of depreciation in total expenses. Profitability analysis from the accounting data is therefore valid for banking industry. To an analyst, profitability ratio is more important, as seen above, then the absolute level of profits as a measure of performance because an entity may improve its absolute profits by employing additional resources but without improving its profitability.

Because of paucity of data and information the profits and profitability data used in this study are limited to the period 1970-81. As Table 6.5 shows, the profit level recorded by the Nigerian banking system increased 12.6 times the 1970 level in 1981, registering an average annual growth rate of 25.9 per cent.

Profits are also affected by inflation and thus the level of profits may increase because of inflation without indicating efficiency in the management of bank resources. Inflation has become a permanent feature of the Nigerian economy since 1970. In 1970, for instance, the average consumer price index was 52.8 (1975=100). For 1981 it was 263.5. The increase in index over the 12 years was thus 399.1 per cent or an average annual rate of increase of 16.1 per cent.

To take account of the effect of inflation on bank profits therefore, we deflated the current price profits by the consumer price index. The growth of profits in real terms showed an upward trend during the period 1970-75 with a registered average annual increase of 20 per cent. Thereafter, except in 1977 when the recorded increase was 59 per cent, the growth rate started declining. Thus the growth in profits particularly between 1976 and 1981 was as a result of inflationary trend in the economy. Therefore, the notion that the profitsof the Nigerian banking system have been excessive may not be true. Although the accounting profit data can be validly applied to the banking industry because the divergence between accounting and economic profit is small, the historical cost accounting conventions used is generally recognised to overstate profits during inflation (CLCB 1978, p.167). Fig 6.6 brings out clearly the influence of inflation on profits particularly in the period 1976-1981.

Table 6.5 **Profits and profitability measures of the Nigerian banking system 1970-81**

Year	(Million naira) Net profits (current prices)	Net profits (constant 1970 prices)	Net profit / capital	(Percentages) Net profit / total assets	Price * index 1970=100
1970	14.6	14.6	25.5	1.3	100.0
1971	18.9	16.3	26.9	1.5	115.9
1972	27.8	23.4	36.2	1.9	118.9
1973	35.6	28.3	41.4	2.0	125.7
1974	43.5	31.0	43.5	1.5	141.4
1975	67.0	35.4	52.6	1.6	189.0
1976	79.5	33.9	50.6	1.2	234.4
1977	151.0	53.9	74.9	1.8	280.1
1978	161.6	46.4	60.5	1.8	248.3
1979	156.1	40.3	47.6	1.4	387.3
1980	157.2	38.2	41.6	1.1	411.8
1981	184.1	37.0	56.2	1.2	498.0

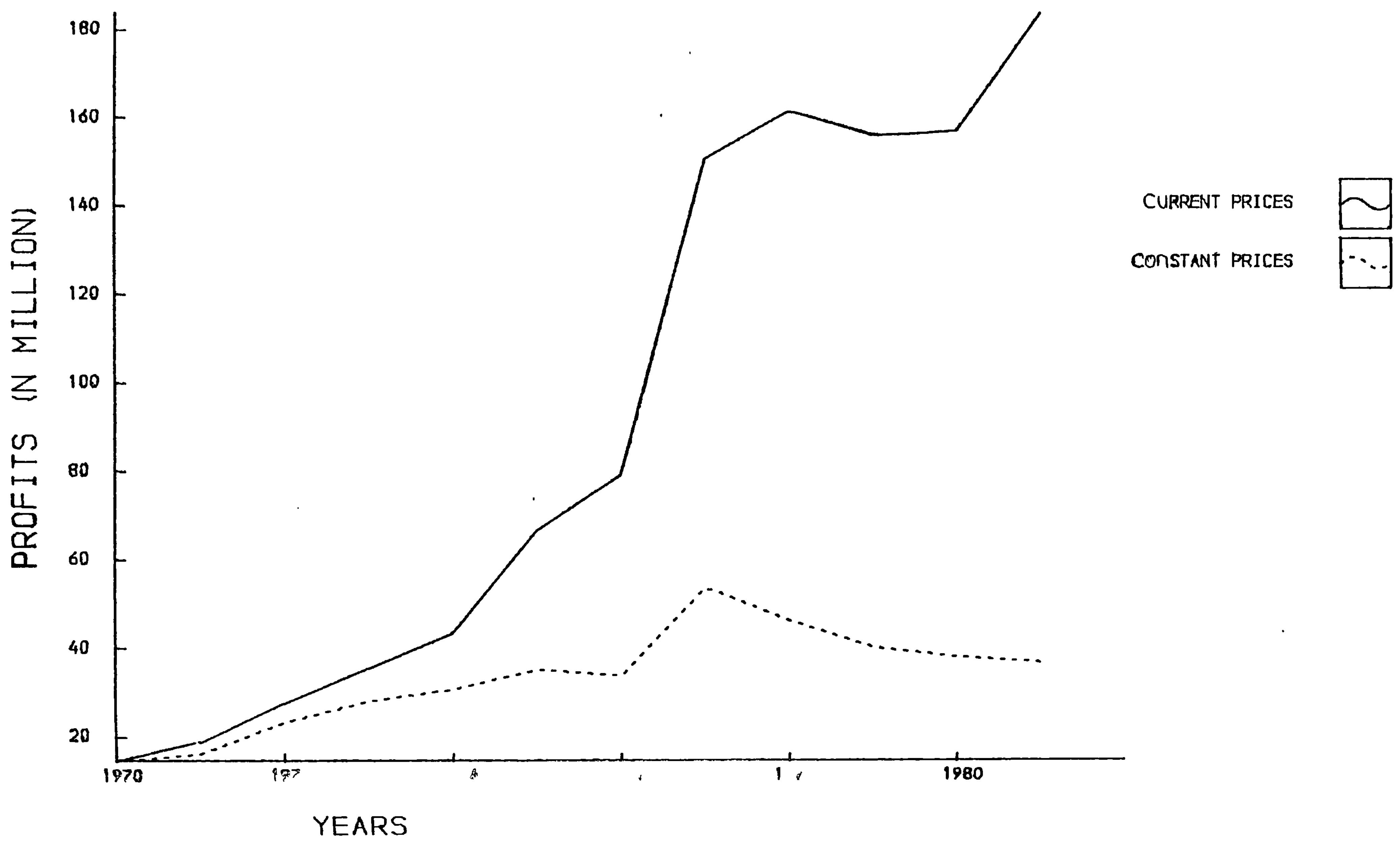
Sources : 1 CBN i <u>Annual Report and Statement of Accounts - various years</u>
ii <u>Economic and Financial Review</u> - various years
iii <u>Monthly Report</u>, December 1981 and March 1982

2 <u>Annual Reports</u> of the various commercial banks for various years

Note * : The Consumer Price Index is a derived consumer index based on 1975 weights

Much more relevant to the financial health of the banks, however, is profit attributable to shareholders after providing for taxation (CLCB 1978, p.169). Thus profitability as shown by return on capital showed an increasing trend from 1970 to 1975; it fluctuated in the period 1976-81. This underlines the observation of the Committee of London Clearing Bankers that bank profits are inherently cyclical. The ratio, however, averaged 46.5 per cent for the entire period and showed an average annual increase of 7.9 per cent.

FIG 6.6 PROFITABILITY OF THE COMMERCIAL BANKS 1970 -81



The other measure of profitability is the return on assets which indicates the earning capacity of the banking system. This ratio averaged 1.5 per cent during the period 1970-81. The declining trend in the ratio in the period 1978-81 may be attributed to rural expansion in bank offices. We noted that under the rural banking scheme a total of 194 banks were established in the rural areas of the country between 1977 and 1980. This must have overstretched the resources of the banks which were invested with future expectations of increased earnings yet to materialise. Besides, such expansion usually involves high input prices such as wage rate which in Nigerian banks has tended to rise at a higher rate than the national average wage ratē.

6-3.1 A Comparative Analysis

Accurate comparison of profit and profitability of banks of different countries is not possible because of the differing accounting practices and because, in some countries banking profits are not fully disclosed. This problem is accentutated when comparison is between developed and developing banking systems of different countries. However, any comparison should serve only as an indication of relative performance of the banks, ceteris paribus. On this understanding a comparative analysis of the Nigerian banking system's profits and profitability was undertaken.

As shown in Table 6.6 the comparison indicates that the Nigerian banking system has performed creditably well. The return on equity seems excessive. This may be explained by the fact that the Nigerian banking system is more or less the financial system of the economy. This implies that the banking system does not face any serious competition from the other non-bank financial institutions most of which are limited in their scope of operations and also are at their rudimentary stages of development. In the developed banking systems commercial banks have to face keen competition and therefore share the markets with other financial institutions. In the United Kingdom, for example, the clearing banks have to face keen competition from not only the building societies (which hold more sterling deposits than the clearing banks) but also from other deposit taking institutions.

Table 6.6 **A comparative analysis of the profitability performance of commercial banks of selected countries 1972-1976 (Return on equity)**

(Percentages)

	1972	1973	1974	1975	1976
United Kingdom (big four)	15.3	13.8	8.0	6.7	9.7
France (big three)	12.9	13.2	1.7	20.2	15.9
Germany (big three)	7.9	6.9	9.1	9.5	9.0
Japan (big three)	15.2	14.5	12.5	9.1	8.0
United States (big three)	12.5	13.4	13.9	13.4	12.5
Nigeria	36.2	41.4	43.5	52.6	50.6

Sources: 1 The London Clearing Banks; (1975) Evidence By The Committee of London Clearing Banks to the Committee to Review the Functioning of Financial Institutions (Table 38)

2 Table 6.5

The return on assets as shown in Table 6.7 seems to be in line with the performance series of the more developed banking systems. The good performance indicated here is also explanable by the same reason of being more or less the financial system of the country. That the banks do not face any strong competition from the other financial institutions does not imply that the banking system is not competitive. There is a good degree of competition between the individual banks.

Table 6.7 A comparative analysis of the profitability performance of commercial banks of selected countries 1972-1976 (Return on Assets)

(Percentages)

Year	United States	United Kingdom	Nigeria
1972	-	1.3	1.9
1973	0.76	1.5	2.0
1974	0.72	1.0	1.5
1975	0.69	0.8	1.6
1976	0.70	1.2	1.2
1977	0.71	-	1.8

Sources : 1 The London Clearing Banks (1978) Evidence By The Committee of London Clearing Bankers to the Committee to Review the Functioning of Financial Institutions (Table 36)

2 Federal Reserve Bulletin (September 1979) Insured Commercial Bank Income in 1978, p.697

3 Table 6.6

6-4 INTERMEDIATION ACTIVITY OF THE BANKS

The stated welfare assumption is that commercial banks more than other financial institutions can directly affect the level of economic growth through the granting of loans. Given this view, it follows, therefore, that the greater the percentage of a bank's total resources placed in loans the better the bank's performance (Brucker 1970). Thus an important function of the banking system is to provide financial intermediation, and this is reflected in the loans and advances provided by the banks. The amount of loans and advances outstanding and the loans and advances to deposits ratio can be used to evaluate the intermediation activity of the Nigerian banking system.

As shown in Table 6.8 loans and advances outstanding of the Nigerian banking system registered fifty-six-fold increase in the period 1960-80. It increased from a modest level of 114 million naira in 1960 to 6,379.1 million naira in 1980, recording an average annual increase of 24.2 per cent. The percentage of the loans and advances of the total assets has not, however, been stable. From 47.8 per cent in 1960, the proportion registered a high of 61.2 per cent in 1966 and thereafter plunged to a low of 30.5 per cent in 1970 and further to 26 per cent in 1975. After recording an improved share of 33.3 per cent in 1976 there was an upward trend reaching 55.2 per cent in 1980. This trend is clearly shown in Fig 6.7.

The loans and advances to deposits ratio gives an impression of the extent to which commercial banks used the resources available to them, and thus, it is considered a positive index of performance of the banking system. The credit needs of the business firms are best served through intermediation by commercial banks. Of the alternative sources of funds, the interest rates in the unorganised money market are generally higher than the interest rates in the organised money market. In the organised money market, the banking system is the dominant set of institutions. The non-bank financial intermediaries in the country are still at their early stages of development and therefore lack the resource base for effective lending operations.

FIG 6.7 RATIO OF BANKS LOANS & ADVANCES TO ASSETS 1960 -80

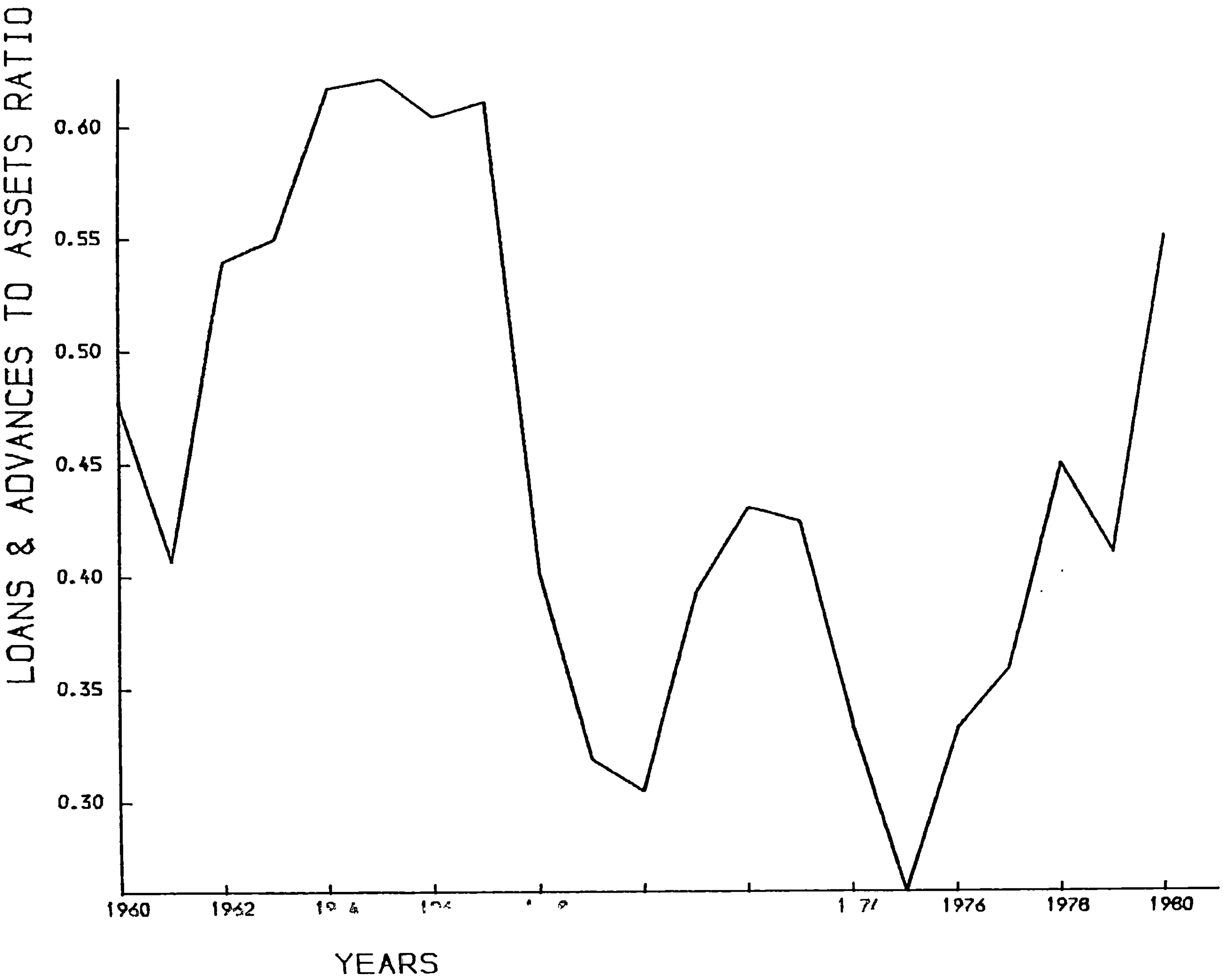


Table 6.8 **Loans and advances of the Nigerian banking system 1960-80**

Year	(Million naira) Loans and advances	(Ratio) Loans and advances /deposits	(Ratio) Loans and advances /assets
1960	114.0	0.832	0.478
1961	120.0	0.780	0.407
1962	154.1	0.886	0.540
1963	178.9	0.933	0.550
1964	244.8	1.064	0.618
1965	270.0	1.017	0.622
1966	298.1	1.003	0.605
1967	275.0	1.138	0.612
1968	225.7	0.683	0.403
1969	242.7	0.616	0.319
1970	351.3	0.561	0.305
1971	502.0	0.764	0.393
1972	619.5	0.780	0.431
1973	753.4	0.744	0.425
1974	938.1	0.554	0.334
1975	1,121.5	0.541	0.260
1976	2,122.9	0.510	0.333
1977	3,074.6	0.587	0.360
1978	4,109.7	0.775	0.451
1979	4,618.7	0.664	0.411
1980	6,379.1	0.696	0.552

Sources : CBN i Economic and Financial Review - various years

ii Annual Report and Statement of Accounts, December 1980

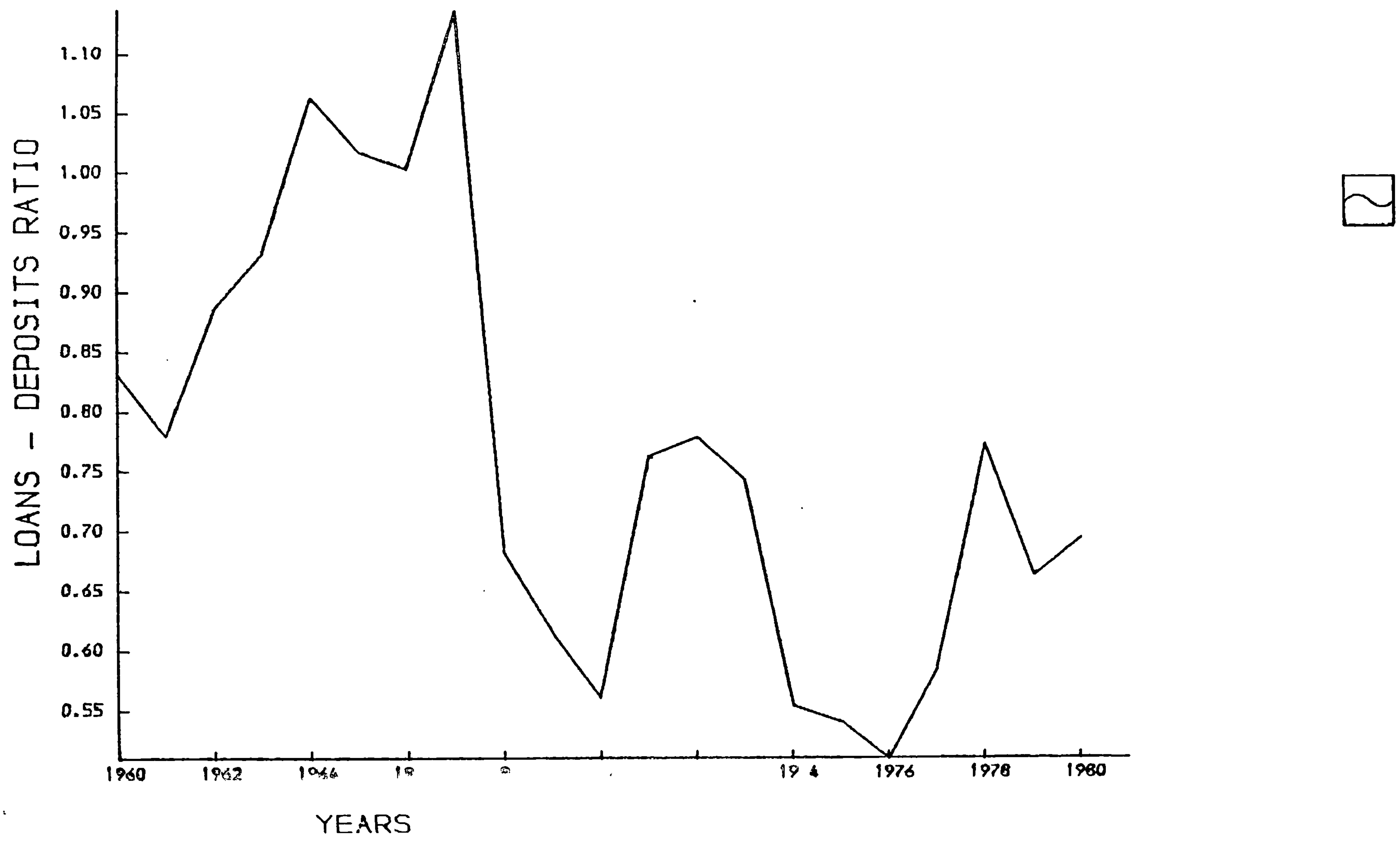
The Nigerian banking system did not perform creditably well with respect to the use of resources available to it as represented by loans and advances to deposits ratio in the period under review as expected. (See Table 6.8) After recording an encouraging ratio of 83.3 per cent in 1960, reaching a peak achievement of 113.8 per cent in 1967, the ratio remained disappointingly low for the rest of the period, recording the highest proportion of 78 per cent in 1972, and the lowest ratio of 51 per cent in 1976. The mean annual loans and advances to deposits ratio for the entire period 1960-80 is 73 per cent. Fig 6.8 shows the fluctuating but decreasing trend in this ratio since 1967.

This phenomenon is clearly of particular importance, since the transformation of deposits into loans is the essence of bank intermediation, for which the purchase of securities - the increased share of which in total assets has completely made up for the drastic decline in loans (See Chapter Four) - ought to be of subsidiary nature.

The reduction in loans and advances to deposits ratio is due in various degrees to different factors. A first set of circumstances operated between the period 1968 and 1970 when the ratio dropped from 1.34 in 1968 to 0.56 in 1970 (See Table 6.8) - a period during which, on the one hand, loans and advances were kept in check especially by the risk and the uncertainty of the economic and political situation arising from the 1967-70 war, and on the other hand, securities were made attractive especially by the stabilization of their prices by the CBN. Besides, the banks were faced with the "obligation to invest in securities" - a portfolio constraint - which operated during this period as a consequence of Federal Government's need for funds with which to prosecute the 1967-70 war.

The next set of circumstances occurred in the period between 1974 and 1976, a period when a different form of portfolio constraint was seriously operative. The CBN circulars placed a limit on the margin by which loans and advances to deposit ratio of one year should not

FIG 6.8 RATIO OF BANKS LOANS & ADVANCES TO DEPOSITS 1960 -80



exceed the credit of the previous year. In addition, there was the slow down in the loans and advances given by banks to the public in 1976 for the implementation of the indigenisation programme because of their experiences in financing the first phase of the programme in 1972. Thus despite the payment of Udogi salary increases and the rise in petroleum receipts which led to an inordinate swelling of demand and other deposits, the banks were reluctant to finance new purchases of new issued shares in 1976 as they had done in 1972 because of the delays experienced in sending returned funds (since most of the issues were oversubscribed), and in sending certificates of shares issued and sometimes misdirection of shares.

An important proportion of the decline in loans and advances to deposits ratio could be accounted for by the fact that the banks have not been aggressive in seeking out loan opportunities; they have generally waited for the investors to come to them with investment proposals which have to be carefully examined.

6-5 CONCLUSIONS

The intangible nature of the products of service industries like banking creates serious output problems and makes it difficult to evaluate the output performance of these industries.

The long-run output performance of the Nigerian banking system exhibited an upwards trend in the period under review. The output measures of deposits at current and constant prices, deposit-mix of time plus savings deposits to total deposits ratios, earning assets weighted and unweighted series indicated an average annual increase in output performance of the banking system in the range of 12.5 per cent to 25.6 per cent.

The profit and profitability performance measures showed a mean annual increase in the range of 7.9 per cent to 25.9 per cent, while loans and advances measure indicated a long-run increase in the banking system's intermediation activity performance of 24.2 per cent. The loans and advances to deposits ratios and loans and advances to assets ratios, however, suggested a deterioration in the observed intermediation performance of the Nigerian banking system during the period. On the whole the Nigerian banking system has performed well to a greater extent than is generally recognised.

CHAPTER SEVEN

THE ALLOCATIONAL EFFICIENCY OF THE NIGERIAN BANKING SYSTEM

7-1 INTRODUCTION

The extent to which financial resources of the banking system are directed into important and appropriate uses from the standpoint of the overall economy is termed here allocational efficiency. The impact of the banking system on the direction and level of economic growth depends crucially on its allocation of financial resources mobilized. Commercial banks are usually assigned a crucial role in the transmission process, because as financial intermediaries, they allocate scarce resources to the most productive uses. Inspite of this, however, there are some conditions (as we saw in Chapter Five) both in the developing and the developed countries, but more so in the former group of countries, under which major intervention in the operations of commercial banks becomes necessary.

Among the possible reasons a banking system's allocation of financial resources may be inefficient is that the market criteria alone do not determine bank portfolio composition. In ordering loan application, for instance, subjective judgements may be substituted for an objective evaluation of risks and returns. For example one of the reasons why governments in most developing countries intervene in the operations of commercial banks is that these banks are biased against one sector of the economy or one segment of the population. This discriminatory attitude is more prevalent in economies like Nigeria where foreign banks dominated the banking system. On this Otiti (1980, p.26) observed:

> Before indigenisation, the banking industry was dominated by a few foreign banks ... As profit maximisers, they featured prominently in the provision of facilities in foreign trade or concentrated in sectors where profits were high while neglecting vital sectors which, although unprofitable in the short run, has prospect for future growth. Specifically, these banks neglected the development of indigenous entrepreneurship, agriculture and industry and in effect virtually neglected the development of the economy, concerning themselves more with the import trade, thus promoting the sale of foreign goods in the country.

A related serious limitation of the market allocation of financial resources by the banking system is, as noted by Adbi (1977), the possible divergence between private and social costs and benefits. The banks pursue benefit maximisation which may not coincide with social benefits. Such lack of coincidence could result from market imperfections but it could be attributed to other factors as well; the financial institutions, for instance, may be greater risk avoiders than is socially desirable. In other words, there is a conflict between market equilibrium, which presumably expresses the wishes of the market participants, and the long-run objectives of the government which are based on considerations of the socially optimum growth rate.

In the present chapter, therefore, we are not concerned with the conventional market efficiency criteria of evaluating the allocational efficiency of the Nigerian banking system's resources. The banks' allocational efficiency is here assessed by the extent to which the Nigerian banking system has been able to finance the credit needs of the priority sectors of the economy.

In the context of the overall strategy of Nigeria's economic development, the overriding objective is, as usual, to develop the economy as fast as possible and usher the country into a "self sustaining growth" and "economic take-off". To this effect the highest order of national priorities is accorded to agriculture, industry, transportation and manpower development (Second National Development Plan, 1970-74, p.35).

The chapter is divided into six sections. The next section highlights the position of agriculture and industry in the development of the economy. The third section examines the performance of the banking system in allocating its loans and advances to the two sectors relative to other sectors of the economy. The fourth section examines the loan maturity and loan security patterns of the banking system. The Agricultural Credit Guarantee Scheme is briefly discussed in section five while section six is the conclusions.

7-2 AGRICULTURE AND INDUSTRY IN THE ECONOMY

7-2.1 Agriculture

Agriculture has continued to retain its dominant place in the economy, particularly when it is realised that it is from agricultural exports that the economy has received its principal stimulus to economic growth. Agriculture therefore, is the mainstay of the economy and will continue to be so in the foreseeable future. Some 70 per cent of the nation's labour force depends on the agricultural sector for a living and it provides a significant proportion of the food supply to the rapidly growing population. As the Third National Development Plan rightly outlines, agriculture will continue to furnish the bulk of the nation's employment opportunities and provides most of the country's raw material requirements for local industries and for exports which will continue to be an important foreign exchange earner.

In 1961, agricultural export earnings stood at 268 million naira or 89 per cent of all exports and accounted for 66 per cent of total foreign exchange earnings. In 1967 and 1968, the contributions of primary export products to foreign exchange earnings were 62 per cent and 73 per cent respectively. To this may be added the savings to national foreign exchange resources arising from local supplies of raw agricultural materials which would otherwise have been imported for the use of the nascent processing industries. In 1960 the share of agriculture in the GDP was 63 per cent and in 1966 it was 55 per cent. (See Table 2.2)

However, the proportionate contribution of agriculture both to foreign exchange earnings and the GDP declined significantly with the emergence of crude oil exports. For instance, by 1970, the for ign exchange earnings of the sector declined to 25 per cent and by 1980 it accounted for only 2.4 per cent of the total. (See Table 2.3) In terms of the GDP, the sector's contribution declined from 63 per cent in 1960 to 17 per cent in 1981.

Agriculture has all along been accorded an important consideration which it deserves in the various national plan documents. The problem has been with the implementation of the planned objectives. During the First National Development Plan, 1962-68, agriculture received some 184 million naira or 13.5 per cent of total capital expenditure programme of 1,354 million naira. During the plan period, approximately 43 per cent of the estimated public sector expenditure on agricultural production was unspent. This affected the development and growth of the sector adversely because the underutilization of the capital "provision" left most of the farmers' problems unsolved.

Under the Second National Development Plan, 1970-74, out of the total revised plan allocation of 304,972 million naira, 135,266 million naira was disbursed between 1970 and 1978. Of the revised plan allocation of 794,485 million naira for federal agricultural programmes 37,787 million naira was spent in 1973. More attention was given to agriculture in the Third National Development Plan, 1975-80. The planners realised the need to mobilise more domestic resources for the development of the sector. The Plan states, 'However viewed against its expected role in the socio-economic development of the country, the performance of the sector in recent years clearly underlines the need for much greater mobilization of resources at all relevant levels of the economy than has hitherto been done' (p.63). The estimated total national capital expenditure for the agricultural sector programme was 2.20 billion naira. The Fourth National Development Plan focuses very much on agriculture and manufacturing areas in order to reduce 'the damaging dependence on oil' (Shagari, 1981).

The realisation of the important role of agriculture in the development of the Nigerian economy has spurred the Federal Government into taking various strategies to boost agricultural production. One of the strategies was the Operation Feed the Nation (OFN). The primary objective of the programme is to arouse the consciousness of Nigerians to the need to be self-sufficient in food production. The scheme also involved Government subsidisation of agricultural inputs such as fertilizers, insecticides and improved seedlings.

Another important scheme to boost agricultural production is the Integrated Rural Development (IRD). This scheme is financed jointly by the various state Governments and the Federal Governments. The programme, which aims at providing improved services to farmers in the form of an integrated package, will ensure the evolution of appropriate infrastructural, institutional and administrative apparatus to facilitate the rapid development of the country's agricultural potential. In areas where the programme is not yet ready to take off on state-wide basis, a simplified small holding programme known as the Agricultural Development Area (ADA) will be implemented. The ADA involves essentially the provision of improved extension services, input distribution and rural feeder roads.

The other scheme is the River Basin Development Authority (RBDA). The concept of River basin development as a tool of agricultural transformation was introduced in 1970. In 1973, two RBDA were established. Subsequently, in 1976, nine others were set up. The Authorities were charged with a range of responsibilities, including the harnessing, management and exploitation of the country's water resources for agricultural and other activities. An allocation of 924 million naira was made to the eleven RBDA programmes and projects in the current plan period which included construction of dams and boreholes for the provision of water for agriculture and other uses, construction of feeder roads and jetties, development of irrigation and drainage infrastructures and training of various cadres of technical and managerial manpower.

In April 1980, the Federal Government launched yet another scheme - the Green Revolution Programme (GRP), designed primarily to modernise the agricultural sector and achieve self-sufficiency in food production by 1985. Under the scheme the Federal Government intends to allocate funds for the resuscitation of areas of food crops, livestock and fish production. The GRP included the increased supply of fertilizers and other material inputs and the expansion of credit facilities under the guarantee scheme to the farmers.

7-2.2 Industry

Industrial sector in Nigeria is, by and large, at the early stages of import substitution particularly in the area of light consumer goods both durables and non durables and processing activities to semi-finished state. Whilst this is a logical starting point for initial industrialization, as an attempt to minimize dependence on imported consumer goods and enhance self-reliance, it cannot create the necessary industrial infrastructural base that will guarantee self-sustaining growth (Zayyad, 1981).

Although the contribution of this sector to the GDP has risen from 5 per cent in 1960 to 8.1 per cent in 1969 (See Chapter Two), its percentage share as at present is still low. It was 8.7 per cent in 1981. The Government regards industrialization as a means of diversifying the economy in order to ensure balanced growth and enhance balance of payments position of the country.

The Federal Government's industrial policies have recently been put together in a policy document: 'Nigeria's Industrial Policy and Strategy Guidelines to Investors'. The document sums up Government's policies thus:

> The direction of Government action in the industrial sector shall be to encourage and promote directly and indirectly rapid development of manufacturing and allied activities as a major factor in the overall economic prosperity of the nation and as a positive input in the attainment of vital social goals.

The principal objectives of industrialization in Nigeria included the following:

- development of indigenous capacity to harness local resources for the production within the country of industrial goods and services necessary to meet the basic needs of the people;

- maximization of local value-added, with special emphasis on the utilization of local raw materials in the pursuit of the goals of national self-reliance as well as optimum development of agro-based industries;

- rationalised intersectoral and intra-sectoral linkages as well as processing, especially in the iron and steel and petrochemical subsectors;

- greater emphasis on local research and development both by the Government and by industrial establishment themselves;

- employment generation;

- vigorous export promotion;

-dispersal of industries to ensure more even development and such that economic viability of industries will not be jeopardised (Ciroma, 1981).

The strategy for achieving the above objectives includes intensive efforts by Government to improve the availability of industrial infrastructures in all parts of the country, as well as judicious application of incentives and disincentives to make investment in the manufacturing attractive while at the same time encouraging greater investment in the priority subsectors; the siting of industries in relatively backward areas, and rapid increase in local value-added, particularly the use of local resources and the development of industrial technology. Towards this end, a more effective use is made and will continue to be made of such incentives as the Pioneer Status which ensures 3-5 years tax holiday for pioneer industries; Approved User Scheme which involves import duty free on certain raw materials or at a concessionary duty rates; Accelerated Depreciation of Capital Investment. There are other incentives such as Custom (Drawback) Regulation which entails the reimbursementfor duty paid on imported raw materials if the product is exported and Graduated Excise Tax Reduction of local value-added tax concession.

The Nigerian Enterprises Promotion Decree 1972 and 1976 is an important scheme devised not only to encourage indigenous entrepreneurs to invest and take advantage of Government incentives in the industrial sector but also had the objective of encouraging foreign investors with high technological know how into more sophisticated industrial activities. The effectiveness of this programme depends, however, on the way it is implemented. A constant revision of the programme will hinder foreign participation in industrial investment in the economy because it will create doubts and uncertainty.

In addition to providing various incentives and industrial infrastructures, the Federal Government in recognition of the limitation of the private sector in Nigeria has directly participated in investing in high technology industries such as Iron and Steel, Liquified Natural Gas (LNG), Nitrogenous fertilizers, Petrochemicals and Pulp and Papers.

7-3 BANKING SYSTEM'S ALLOCATION OF LOANS AND ADVANCES

Having outlined the important role attached to these two sectors in the economy, the allocation of banking system's loans and advances in conformance with development plans and strategies regarding the two sectors and relative to the other sector will be considered indicative of the banks' allocative efficiency.

Table 7.1 **Analysis of the Nigerian banking system's loans and advances 1960-80**

(Percentages)

PRODUCTION

Year	Agriculture, Forestry and Fishing	Manu-facturing	Mining and Quarrying	Real Estate and Construction	Total Production
1960	19.8	4.3	1.0	6.3	31.4
1961	21.0	5.5	0.8	9.2	36.5
1962	23.4	7.6	0.7	6.7	38.4
1963	22.0	10.6	0.6	7.2	40.4
1964	24.7	10.7	0.5	4.7	40.6
1965	25.3	10.7	0.5	4.8	41.3
1966	1.6	13.1	0.5	8.6	23.8
1967	1.3	14.4	0.7	8.1	24.5
1968	1.7	16.4	0.5	8.8	27.4
1969	1.8	17.3	1.3	7.3	27.7
1970	2.0	21.8	1.8	7.4	33.1
1971	1.8	23.8	2.3	7.4	35.3
1972	3.0	23.2	1.6	7.9	35.7
1973	2.9	0.8	24.2	10.2	38.1
1974	2.9	27.5	1.3	10.4	42.1
1975	2.6	28.6	1.1	14.8	47.1
1976	3.8	28.7	0.7	19.4	52.6
1977	4.5	27.2	1.2	21.5	54.4
1978	5.6	27.6	1.0	21.4	55.6
1979	7.1	29.4	1.0	22.7	60.2
1980	7.3	30.8	0.8	22.8	61.7

Sources : CBN i <u>Economic and Financial Review</u> - various years

ii <u>Annual Report and Statement of Accounts</u>, December 1980

Table 7.1 Analysis of the Nigerian banking system's loans and advances 1960-80 (continued)

(Percentages)

	SERVICES		
Year	Public Utilities	Transportation and Communication	Total Services
1960	0.9	-	0.9
1961	0.2	-	0.2
1962	0.2	-	0.2
1963	1.1	-	1.1
1964	0.6	-	0.6
1965	1.2	-	1.2
1966	0.4	3.4	3.8
1967	1.3	3.2	4.5
1968	1.0	4.1	5.1
1969	0.7	4.0	4.7
1970	0.2	5.4	5.6
1971	0.8	6.3	7.1
1972	0.8	7.2	8.0
1973	1.5	6.9	8.4
1974	0.8	7.0	7.8
1975	1.2	5.7	6.9
1976	1.0	8.5	9.5
1977	1.5	7.6	9.1
1978	1.6	6.9	8.5
1979	1.2	7.2	8.4
1980	1.3	7.6	8.9

Table 7.1 Analysis of the Nigerian banking system's loans and advances 1960-80 (continued)

(Percentages)

	GENERAL COMMERCE				
Year	Bills Discounted	Domestic Trade (1)	Exports (1)	Imports (1)	Total Commerce
1960	2.2	36.9	-	-	39.1
1961	1.9	32.4	-	-	34.3
1962	4.0	36.0	-	-	40.0
1963	8.3	33.6	-	-	41.9
1964	12.3	27.3	-	-	39.6
1965	15.6	21.4	-	-	37.0
1966	20.2	41.4	-	-	61.6
1967	13.2	46.8	-	-	60.0
1968	2.3	49.9	-	-	52.2
1969	1.9	9.5	13.3	27.5	52.2
1970	1.6	9.2	19.8	17.0	47.6
1971	2.0	11.2	18.3	12.6	44.1
1972	1.3	11.9	14.6	8.3	36.1
1973	0.5	11.2	11.5	12.2	35.4
1974	1.5	10.6	9.8	8.6	30.5
1975	2.0	10.0	7.0	9.0	28.0
1976	1.1	9.9	4.5	9.5	25.0
1977	0.8	9.7	3.3	9.4	23.2
1978	1.0	10.0	1.9	8.2	21.1
1979	1.4	9.6	1.7	6.0	18.7
1980	0.4	10.0	1.6	7.0	19.0

Notes : (1) The figure for Domestic trade, Exports and Imports were not disaggregated enough and therefore were put under Domestic Trade until 1968.

Table 7.1 **Analysis of the Nigerian banking system's loans and advances 1960-80 (continued)**

(Percentages)

	OTHERS				
Year	Credit and Financial Institutions	Governments	Personal and Professional (2)	Miscellaneous (2)	Total Others
1960	5.1	1.9	21.6	-	28.6
1961	4.0	1.4	23.6	-	29.0
1962	1.1	1.0	19.3	-	21.4
1963	1.5	0.9	14.2	-	16.6
1964	3.0	0.8	15.4	-	19.2
1965	1.2	0.7	18.6	-	20.5
1966	2.5	0.4	1.9	6.0	10.8
1967	3.3	0.6	2.7	4.4	11.0
1968	4.0	1.3	3.2	6.8	15.3
1969	1.9	2.0	4.7	6.8	15.4
1970	0.8	0.4	6.6	6.0	13.8
1971	1.2	0.7	6.6	5.0	13.5
1972	2.3	1.4	10.0	6.5	20.2
1973	1.6	2.3	5.6	8.6	18.1
1974	2.3	3.4	6.6	7.3	19.6
1975	3.6	2.6	6.0	5.8	18.0
1976	2.4	2.6	4.6	3.3	12.9
1977	3.1	2.8	4.6	2.8	13.3
1978	3.6	3.2	5.0	3.0	14.8
1979	1.8	3.6	4.3	3.0	12.7
1980	3.2	2.5	3.5	2.9	12.1

Notes : (2) The figures for Personal and Professional and Miscellaneous were also put together under Personal and Professional until 1965.

FIG 7.1 LOANS & ADVANCES TO AGRICULTURE AS % OF TOTAL LOANS 1960–80

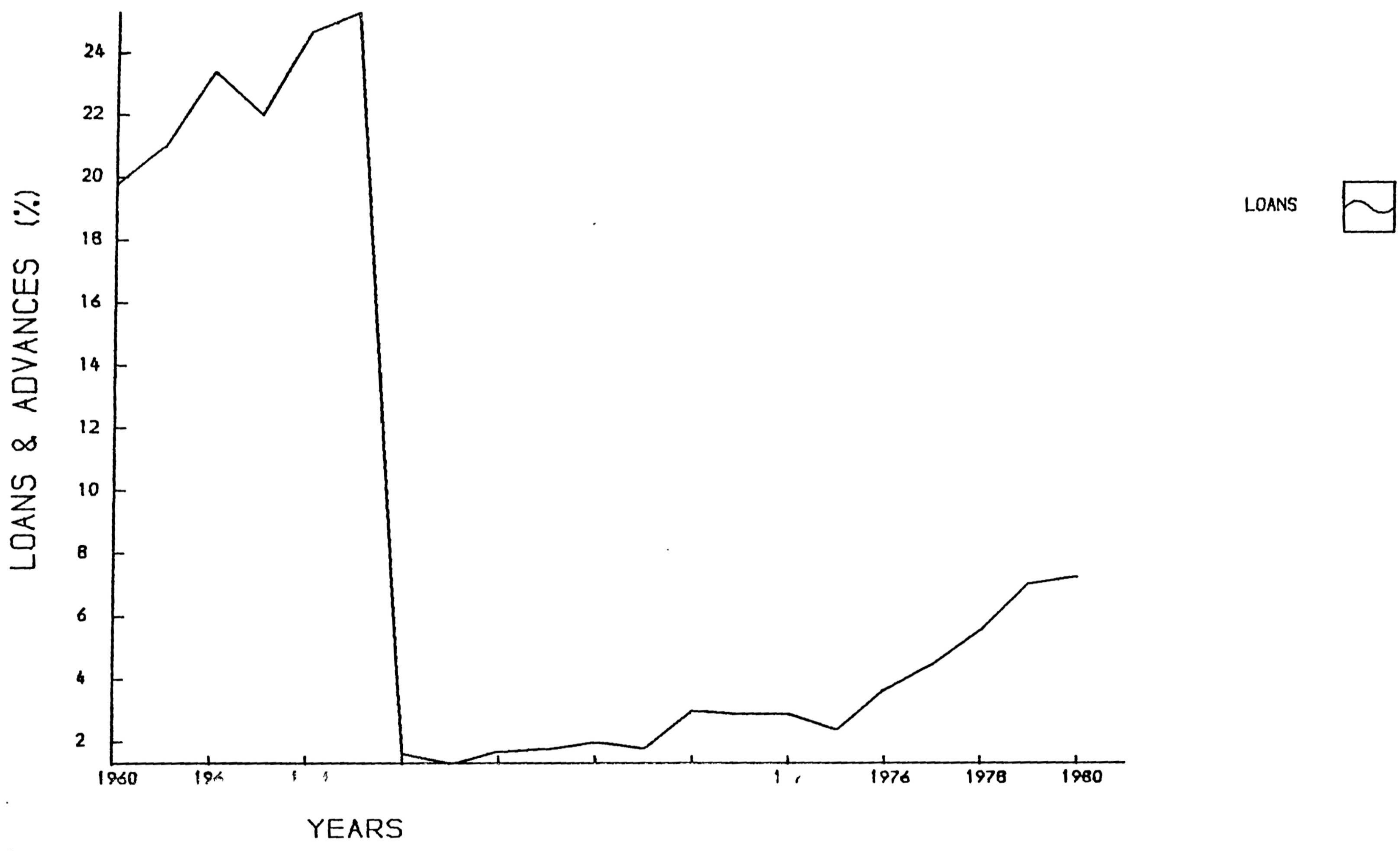


Table 7.1 shows the percentage distribution of the banking system's loans and advances among the sectors of the economy. It is shown that the banks' allocation of resources to the agricultural sector is unimpressive. The sector's share of loans and advances increased from 19.8 per cent in 1960 to 25.3 per cent in 1965. Thereafter there has been a declining trend. The share declined sharply from 25.3 per cent in 1965 to 1.6 per cent in 1966. The inevitable neglect of the vital sector by the banks and the Government during the war period 1966-1970 is clearly shown in the Table and Fig 7.1. The average annual allocation of banks' loans and advances for the period 1966-70 was 1.7 per cent. This neglect is understandable because the Government directed all the economy's resources to the successful prosecution of the war.

But the situation did not improve much after the war because the Government continued to neglect this sector because of the new found wealth in the crude oil exports which it erroneously thought to be a substitute for agricultural wealth and production; and also because of the "wealth illusion" or "false sense of opulence" of the economy up to 1975. The Third National Development Plan made efforts to put agriculture in its rightful priority position. Thus between 1971 and 1975; the proportion of the banking system's loans and advances allocated to this sector averaged annually 2.6 per cent. Within the period 1976-80 there was a slight improvement in the percentage share of credit to the sector. It rose from 3.8 per cent in 1976 to 7.3 per cent in 1980, registering average annual share of 5.7 per cent for the period 1976-80. For the entire period 1960-80 the average annual loans to the agricultural sector was 8.9 per cent, but for the period 1960-65 alone the recorded annual average share of banks' loans to the sector was 22.7 per cent. Thus if we contrast the average annual proportion of 22.7 per cent during 1960-65 with the average annual percentage share of 4.2 during 1971-80 one might concluded that the agricultural sector had been completely neglected in recent years as far as loans from banks are concerned. In this respect, therefore, the banking system has not performed its allocative role creditably. There is thus the need for changes in the banking system's credit policy.

In absolute value, however, the amount of loans and advances going to agriculture rose from 22.6 million naira in 1960 to 463.5 million naira in 1980, recording an average annual increase of 31.5 per cent. (See Table 7.2). Fig 7.1 and 7.2 show clearly the period of neglect of the sector as 1966-74. A significant increase in loans and advances to the sector occurred in the period 1975-80. However it is observed that most of the loans were commercial credits which were meant for the finance of purchases and exports of the Marketing Boards' controlled produce. Only a very small proportion of the loans were granted for direct agricultural production. The banking system was more interested in financing facility - the bill market scheme - introduced in 1962 to finance Marketing Boards exports. The facility broke down in 1967 when the commercial banks withdrew from the scheme as a result of the war which made such financing very risky. The bank's withdrawal from the scheme accounted for the drastic fall in the proportion of loans and advances to the agricultural sector during the war period. Since 1967, the financing function of the Marketing Board has been taken over by the Central Bank, and the non-availability of the scheme to the banks after the war was responsible for the inability of the banks to reach their 1965 level of proportion of loans and advances to the agricultural sector despite the present efforts being made by the Government to encourage and persuade the banks to lend more to this sector.

Table 7.2 Analysis of Commercial banks' loans and advances to the agricultural sector, 1960-80

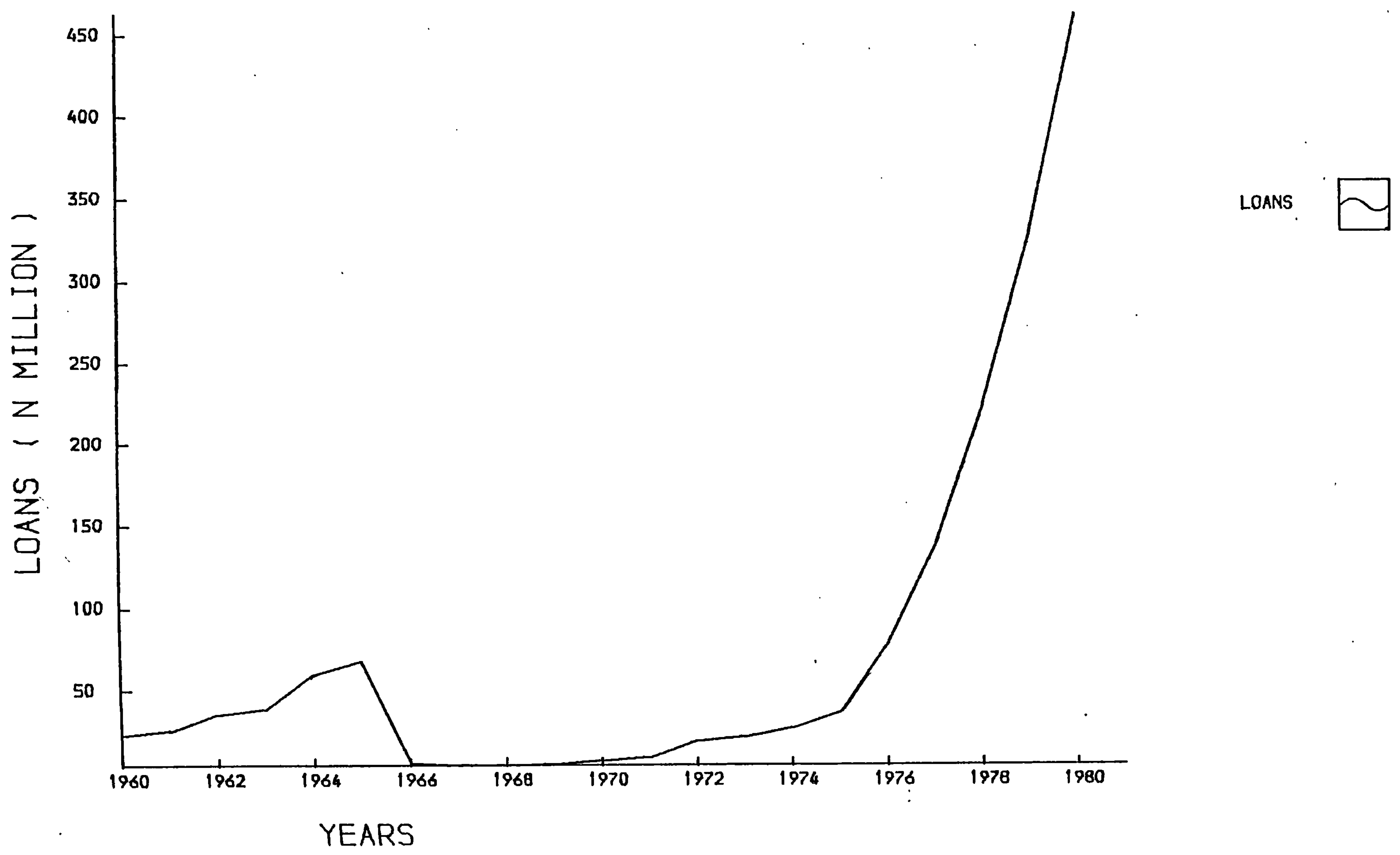
	(Million naira)		(Percentages)	
Year	Total loans and advances	Advances and loans to the agricultural sector	Loans and advances to agriculture as percentage of total loans and advances	Annual increase of loans to agricultural sector
1960	114.0	22.6	19.8	
1961	120.0	25.2	21.0	11.5
1962	154.1	36.1	23.4	43.3
1963	178.9	39.3	22.0	8.9
1964	244.8	60.4	24.7	53.7
1965	270.1	68.3	25.3	13.1
1966	298.1	4.8	1.6	-93.0
1967	275.0	3.7	1.3	-22.9
1968	225.7	3.8	1.7	2.7
1969	242.7	4.8	1.8	26.3
1970	351.4	7.0	2.0	45.8
1971	502.0	9.3	1.8	32.9
1972	619.5	19.2	3.0	106.9
1973	753.5	21.6	2.9	12.5
1974	938.1	27.2	2.9	25.9
1975	1,537.3	37.3	2.4	37.1
1976	2,177.9	79.6	3.7	113.4
1977	3,074.6	139.1	4.5	74.7
1978	4,109.7	224.0	5.6	61.0
1979	4,624.4	329.6	7.1	35.1
1980	6,349.0	463.5	7.3	40.6

Source : CBN i Economic and Financial Review - various years

ii Annual Report and Statement of Accounts, December 1980

iii Monthly Report, December 1981

FIG 7.2 BANKS' LOANS & ADVANCES TO AGRICULTURAL SECTOR 1960-80



The interest of the banks in financing the marketing end of the agricultural activities was because the CBN granted discounting facilities for the produce papers and therefore, the papers served as first class liquid assets for the banks. Thus, apart from being riskless they are short-term advances. The conclusion is that the banking system has shied away from financing the priority sector of agriculture because such financing is considered very risky. The Nigerian commercial banks can be qualified as greater risk avoiders than is socially desirable, and consequently there is the need for the intervention of the monetary authorities to direct the banks loans to the desired sectors. The dismal performance of the banking system in financing the agricultural sector is depicted in Fig 7.3. Not only has the proportion of loans to the sector been low, but the annual changes in the loans and advances have been fluctuating very much over the period 1961-80.

Nwankwo (1975), however, argued that although it appears that the amount of banks' lending going to agriculture declined drastically, both absolutely and in relation to other sectors, despite the fact that topmost priority is assigned to agricultural development in planning strategy, a close examination makes this less surprising. He contends that the decline is technical and statistical rather than real, because with effect from January 1966, loans for the finance of agricultural exports which hitherto had been included under agriculture were classified under general commerce. This explains further the sharp and drastic decline in loans and advances going to the sector from 1966.

In the manufacturing sector, on the other hand, the banking system's performance, although not impressive, has been better than in agricultural sector. As indicated in Table 7.3 the banking system's allocation of loans and advances to the manufacturing sector shows a long-run increasing trend. It increased from a modest level of 4.9 million naira in 1960, to 1,955.5 million naira in 1980 registering an average annual increase of 288.8 per cent within the period 1960-80. Fig 7.4 shows that the increase was not much in the period 1960-68 and rose moderately in the period 1970-72 before hitting the lowest level ever in 1973. Thereafter there was a tremendous increase in the period 1974-80. Table 7.3 also shows that the manufacturing sector's share of the banking system's loans and advances has been increasing over the period 1960-80. It rose from 4.3 per cent in 1960 to 23.8 per cent in 1971. It declined, however, to a very low proportion of 0.8 per cent in 1973 (See Fig 7.5), after which it assumed an increasing trend reaching 30.8 per cent in 1980. The significant decline in 1973 to 0.8 per cent can, perhaps be explained as a result of import liberalization of 1973. Before 1973 domestic industries were heavily protected through import restrictions. This created scarcity of durable and non-durable goods and the attendant inflationary pressures. As a consequence the Government was forced to dismantle the import restrictions in 1973. Consequently, there was a huge inflow of imported manufactured goods, leading to a fall in the demand for domestically produced goods. The implication was, therefore, an inevitable decline in productivity and consequently a decline in the need for borrowed fund from the banking system. The average annual proportion of loans and advances to the manufacturing sector for the entire period 1960-80 was 18.1 per cent compared with 8.9 per cent over the same period for the agricultural sector.

FIG 7.3 ANNUAL INCREASES OF LOANS TO AGRICULTURAL SECTOR 1960-80

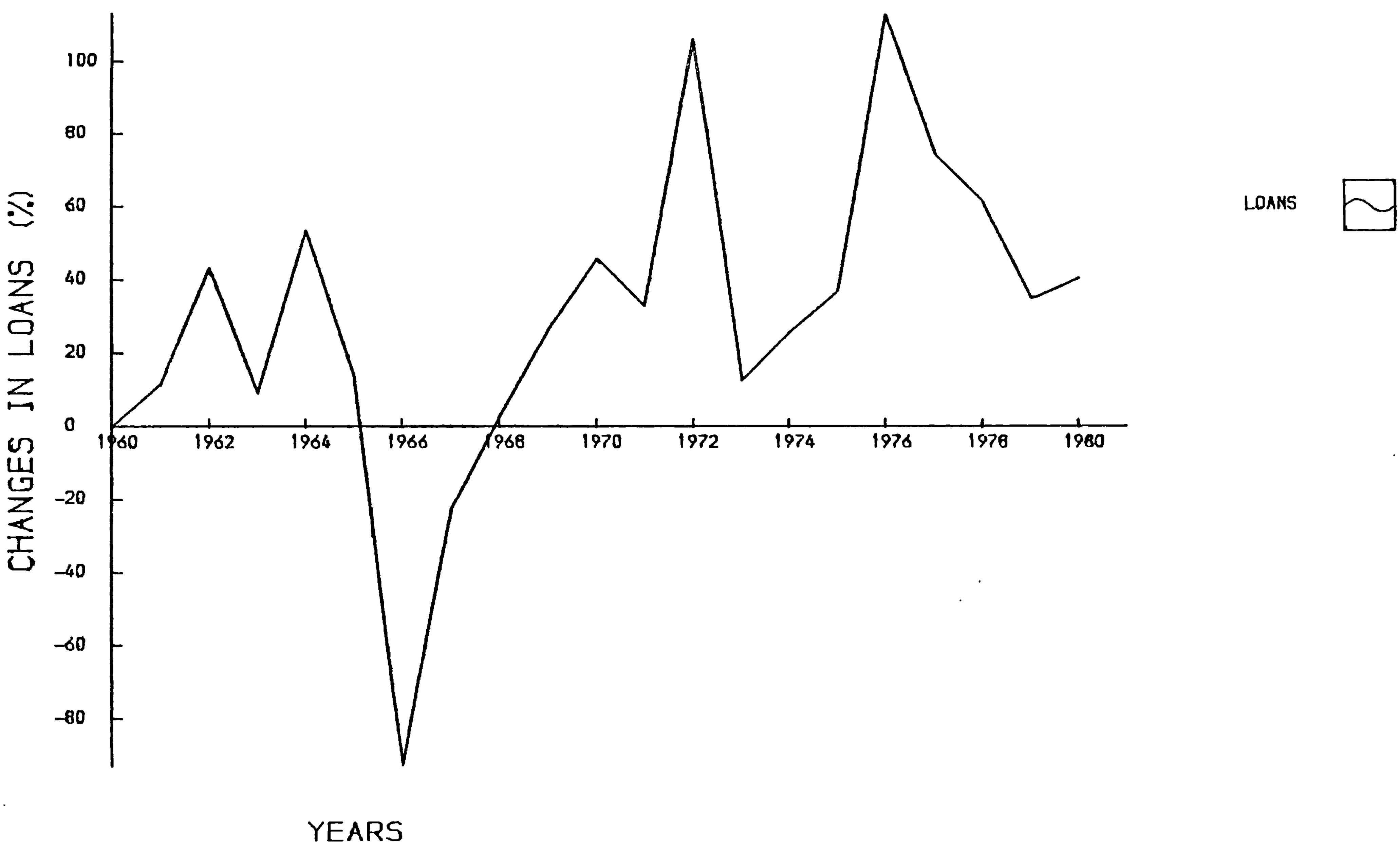


Table 7.3 **Analysis of Commercial banks' loans and advances to the manufacturing sector 1960-80**

Year	(Million naira) Total loans and advances	Advances and loans to the manufacturing sector	(Percentages) Loans and advances to manufacturing as percentage of total loans	Annual increase of loans to manufacturing sector
1960	114.0	4.9	4.3	
1961	120.0	6.6	5.5	34.7
1962	154.1	11.7	7.6	77.3
1963	178.9	19.1	10.6	63 2
1964	244.8	26.3	10.7	37.7
1965	270.1	29.0	10.7	10.3
1966	298.1	39.1	13.1	34.8
1967	275.0	39.6	14.4	1.3
1968	225.7	37.0	16.4	-6.6
1969	242.7	41.9	17.3	13.2
1970	351.4	76.4	21.8	82.3
1971	502.0	119.7	23.8	56.7
1972	619.5	144.0	23.2	20.3
1973	753.5	6.3	0.8	-95.6
1974	938.1	258.5	27.5	4,003.2
1975	1,537.3	410.7	26.7	58.9
1976	2,177.9	609.0	28.0	48.3
1977	3,074.6	837.8	27.2	37.6
1978	4,109.7	1,138.0	27.6	35.8
1979	4,624.4	1,357.3	29.4	19.3
1980	6,349.0	1,955.5	30.8	44.1

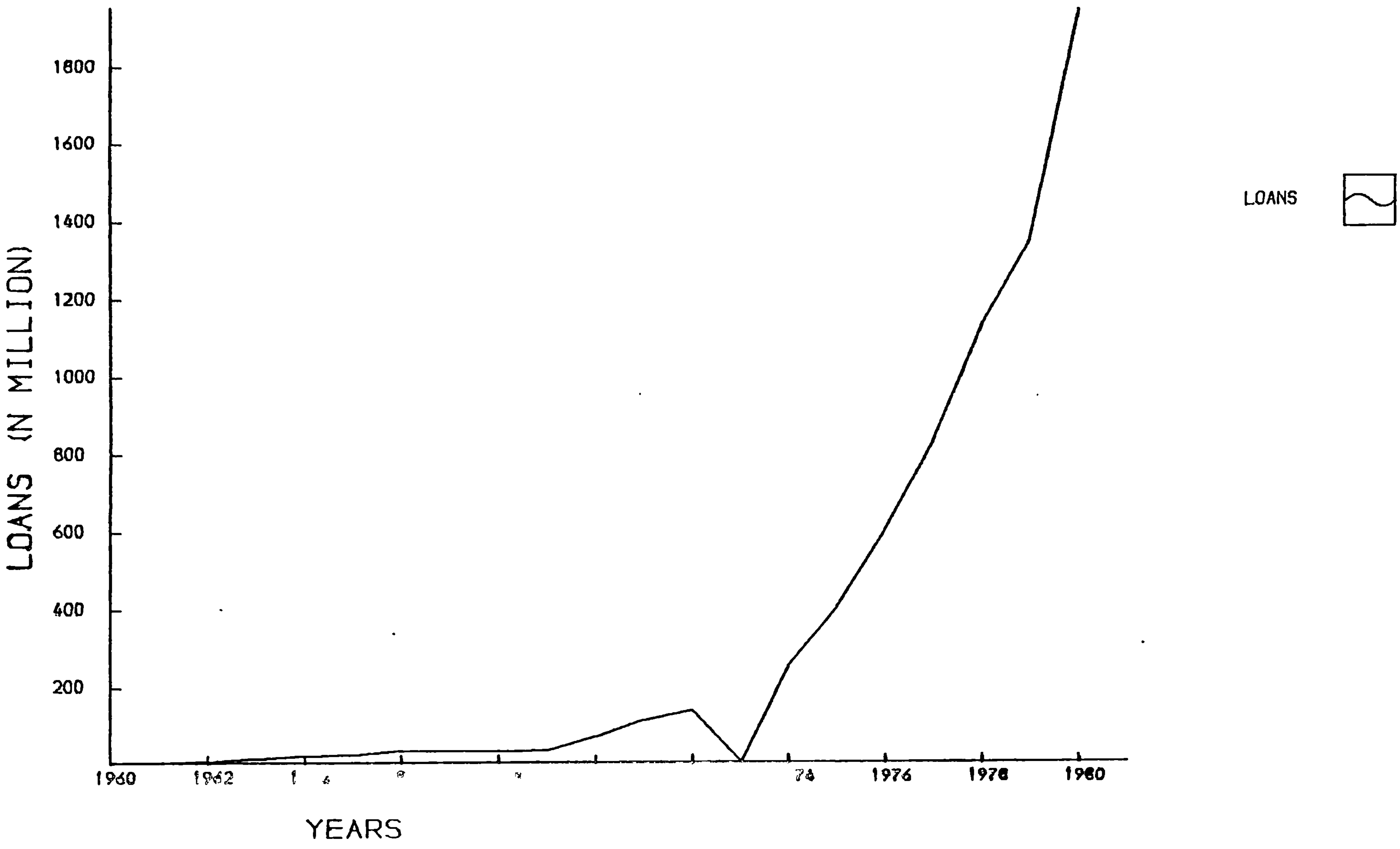
Sources : CBN i <u>Economic and Financial Review</u> - various years

ii <u>Annual Report and Statement of Accounts</u>, December 1980

iii <u>Monthly Report</u>, December 1981

An important feature observed from Table 7.1 is the relatively large proportion of loans and advances going to the general commerce sector, which is made up of loans to exports, imports and domestic trade. In 1966 and 1967, loans to this sector accounted for 61.6 per

FIG 7.4 BANKS LOANS & ADVANCES TO MANUFACTURING SECTOR 1960-80



cent and 60 per cent respectively of the total, and between the period 1960 and 1973, in no year was it below 34 per cent. The average annual share for the period 1960-73 was 44.4 per cent. The concentration of loans to the general commerce sector was due to the dominance of expatriate banks whose primary interest is to finance import and export trade in the country.

Although the proportion of loans and advances to the manufacturing sector has been increasing, it has grown rather slowly in proportion to the total loans granted annually by the banks (S e Table 7.3). In realisation of the unwillingness of the banks to grant more loans to these sectors and in keeping with the topmost priority accorded to production (agriculture, industry and services) the CBN in one of its controlling and supervisory functions has issued since 1969/70 fiscal year annual directives prescribing aggregate and sectoral distribution of bank loans and advances to the economy through the monetary policy circulars called Credit Guidelines. These guidelines have generally striven to steer credit away from the traditional, less productive, sectors of the economy such as general commerce and "others" to the more productive "preferred" sectors such as agriculture, manufacturing and services. Minimum allocations have always been specified for the more productive sectors and maximum allocations have been prescribed for less productive sectors. Thus the extent to which the banking system has performed its allocative role could be assessed by the degree of banks' compliance with the Central Bank's directives.

In the first three fiscal years spanning 1969/70 to 1971/72 as shown in Table 7.4, the monetary policy guidelines specified the desired percentage changes in the sectoral distribution of loans and advances to the economy. Because of the high inflationary pressures in the economy in these years, a ceiling on the expansion of credit was fixed at 10 per cent in 1969/70, raised to 20 per cent in 1970/71 and lowered again to 8.4 per cent in 1971/72. Within the overall ceiling, credit to the manufacturing sector was initially allowed to increase to annual rate of 30 per cent in 1969 then raised to 45 per cent in 1970 and brought down again to 30 per cent in 1971/72. Bank loans to the general commerce sector were to increase by a range of 5.1 to 10 per cent during the period, while those to services sector was permitted to increase initially by 11 per cent, then by 50 per cent because of the short fall in credit to this sector in 1970/71, but had to be reduced to 11.2 per cent in 1971/72. In contrast loans to the category "others" were to decline at annual rate of 10 per cent in 1969/70 to remain at the level it reached in fiscal year 1970/71 and again to decline by 33.6 per cent in 1971/72 relative to the level at the end of the preceding year.

In the succeeding four fiscal years March 1972 to April 1976, the guidelines restored the rationing of bank loans and advances designed as usual to give a favourable bias to directly productive sectors. Accordingly the production and services sectors were to obtain as minima 45 per cent and 11 per cent respectively of banks' aggregate loans and advances in 1972-74. These proportions were adjusted to 48 per cent and 10 per cent respectively in 1975/76. The less preferred sectors of general commerce and "others" were to receive maximum proportions of 30 per cent and 12 per cent respectively in 1972-74 with slight reduction to 10 per cent for "others" in 1975/76.

FIG 7.5 LOANS TO MANUFACTURING SECTOR AS % OF TOTAL LOANS 1960-80

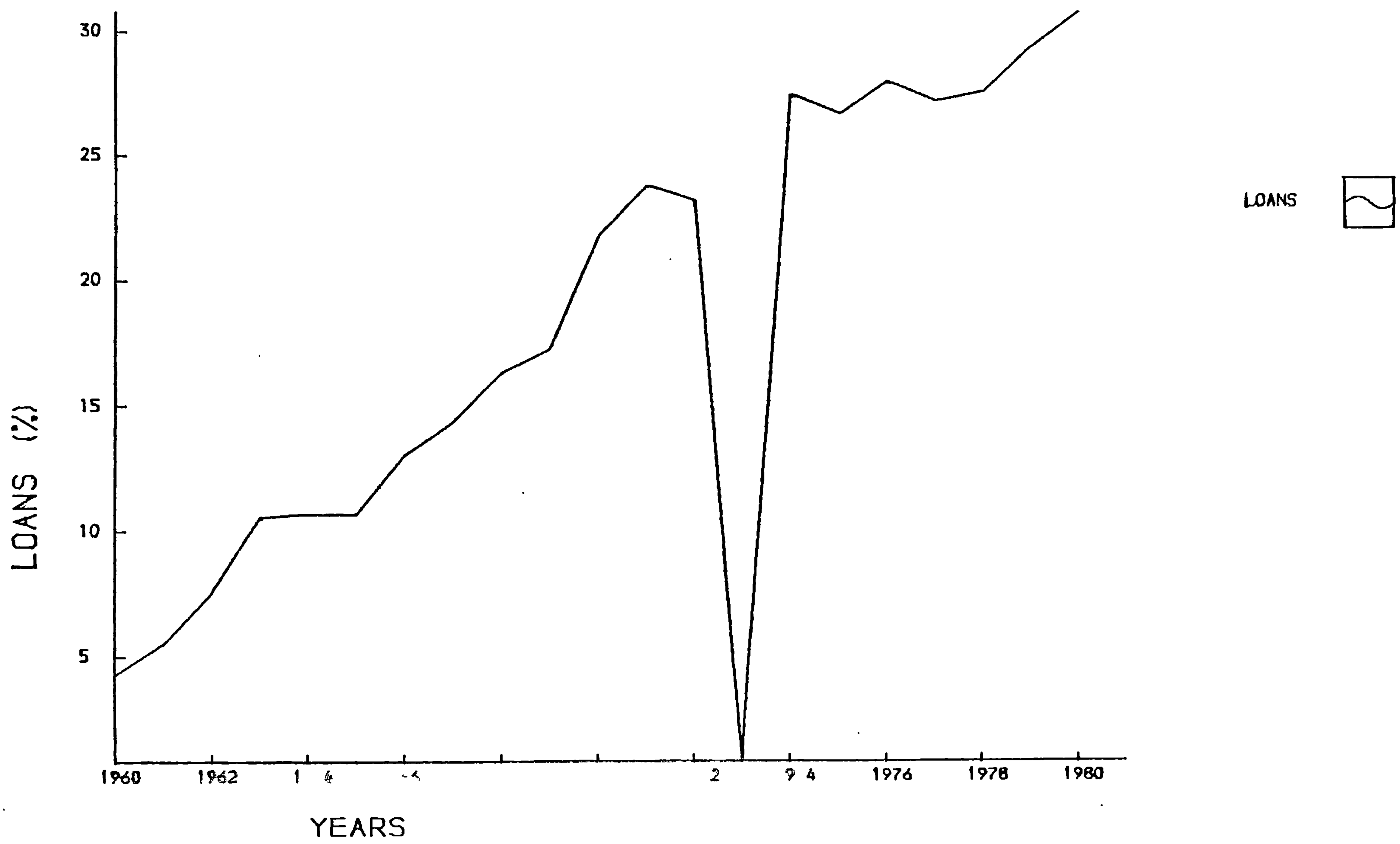


Table 7.4 Prescribed sectoral allocation of commercial banks loans and advances 1969-81

(Percentages)

Sector/subsector	** 1969/70	** 1970/71	** 1971/72	1972/73 1974/75	1975/76	1976/77 1977/78	1978/79	1979/80	1980/81
A Production	30.0	45.0	30.0	45.0	48.0	48.0	50.0	53.0	56.0
Agriculture	90.0	100.0	151.0	4.0	6.0	6.0	6.0	6.0	8.0
Mining and Quarrying	20.0	32.0	30.0	4.0	2.0	2.0	2.0	2.0	2.0
Manufacturing	35.0	48.0	25.0	30.0	30.0	30.0	32.0	36.0	36.0***
Real Estate and Construction	10.0	27.0	11.5	7.0	10.0	10.0	10.0*	9.0*	10.0*
B Services	11.0	50.0	11.2	11.0	10.0	10.0	10.0	11.0	12.0
Public Utilities	5.0	120.2	100.0	3.0	2.0	2.0	2.0	2.0	3.0
Transportation and communications	12.5	38.0	7.3	8.0	8.0	8.0	8.0	9.0	9.0

Notes :

* Subdivided into (i) residential (5 per cent), others (5 per cent) in 1978/79; (ii) residential (5 per cent), others (4 per cent) in 1979/80; (iii) residential (6 per cent), others (4 per cent) in 1980/81.

** Desired percentage changes were specified for these years.

*** Agro-Allied industries (3 per cent), other manufacturing (33 per cent).

Table 7.4 Prescribed sectoral allocation of com[illegible] l ba[illegible] 81 [illegible]nued)

(Percentages)

Sector/subsector	** 1969/70	** 1970/71	** 1971/72	1972/73 1974/75	1975/76	1976/77 1977/78	1978/79	1979/80	1980/81
C General Commerce	5.2	10.0	5.1	32.0	32.0	30.0	28.0	18.0	17.0
Bills Discounted	10.0	14.0	0.0	2.0	2.0	2.0	2.0	2.0	2.0
Domestic Trade	5.0	9.0	0.0	10.0	10.0	12.0	12.0	11.0	11.0
Exports	5.0	11.0	12.3	10.0	10.0	6.0	6.0	6.0	5.0
Imports	0.0	7.0	0.0	10.0	10.0	10.0	8.0	5.0	6.0
D "Others"	-10.0	0.0	-33.6	12.0	10.0	12.0	12.0	12.0	8.0
Credit and financial institutions	-14.0	0.0	0.0	1.0	3.0	3.0	3.0	3.0	1.0
Governments	-10.0	0.0	0.0	2.0	2.0	2.0	2.0	2.0	2.0
Personal and Professional	-5.0	0.0	-50.0	6.0	4.0	4.0	4.0	4.0	3.0
Miscellaneous	-10.0	0.0	-22.0	3.0	1.0	3.0	3.0	3.0	2.0
Total	10.0	20.0	8.4	100.0	100.0	100.0	100.0	100.0	100.0

Sources : CBN 1 Monthly Policy Circulars (CBN Credit Guidelines to all banks), 1969-80

2 Annual Report and Statement of Accounts, December 1980, p.63.

The sectoral distribution of loans and advances in the fiscal year 1976/77 to 1978/79 differed very little from one another and from the preceding years' guideline specifications. What was new in this period was the extension of this type of credit guidelines to the merchant banks and that the guidelines were less binding in the sense that the prescribed ratios could be exceeded provided the exce s was used to finance indigenisation programmes.

The monetary circular guidelines of 1979/80 and 1980/81, howev-r, called for significant structural changes in the distributi n of commercial banks' loans and advances. As Table 7.4 show tot minimum allocation of preferred sectors increased to 70 and 75 pe cent in 1979 and 1980 respectively. Other changes include the re-classification of the subsector of exports from the less preferred to the preferred sectors and the increase in the allocation to manufacturing and a deliberate split of the subsector allocation into agro-allied industries and "other manufacturing". Furthermore, in 1980, the minimum share of the agriculture subsector was raised from 6 to 8 per cent. A new subsector, Development Finance Institution was introduced into the preferred sectors and allocated the 3 per cent formerly allocated to Credit and Financial Institutions in the less preferred sectors. Bills discounted was removed as a subsector of general commerce since such financing could be classified into either imports or domestic trade. All these adjustments raised the total share of the preferred sectors from 70 per cent to 75 per cent and correspondingly reduced the less preferred sectors' share from 30 per cent to 25 per cent.

In addition to stipulating the sectoral allocation of loans, the guidelines also tackled the problem of inadequate credit to the Nigerians. Thus in 1971/72, the required minimum percentage of its total loans which each bank should give to indigenous persons was fixed at 35 per cent. It was also specified that in order to satisfy this requirement 'and to foster the end of expected Government policy that commercial activities gradually pass into the hands of indigenous persons, it will be necessary for banks to shift from expatriate to indigenous persons, their loans and advances for general commerce' (CBN, 1980). In the 1972-76 guidelines the minimum was raised to not less than 40 per cent and the Nigerian business was defined to mean those businesses that are owned 51-100 per cent by Nigerian persons. Indigenous borrowers were allocated 86 per cent of total banks' loans and advances in 1979. However, it was not considered necessary to raise the stipulated minimum in 1980 since following the virtual completion of indigenisation most business borrowers would be indigenous. But it was found necessary, for the purpose of stimulating industrial production, to raise the portion of indigenous borrowers' share of total bank loans that should be reserved for small-scale industries from 10 per cent out of a minimum of 70 per cent to 16 per cent. The re-distribution of the enhanced reserved share was raised on the basis of annual business turnover as follows:

		(Percentage) 1979	1980
A	Up to 25,000 naira	1.0	1.6
B	25,000-50,000 naira	1.0	1.6
C	50,000-100,000 naira	2.0	3.2
D	100,000-200,000 naira	2.5	4.0
E	200,000-500,000 naira	3.5	5.6
	Total	10.0	16.0

Having explained the CBN prescribed sectoral allocations of banks' loans as shown in Table 7.4 we can now examine the extent to which the banks have complied with the guidelines. This is shown in Table 7.5. A cursory look at Table 7.5 shows that there was no full compliance with the stipulated policy targets by the banks. Taking the production sector first, it is shown that the deviations from the policy targets were positive in the years 1970/71to 1971/72 and 1976/77 to 1980/81 while negative deviations were recorded in 1969/70 and 1972/73 to 1975/76. The negative deviation was most serious in 1969/70 when it was 18.5 per cent. While the positive deviations are desirable, it is necessary to investigate the sources of the positive performance. An examination of the subsectors indicates that the positive performance emanates from the real estate and construction subsector which has consistently been positive for all the years 1970-80. The only year in which it recorded a negative deviation was in 1969/70. It is further observed that within the real estate and construction subsector, a greater share of the loans went to the construction subset in which government contracts for the construction of roads, bridges, ports and other buildings dominated, and a very small percentage was allocated to private residential buildings.

This further emphasizes the banking system's preference for short-term less risky and so-called self-liquidating loans. The bulk of the loans to real estate and construction subsector are not only short-term but also guaranteed by the Government. This attitude of the banks prompted the CBN to specify, in 1978/79, that of the 10 per cent loans to the subsector half should go to residential buildings and of the 9 per cent in 1979/80, 5 per cent should be allocated to residential building; and in 1980/81 residential building was to receive 6 per cent out of the 10 per cent prescribed for real estate and the construction subsector.

It is also evident from Table 7.5 that the banking system has not complied even for one year with the prescribed policy target for agriculture. The negative deviation was as high as 85 per cent in 1971/72. Although there has been some improvement in recent years, the Table reveals the reluctance of the banking system to lend to agriculture and this substantiates our earlier observation that the Nigerian banks are greater risk avoiders than is necessary.

The banks' performance with respect to loans to the manufacturing subsector is not impressive either. There were negative deviations from the prescribed targets in the years 1969/70 when the deviation was 18.9 per cent and 1972/73 to 1980/81 with negative deviation as high as 6.6 per cent in 1979/80.

The non-compliance of the banks with the prescribed targets in the preferred sectors is again manifested in the services sector. Apart from 1970/71 and 1971/72 the banks' performance is very disappointing. It showed negative deviations in 1969/70 (of 10.1 per cent) and in the period 1972/73 to 1980/81. In 1980/81,the recorded 8.5 per cent share of the services sector was 3.5 percentage points below the prescribed minimum of 12 per cent.

It is encouraging, however, that with the guidelines less of the banks' loans and advances are being lent to general commerce even though there was no full compliance with prescribed targets. As would be expected, the negative deviations of the production and services sector were made up in the less preferred sector - "others". The sector recorded positive deviations over the entire period 1969-80.

Table 7.5 Deviations from prescribed targets of sectoral allocations of commercial banks' loans and advances 1969/70–80/81

(Percentages)

Sector/subsector	1969/ 70(1)	1970/ 71(2)	1971/ 72(3)	1972 /73	1973 /74	1974 /75	1975 /76	1976 /77	1977 /78	1978 /79	1979 /80	1980 /81
A(4) Production	-18.5	15.0	51.1	-7.6	-6.4	-1.7	-0.9	4.6	6.4	5.6	7.2	4.8
Agriculture	-74.3	-41.0	-85.5	-1.5	-0.9	-1.0	-3.4	-2.2	-1.5	-0.4	-0.9	-1.2
Mining and Quarrying	107.7	50.0	113.9	-2.2	-2.5	-2.7	-0.9	-1.3	-0.8	-1.0	-1.0	-1.1
Manufacturing	-18.9	19.0	70.6	-5.1	-5.7	-2.0	-1.4	-1.3	-2.8	-4.4	-6.6	-5.2
Real Estate and Construction	-14.9	13.0	29.4	1.2	2.7	4.0	4.8	9.4	11.5	11.4	12.7	13.0
B(4) Services	-10.1	14.0	62.8	-3.1	-3.1	-3.2	-3.1	-0.5	-0.9	-1.5	-3.6	-3.5
Public Utilities	-25.1	-134.0	125.8	-2.3	-2.6	-2.1	-0.8	-1.0	-0.5	-0.4	-1.8	-1.4
Transport and Communications	-5.5	40.0	72.1	-0.8	-0.5	-1.1	-2.3	0.5	-0.4	-1.1	-1.8	-2.0

Notes : (1) Deviations of monthly average up to May from target
(2) Deviations of monthly average up to March 1971 from target
(3) Deviations of monthly average up to March 1972 from target
(4) Production and services sectors are the preferred sectors

Table 7.5 Deviations from prescribed targets of sectoral allocations of commercial banks' loans and advances 1969/70-80/81 (continued)

(Percentages)

	Sector/subsector	1969/ 70(1)	1970/ 71(2)	1971/ 72(3)	1972 /73	1973 /74	1974 /75	1975 /76	1976 /77	1977 /78	1978 /79	1979 /80	1980 /81
C	General Commerce	-17.7	3.0	34.5	3.7	2.3	2.3	-4.0	-5.0	-6.8	-6.9	1.7	0.3
	Bills Discounted	-14.5	23.0	66.2	-0.8	-0.4	-0.1	0.0	-0.9	-1.2	-1.0	-0.6	-1.5
	Domestic Trade	-2.5	31.0	89.5	2.6	3.2	1.1	0.0	-2.1	-2.3	-2.0	-1.4	-0.7
	Exports	-32.9	-37.0	12.0	1.0	-0.1	-1.8	-3.0	-1.5	-2.7	-4.1	-3.3	-3.5
	Imports	-	63.0	21.4	0.3	-0.4	-1.5	-1.0	-0.5	-0.6	0.2	0.0	0.4
D	"Others"	17.0	31.0	81.1	7.0	7.2	7.2	8.0	0.9	1.3	2.8	4.7	3.9
	Credit and Financial Institutions	-36.6	-7.0	66.7	1.4	0.7	1.0	0.6	-0.6	0.1	0.6	0.8	1.5
	Governments	87.0	-36.0	70.4	-0.6	0.1	0.8	0.6	0.6	0.8	1.2	1.6	0.2
	Personal and Professional	59.3	89.0	-121.8	2.9	1.3	0.5	2.0	0.6	0.6	1.0	1.3	1.0
	Miscellaneous	16.0	25.0	-51.8	3.3	5.1	4.9	4.8	0.3	-0.2	0.0	0.1	1.1

Sources : 1 CBN i Economic and Financial Review - various years
ii Annual Report and Statement of Accounts, December 1980

2 Tables 7.1 and 7.4

3 Adewunmi, Oluwole. Loan Management in Nigerian Banks: A Study of Efficiency of Commercial Bank Lending Functions in a Developing Economy, (Unpublished Ph.D Thesis, 1980)

The allocation to this sector exceeded the prescribed maximum by as much as 17 per cent, 31 per cent and 81 per cent in the years 1969/70, 1970/71 and 1971/72 respectively. The average annual percentage by which the actual allocation of loans to "others" sector exceeded the prescribed maximum for the entire period 1969-80 was 14.3 per cent.

It is thus evident that the Nigerian banking system has not met adequately the financial needs of the economy from the development priority standpoint. It is true that the needs for credit can be assessed by actual demand, but in a developing country like Nigeria, the bankers do not have to determine the credit needs of the economy by simply sitting behind their desks waiting for potential borrowers to come in. As Crosse and Hempel (1980, p.210) observed, 'To know something about the credit market of a community, it is necessary to go outside the bank, in thought at least, and find out who is borrowing where'. In other words the bankers have to stimulate effective demand for credit in the economy.

7-4 THE TERM STRUCTURE OF BANK LOANS AND ADVANCES

To further evaluate the allocational efficiency of the Nigerian banking system, we examine the term "structure of bank loans and advances". This is revealed in the pattern of loan maturity structure and pattern of loan security of the banks. The analysis will show the suitability of the loans and advances to the borrowers' needs particularly to the priority sectors of the economy.

7-4.1 Maturity Pattern of Bank Loans and Advances

The maturity pattern of commercial banks' loans and advances in Nigeria can be divided into four categories:

1 those maturing within three months;

2 those maturing within six months;

3 those maturing within twelve months;

4 those maturing later than twelve months.

As observed by the CBN, 'During the 1963-68 period about two thirds of all advances granted by the commercial banks matured within three months. The predominance in commercial bank loan portfolios of loans maturing within three months is to be expected in view of the fact that commercial bank activities have been largely concentrated in financing trade' (Economic and Financial Review June 1969, p.5). This observation was corroborated by Ojo (1976) who showed that in 1972 about 50 per cent of all bank loans in Nigeria was made on call basis, more than 60 per cent within three months maturity and only about 1 per cent was of more than five years maturity.

As shown in Table 7.6 there has not been much change in the above observations in the maturity pattern of the banking system's loans and advances. For instance, from 1963 to 1975, 90 per cent, on the average, of banks' loans and advances were of less than one year maturity. The proportion of this kind of loans was 79.5 pr cent in 1979. Within the same period, 1963-75, 8.3 per cent of bank loans matured between 1 and 5 years, having on the average, only 1.5 per cent of the loans of over five years' maturity. The situation seemed to have improved in 1979 when 3.6 per cent of the loans were of over five years' maturity and 16.9 per cent had a maturity of between one and five years. The sharp drop in 1970 of the proportion of loans maturing after five years from the more or less constant level of 2 per cent to 0.7 per cent is quite disturbing.

Table 7.6 **Maturity pattern of Commercial banks' loans and advances 1963-79**

(Percentages)

Maturity Pattern	1963	1964	1965	1966	1967	1968	1969	1970	1971
Within 1 year	91.9	93.6	95.0	88.8	91.0	90.4	89.3	89.9	87.0
1-5 years	8.1	)	)	9.0	7.0	7.6	8.5	9 4	11.9
		) 6.4	) 5.0						
After 5 years	0.0	)	)	2.2	2.0	2.0	2.2	0.7	1.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Table 7.6 continued

(Percentages)

Maturity Pattern	1972	1973	1974	1975	1976	1977	1978	1979
Within 1 year	90.0	88.2	86.6	88.3	...	...	...	79.5
1-5 years	9.0	10.9	11.9	10.3	...	...	...	16.9
After 5 years	1.0	0.9	1.5	1.4	...	...	...	3.6
Total	100.0	100.0	100.0	100.0				100.0

Sources : 1 CBN Economic and Financial Review, June 1969

2 Ojo, Ade T and Adewumni, 'Wole (1982), Banking and Finance in Nigeria

The implication of this pattern of maturity of banks' loans and advances is that since the banking system concentrates on the shortest maturity loans, it can only make a disproportionately insignificant contribution in the medium- and long-term industrial and agricultural financing. With short-term loans and advances the banks can only meet the working capital needs of industries and probably the seasonal financial requirements of farmers. However, while this type of working capital is important to these sectors what is necessary for long-term planning and development for these sectors is "development capital", made up of loans and advances of sufficient duration. 'The restriction of bank lending to working capital requirements which is customary in, say, the United Kingdom would be perculiarly unfortunate in the light of the needs and nature of the industries struggling to establish themselves in underdeveloped territories where no long-term capital market exists' (Nevin, 1961, p.50).

Thus the strict adherence of the banks to the orthodox commercial loan or real bill doctrine of so call self-liquidating loans is unimpressive and discouraging. These canons may have been useful in nineteenth century Britain. Even then, without a certain degree of courageous lending British industrialists would have found it difficult fo find the necessary capital to develop. The reason usually offered by bankers for restrictinig their loans to short-term is the short-term nature of their deposits. But as the Radcliffe Report (para. 128) observed, 'individual balance go up and down, depositorscome and depositors go, but the total on current account goes on for ever' (See CLCB 1978, p.50). So although the banks must cater for a degree of day to day volatility, long experience enables them to assume that their deposit base as a whole will remain reasonably stable. Given this stability, an important percentage of the financial resources usually considered short-term can be used for long-term lending without endangering the liquidity of the banking system. More recent experience of post-war Germany and Japan shows clearly what contribution a dynamic banking system can make to real economic development. 'By going out of their way to explore other criteria for lending, by going beyond the so called canons, by venturing along with their customers, commercial banks in these countries helped to develop the level of entrepreneurship which we see in those countries today' (Frimpong-Ansah, 1971).

The process of "maturity transformation" - transforming short-term deposits to longer-term loans - is one of the useful functions of commercial banks. The banks usually contend that a great proportion of their loans granted are de facto medium- and long-term when account is taken of their more or less automatic renewal. This is true to a very limited extent because as Ojo (1976) noted, in a number of cases a renewal of existing loans has not been automatic, customers would first have to repay the loans at the expiration of each approved loan term before a new one is granted. The argument here is that banks should designate such proportion of their loans and advances as medium- and long-term. The designation is important because it will not only eliminate the problem of the customer having to borrow at highter costs elsewhere to repay previous loans in order to be granted another loan but also will enable the borrower to undertake long-term investment planning for the application of the proceeds of the loan.

7-4.2 Pattern of Loan Security

'A realistic collateral policy should serve to improve creditworthiness enough to enable bank management to make economically desirable loans and should not be used to restrict credit' (Crosse and Hempel, 1980, p.222). Nigerian experience has been one where the collateral policy of the commercial banks has not been realistic in the sense that the policy does not take into account the social and economic environment perculiar to the economy in which the banks operate. The security and collateral policy of the Nigerian banking system is entirely alien to the Nigerian economy and this is why the collateral securities the indigenous borrowers have available are not acceptable to the banks and the type of securities demanded by the banks are not available to a greater proportion of Nigerians. The use of such collaterals as title to goods, negotiable securities and life insurance policies is foreign to the Nigerian economy and these are available to a small percentage of the population, who may not actually need them in order to borrow from the banks since such people can invariably use their "names" alone as an acceptable security.

There is thus a good measure of bias against one segment of the population and sector of the economy by banks in the allocation of their loans and advances as a result of the type of security demanded by the banks. As Atenaga observed, '... even when the business comes there is hardly any project evaluation, most decisions being made on the basis of who is behind the project. The files of projects with Government backing, no matter how little, are not even evaluated, just passed along and so limited funds are generally always diverted more to unprofitable schemes to the detriment of the economy' (Business Times, 20 July 1981, p.24).

Broadly considered loans and advances granted by the Nigerian banking system can be grouped into three categories:

1 Secured against real estate;

2 Unsecured; and

3 Otherwise secured.

The last group includes those secured by bills of lading or other documents of title to goods, negotiable securities, guarantees, life assurance policies, liens e.t.c. (CBN Economic and Financial Review, 1969, p.8). An examination of Table 7.7 indicates that commercial banks prefer to have their loans and advances made against "otherwise secured" security. The proportion of banks loans granted against this type of security was 51.9 per cent in 1975 and, in no year between 1964 and 1975 (for the years which data were available) was the proportion less than 40 per cent, and the average annual percentage for the period was 46.7 per cent. As we noted earlier the securities against which these loans were made are those that are not within the reach of many Nigerian borrowers. Most farmers and small-scale industrialists do not possess such negotiable securities, life insurance policies and other documents of title to goods. The implication, therefore, is that credit expansion is restricted to only some few privileged individuals, while a large proportion of the nation's savings lie idle in the banks, with banks maintaining liquidity ratios of over 60 per cent. For instance in 1970, 1972, 1974 and 1975 the liquidity ratios of the banking system were as high as 89.5 per cent, 58 per cent, 65.4 per cent and 56.4 per cent respectively. At the same time, a considerable amount of genuine demands for credit were being turned away for reasons of lack of adequate security.

Table 7.7 **Security pattern of commercial banks' loans and advances 1963-1979**

(Percentages)

Type of Security	1963	1964	1965	1966	1967	1967	1969	1970	1971
1 Secured against plant equipment and other real estate	29.3	24.4	22.3	27.0	25.5	27.5	...	...	...
2 Otherwise secured	34.1	40.7	45.0	43.3	48.3	47.9	...	...	...
3 Unsecured	36.6	34.9	32.7	29.7	26.1	24.6	...	...	..
Total	100	100	100	100	1000	100			

Table 7.7 continued

(Percentages)

Type of Security	1972	1973	1974	1975	1976	1977	1978	1979
1 Secured against plant, equipment and other real estate	31.1	30.9	28.5	28.0	...	...	...	40.2
2 Otherwise secured	45.2	47.3	49.7	51.9	...	...	...	48.1
3 Unsecured	23.7	21.8	21.8	20.1	...	...	...	11.7
Total	100	100	100	100				100

Sources : 1 CBN Economic and Financial Review, June 1969

2 Ojo, Ade T and Adewumni, 'Wole (1982), Banking and Finance in Nigeria

The next type of loans preferred by the banks are loans unsecured. The average annual share of loans and advances granted under this condition was 27.2 per cent in 1963-75 period. This proportion declined significantly in 1979 to 11.7 per cent. It should be noted, however, that even though this type of loans is tagged unsecured, a large percentage of them are in real sense more secured than those shown as secured.

> The unsecured (loans) are usually temporary out-of-pocket loans ... granted to customers of undoubted financial strength and to salary earners in the middle and top income groups, whose monthly salaries are paid regularly into the banks (from which any temporary accommodation given would be liquidated). This explains to some extent why about 90 per cent of all bank loans maturing within three months were granted by non-indigenous banks. Apart from their being mainly for consumption and less productive purposes, loans in the "unsecured" category are usually granted in small amounts than those shown as secured, and in many cases they might be too small to be of much economic significance to the borrowers (Ojo, 1976, p.39).

As Table 7.7 shows the least preferred type of loans by the banks are loans secured against plants and equipment and other real estate. The average annual proportion of bank loans granted against this type of securities is 27.5 per cent in the period 1963-75. The figure is higher than those of unsecured loans because of the increase in the acceptance of real estate as collateral security by the bank in recent times as a result of indigenisation of the banking system. The proportion was 40.2 per cent in 1979.

Table 7.8 Comparative analysis of the pattern f [illegible] between expatriate and indigenous commercial banks 1963–68

(Percentages)

Year	Secured against plant equipment and other real estate		Otherwise secured		Unsecured	
	Expatriate banks	Indigenous banks	Expatriate banks	Indigenous banks	Expatriate banks	Indigenous banks
1963	19.1	57.0	35.9	29.2	45.0	13.8
1964	14.0	54.9	44.0	31.0	42.0	14.1
1965	10.4	56.2	48.4	34.9	41.2	8.9
1966	15.7	57.2	49.0	28.0	35.3	14.8
1967	15.1	56.3	53.1	33.9	31.8	9.8
1968	17.8	54.0	52.3	35.5	29.9	10.5
Average	15.4	55.9	47.1	32.1	37.5	12.0

Source : CBN Economic and Financial Review, June 1969.

The type of security available to Nigerians is real estate, particularly landed property, but unfortunately this is the type of security least preferred by the banks particularly by foreign banks. For instance before the indigenisation of the banking system, foreign banks gave a large proportion of their loans against "otherwise secured", while the indigenous banks granted a small proportion of their loans against the same type of securities in the corresponding period. As Table 7.8 shows, in the period 1963-68, for which data were available the expatriate banks gave, on the average, 47.1 per cent of their loans against this form of securities while the indigenous banks correspondingly advanced only 32.1 per cent of their loans against the same form of securities. In contrast, under loans secured against real estate, the indigenous banks, on the average, granted 55.9 per cent of their loans and advances while the foreign banks gave only 15.4 per cent of their loans against real estate.

Under unsecured loans, the expatriate banks gave 37.5 per cent of their loans and advances to their customers, as against only 12 per cent granted by the indigenous banks. As pointed out earlier, this is because the expatriate banks have more of this group of borrowers whose monthly salaries are regularly paid into their accounts with the banks, with the result that such loans are in actual fact secured. It is clear that the expatriate banks following the "traditional banking principles" prefer negotiable securities and other instruments of title to goods without taking 'account of the particularism of the domestic situation in moulding banking canon' (Nwankwo, 1975, p.92)

7-5 AGRICULTURAL CREDIT GUARANTEE SCHEME

In the realisation of the problems posed by the paucity of the flow of credit to the agricultural sector and because of the ineffectiveness of credit guidelines to stimulate adequate flow of funds to the priority sectors and also the need to underwrite the often feared credit risks, and finally to minimise the problem of lack of adequate collateral securities, the Federal Government set up an Agricultural Credit Guarantee Scheme Fund. The law establishing the Fund was promulgated in March 1977. The Scheme involved an authorised capital of 100 million naira which was subscribed to by the Federa Government and the CBN in the proportion of 60 per cent to 40 perce respectively.

Through the scheme, loans granted to farmers by commercial banks and merchant banks are guaranteed up to 75 per cent by the Federal Government and the CBN. The maximum loan that could be guaranteed to an individual farmer is 50,000 naira and in case of co-operative societies and other corporate bodies it is 1.0 million naira. To avoid the misuse of the funds made available under the Scheme, the Schedule to the Act defines agricultural purposes in respect of which loans can be guaranteed by the Fund as those connected with the establishment or management of plantations for the production of rubber, oil palm and similar crops, the cultivation of cereal crops, animal husbandry including cattle rearing and poultry and fish farming. In addition the Act provides that where such loans are to be used to purchase livestock, machinery or farming equipment, the loan should not be paid directly to the borrower, but to the supplier of the desired farming equipment, who is required to furnish the bank with document as evidence of the items needed. It is an offence under the Act to apply the loan for purposes other than the ones for which it was granted.

The security which may be offered to a bank for the purpose of any loan made under the scheme includes any or a combination of the following: a charge on land or on movable property of the borrower, a life assurance policy, stocks and shares and a personal guarantee. The interest rate chargeable by banks on credit facilities provided under the Scheme will be prescribed from time to time by the Federal Commissioner for finance. At present, the rate chargeable on loans to institutions which on-lend to others is 4 per cent per annum, and in all other cases 6 per cent per annum.

The performance of the Scheme and the banks is shown in Table 7.9. Between 3 April 1978 when the Scheme came into operation and December 1980, a total of 2,339 agricultural loans amounting to 74.6 million naira were guaranteed by the Fund. In the first year of its operation a total of 341 loans valued 11.3 million were guaranteed, and in 1979, the total number of loans guaranteed rose to 1,105 amounting to 33.6 million naira; the number and value of loans guaranteed in 1980 were 893 and 29.7 million naira respectively.

Inspite of the fact that this scheme reduces the risk burden on commercial banks, the banking system has not shown interest in advancing loans to the agricultural sector. It was reported that some banks claimed that they were not sufficiently liquid to lend to agriculture and also gave the credit restraint of the CBN as a rather lame excuse for not granting loans to farmers under the scheme. Under the above pretex viable agricultural proposals have been turned down (Adegite 1978). In view of this the CBN has directed all banks to lend to agriculture over and above the 6 per cent prescribed under the sectoral allocation guidelines. Investigation has shown that the banks never met the 6 per cent prescribed sectoral allocations in the 1978-80 period and therefore did not perform well under the scheme.

Table 7.9 Loans granted by the Agricultural Credit Guarantee Scheme Fund 1978-80

State	Number of Loans 1978[1]	1979	1980	Amount ('000 naira) 1978	1979	1980
Anambra	16	50	44	247.4	1,283.1	1,126.1
Bauchi	15	132	190	1,271.2	1,543.3	1,327.9
Bendel	18	96	46	558.2	6,701.3	2,132.0
Benue	3	5	5	290.5	140.5	63.0
Borno	12	21	7	178.4	739.2	39.0
Cross River	13	13	27	483.5	288.8	556.0
Gongola	-	15	15	-	501.5	436.8
Imo	26	88	52	605.3	1,704.4	993.6
Kaduna	77	170	158	985.6	3,185.6	1,412.0
Kano	22	229	84	627.8	3,138.6	2,994.9
Kwara	44	38	24	2,043.1	814.8	1,082.1
Lagos	5	16	24	300.0	3,203.1	3,510.8
Niger	3	12	31	83.0	202.6	334.2
Ogun	15	22	20	772.8	2,291.0	3,037.6
Ondo	1	14	15	25.0	358.9	1,850.5
Oyo	22	84	59	1,013.6	3,976.9	5,244.3
Plateau	8	41	27	688.7	854.3	1,238.1
Rivers	16	18	19	434.6	2,036.0	1,789.7
Sokoto	25	41	46	675.7	633.0	416.4
Total	341	1,105	893	11,284.4	33,596.7	29,685.2

Source : CBN <u>Annual Report and Statement of Accounts</u>, December 1979, and 1980.

Note 1 : Started in April

7-6 CONCLUSIONS

Although, generally, loans and advances by the banking system to the economy have increased, it is obvious that they have been inadequate both in terms of overall volume and in their sectoral distribution. The banks by concentrating a greater proportion of their loans on general commerce and insisting on "adequate" collateral securities are biased against a particular sector - agriculture - and segment of population. This undesirable operational policy of the banks has necessitated the direct intervention of the monetary authorities to correct the sectoral distortions in loan allocations.

Consequently guidelines on the allocations of bank loans have continued to be issued each financial year since 1969/70 with emphasis on more credit in favour of the priority sectors of production and services. The guidelines have favourable impact in directing more loans to the priority sectors than would have been possible. However, it is clear that commercial banks have consistently resisted financing the agricultural sector. Contrary to the guidelines' specifications, the proportion of loans to "non-productive" less preferred sectors has continued to increase. Particularly disturbing is the continued proportional increase of loans allocated to the "others" sector. The banking system has not, therefore, performed efficiently its allocational functions because the banks are greater risk avoiders than is socially desirable which as a consequence has led them to operate an undesirable collateral security policy that restricts credit.

An important observation in the guidelines is that the distinction in the breakdown of the sectors and the application of strictly numerical criteria for assessing the performance of the banks leave a lot of room for misjudgement of the credit needs of the economy. For instance, it is extremely difficult to distinguish between general commerce (domestic trade) and agriculture (or trade in agricultural products). Besides, that the increasing volumes of loans are going to, say, the manufacturing sector (rising from 4.5 per cent in 1960 to 21.8 per cent in 1970 and 30.8 per cent in 1980) does not distinguish between varying needs in the manufacturing sector.

It is our view that there is need for a finer breakdown of the sectors and the level of loans and advances allocated to them A beginning was made by separating residential and other construction in the real estate and construction subsector in 1975 and the remov of bills discounted as a subsector of general commerce in 1980, but hi did not go far enough.

Our observation corroborates Okigbo's (1981) suggestion that the CBN's policy should, for instance, break agriculture into a finer group to separate direct production finance from indirect financing. Processing should be separated from direct production and from food procurement. The industrial aspect of agriculture, while important for stimulating raw materials production, stands apart from agricultural production proper. Furthermore, in industry which is an omnibus category, there is a great difference in the credit needs of large and medium-scale industries on the one hand, and small-scale industries on the other. Each of these categories requires a different orientation in terms of credit policy. These observations apply to the other sectors and subsectors.

Finally, the banking system's restriction of its loans and advances to the shortest maturity advances has been criticised by many scholars (Nwankwo 1975, Diaku 1972, Ojo 1976) to name but a few, because the banks are disposed to lend on medium- and long-term basis. The banks should reconsider their archaic traditional commercial loan policy and engage not only in more maturity transformation but develop a dynamic demand for their loans in all sectors particularly in the priority sectors of the economy by helping their customers to work out sound projects 'and help them with credit supported by useful suggestions to grow' (Frimpong-Ansah 1971).

The Nigerian banking system should not regard Government directives on its loan operations as punitive measures because Government directives are aimed at overall development of the economy, and therefore, banks' compliance with the directives will, both in the short-run and long-run, enhance banks' profitability. An observation y Stammer (1972) of Hong Kong experience should serve a good lesson to the Nigerian banking system and the monetary authorities. Stammer observes:

> The availability of commercial banks' loans and advances virtually from the start of industrialization - often to relatively untried businesses against little security - has contributed to the rapid success of industrial development. The Hong Kong commercial banks have to some degree accepted risks which elsewhere are the responsibility of equity investors. Their liberal lending policy is more surprising when one considers that a large part of deposits is owed to foreigners and banks are not supported by official rediscount facilities (p.324-25).

CHAPTER EIGHT

THE ROLE OF COMMERCIAL BANKS IN FINANCING THE NIGERIAN PUBLIC SECTOR

8-1 INTRODUCTION

The last chapter examined the allocative efficiency of the banking system with respect to the private sector of the economy. In the present chapter we are interested in further exploring the role of the banking system in financing the public sector of the Nigerian economy.

Today the goal of accelerated economic development through comprehensive development plans is widely accepted throughout the developing countries. Development planning has become particularly popular in the developing countries because it is regarded as the best strategy of utilizing their available scarce resources, transforming their economies, and of narrowing the development gap between them and the advanced industrial countries. Unfortunately, however, there is never enough Government resources or public savings defined as the excess of current revenue over current expenditure to finance the Government part of the development plans. As a consequence, resort is increasingly being made to other sources of funds such as borrowing domestically (and abroad).

In Nigeria the need to raise substantial sums of funds domestically to finance the various development programmes since 1960 has meant that the Government has had to depend very much on the financial institutions particularly the banking system. The Government in implementing the various development programmes has thus borrowed substantially from the banking system and we are, therefore, interested in examining how the banks have responded to the public sector needs for financial resources to finance the development plans.

The present chapter is divided into four sections. The next section examines the size and the role of the public sector. Section three discusses the composition, size and growth of the national public debt. Section four analyses the ownership of the public debt. The last section is the conclusion.

8-2 THE SIZE AND ROLE OF THE PUBLIC SECTOR

The public sector in Nigeria can be defined to embrace the thre tiers of the Government, Federal, State and Local - as well as the parastatal institutions and enterprises. There are important links between the various arms, and in particular the Federal Government accepts the responsibility, to a great extent, of financing the other parts of the sector.

It has been observed that the size of the public sector in Nigeria has been expanding with the boundary between the public sector and the private sector receding over the years. As Uzoaga and Okafor (1975) observed, the increasing bureaucratization of economic life has made it difficult to draw a watertight line that separates the real private sector from the operational public sector in Nigeria. This is because no particular economic activity is reserved exclusively for the play of private initiative. Furthermore, Ejiofor and Okafor (1980) noted that the Udoji Report 'emphasised the increased bureaucratization of economic life'.

> Today the public services of Nigeria are involved in affairs that were beyond the immagination of our civil servants 15 years ago. We are now selling insurance and minting coins, we are sailing ships and refining oil ... we are banking and

> building. Tomorrow, we shall be forging steel and educating every young Nigerian through his primary years (Udoji Report: Public Service Review Commission, para. 419, 1975).

The increasing importance both in size and structure of the public sector in recent years is the outcome of certain economic and political developments in the country since 1960. (See Chapter Two). Some of these changes include the fact that the mid-1960s witnessed the emergence of new development patterns. Since 1960 Nigeria embraced systematic economic planning as as instrument for effect ve management of the economy and thus has formulated four and execut d three comprehensive development plans. These are:

1 The Six-Year Development Plan, 1962-68.

2 The Second National Development Plan, 1970-74.

3 The Third National Development Plan, 1975-80.

4 The Fourth National Development Plan, 1981-85.

Implementing these plans involves stupendous investment expenditures not only on improvement of infrastructures but, in view of the absence or lethargy of the private sector enterprises, on the development of the superstructure as well. For instance, the 1962-68 Plan and the 1970-74 Plan involved capital expenditure of 2.2 billion naira and 3.0 billion naira respectively while the Third National Development Plan involved capital expenditure of 30.0 billion naira. The Fourth and current plan envisages capital expenditure of 82.0 billion naira. The Governments of the Federation have had to finance a large part of the Development Plans. Over the three plan periods the share of the public sector in the total investment programmes has shown a consistent increase. It increased from 1,073 million naira or

39.9 per cent of the total investment in the plan period 1962-68 to 2,237 million naira or 41.6 per cent of the total investment in 1970-74 plan period. By 1980 the share of the public sector to total investment in 1975-80 plan period was 20 billion naira or 66.7 per cent (See Table 8.1). The increase is due to the emphasis being placed on investment in economic services especially in transport, mining and manufacturing sectors as well as Government Commitment to indigenise the economy through direct public participation in various economic activities.

In addition, national defence requirements which before 1960 were very small have grown tremendously both in size and complexity thus absorbing a substantial proportion of the national product. Next, there was the creation of 12 states in 1967 and a further restructuring of the country into 19 states with 20 Governments in 1976, as well as the carving out of many more local governments in the country. These increased the size of the public sector, and being the dominant segment of the sector, the Federal Government was saddled with heavier responsibility of being the main source of finance to the states and local governments.

As Okigbo (1981) contended, the role of the public sector goes far beyond the financial sector, it is the prime mover of economic activity because of its tremendous size and the proportion of output for which it is directly responsible. Between 1960 and 1977 Government expenditure on consumption (excluding defence expenditure) and investment accounted for a rising proportion of total expenditure on product. It increased from about 10 per cent in 1960 to nearly 27 per cent in 1976 and 45.2 per cent in 1977. Government expenditure on investment had by 1973, overtaken private sector investment and by 1977 stood at more than twice the relative value of private sector investment.

Table 8.1 **Share of public and private sectors in total investment programme 1962-80**

	(Million naira)			(Percentages)	
Plan Periods	Total Investment	Actual Public sector	Actual Private sector	Public sector's share of total investment	Private sector share of total investment
1962-68	2,200	1,073	1,612	39.9	60.1
1970-74	5,300	2,237	3,100	41.6	58.4
1975-80*	30,000	20,000	10,000	66.7	33.3

Sources : 1 Olaseni Akintola-Bello (1977) Capital Budgeting Decisions in Nigerian Public Enterprises (PhD Thesis University of Wales).

2 Federal Republic of Nigeria
i The Second National Development Plan, 1970-74
ii The Third National Development Plan, 1975-80

Note * : This is the effective public capital programme obtained by setting out inter-governmental transfers and assumed under-spending from the nominal programme of 33 billion naira. The 10 billion naira for the private sector is obtained by assuming underspending of 20 per cent.

The contribution of the public sector to GDP is shown in Table 8.2. The contribution of the sector shows a marked increasing trend since 1962 relative to the private sector. In 1962, only 9.2 per cent of the GDP was directly contributed by the public sector but by 1974 it was 39 per cent and declined to 36 per cent in 1978. The private sector's contribution, on the other hand, has declined from 90.9 per cent in 1962 to 61.9 per cent in 1974 and by 1978 it increased slightly to 64 per cent. Table 8.3 explains further the relative roles of the private sector and public sector in accounting for investment expenditure of the economy. The contribution of the public sector rose from 35.7 per cent in 1965 to 61.5 per cent in 1974 and reached 68.3 per cent in 1977, but it declined to 57.9 per cent in 1978. The private sector's share of the investment fell from 64.3 per cent in 1965 to 38.5 per cent in 1974, and further to 32.5 per cent and 31.7 per cent in 1976 and 1977 respectively before moving up to 42.1 per cent in 1978. The increased investment by the public sector is a consequence of increased public sector acceptance of an obligation of general economic health of the country which has led the Government to intervene generally and specifically in the organisation of industry and agriculture. In Nigeria many basic industries are publicly owned. This is partly because of the desire to avoid a private monopoly in circumstances where economies of scale dictate a small number of concerns and to ensure proper balance between social and commercial objectives, and partly because of the need to rescue industries which are economically important from foreign domination (e.g. banks). Moreover, the ingrained habit, in most developing countries of looking up to the Government to provide, is a plausible explanation of increasing trend of public sector spending.

Table 8.2 **Public sector contribution to GDP 1962-1978**

(Percentages)

	1962	1965	1974	1976	1977	1978
Public sector	9.2	9.2	39.0	38.0	36.7	36.0
Private sector	90.9	87.9	61.9	61.7	63.3	64.0

Source : Okigbo PNC (1981) Nigerian Financial System : Structure and Growth

Table 8.3 **Gross Investment by public and private sectors 1962-78**

(Percentages)

	1962	1965	1974	1976	1977	1978
Public sector	40.4	35.7	61.5	67.5	68.3	57.9
Private sector	59.6	64.3	38.5	32.5	31.7	42.1

Source : Okigbo PNC (1981) Nigerian Financial System : Structure and Growth

A look at Table 8.4 shows that the Federal Government expenditure increased from 163.9 million naira in 1961 to 19,811.4 million naira in 1980 recording about 120 times the 1961 level, an average annual increase of 30 per cent. Fig 8.1 shows that the growth of government expenditure became remarkable since 1972. As is clear from the Table, since 1970 the Federal Government became a major source of revenue for the states. Expenditures on transfers consist of Federal Government statutory appropriations to states as well as loans and grants to state Governments. This form of expenditure forms a substantial proportion of Federal Government expenditure on current account. Transfers on capital account are much smaller than on current account. In aggregate, the expenditure on transfers grew from 15.6 per cent in 1961 to 52 per cent in 1971 and to 57.3 per cent in 1973 before it started a downward trend to 43 per cent in 1978. In 1979 it was 25 per cent.

It is also seen that the growth of the public sector is related to increases in the wealth of the country. While the Government expenditure grew at an average annual rate of 30 per cent, total output (GDP) rose from 6.9 per cent in 1961 to 15.4 per cent in 1971 and to 40.5 per cent in 1975. It declined marginally in 1976 to 38.1 per cent before rising to 42.9 per cent in 1978. It was 39.2 per cent in 1980.

One conclusion emerging from this analysis is that, as a whole, the growth of the public sector is due to increases in the resources available to the Government during the period. This implies that the demand for public goods and services especially in developing countries is highly income elastic. This is understandable in most developing countries where considerable expenditure is needed to ease some of the social and economic infrastructure problems which constitute great constraints on economic growth and development (Akintola-Bello, 1977).

The relevant question to our study, however, is how these expenditures have been financed over time. There are three main sources of finance open to the Government: budget surplus or public savings, internal loans and grants and external loans and grants.

FIG 8.1 GROWTH OF FEDERAL GOVERNMENT EXPENDITURE 1961 - 80

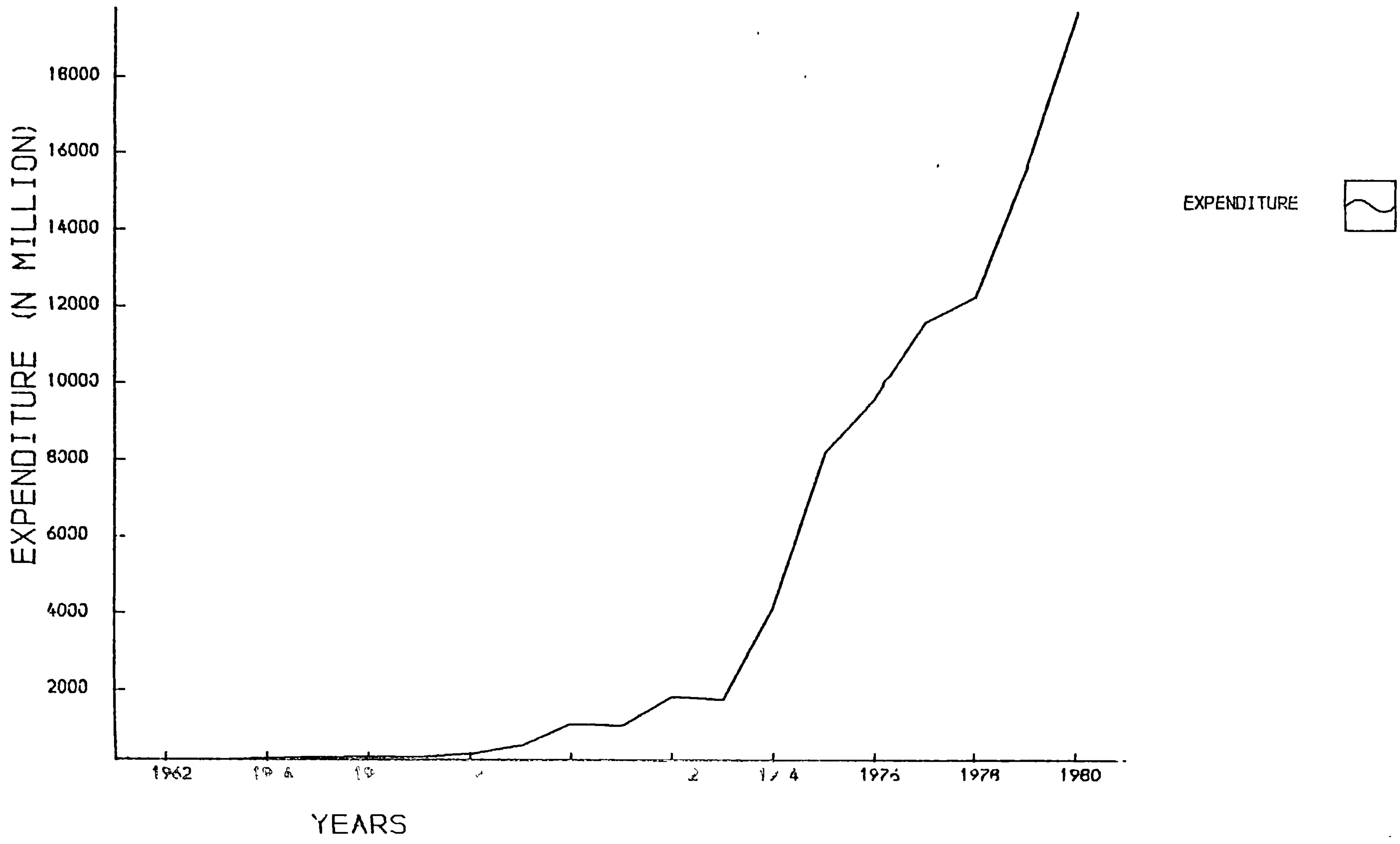


Table 8.4 Current and capital expenditures o tr F d

Year	Current Expenditure (Million naira): Expenditure on goods and services	Current Expenditure: Transfer payments	Current Expenditure: Total current expenditure	Capital Expenditure: Expenditure on goods and services	Capital Expenditure: Transfer payments	Capital Expenditure: Total capital expenditure	Grand total expenditure	GDP at current prices	(Percentages) Transfer payment as per cent of total expenditure	Total expenditure as per cent of GDP
1961	77.1	19.7	96.8	61.2	5.9	67.1	163.9	2,378	15.6	6.9
1962	75.6	28.0	103.6	60.4	3.5	63.9	167.5	2,516	18.2	6.7
1963	78.9	40.8	119.6	62.4	1.5	63.9	83.6	2,946	23.0	6.2
1964	110.9	31.7	142.6	74.8	0.9	75.7	218.3	3,145	14.9	6.9
1965	119.0	37.9	156.9	76.1	3.5	79.6	236.5	3,361	17.9	7.0
1966	122.1	55.2	177.3	74.0	3.9	77.9	255.2	3,614	23.2	7.1
1967(1)	113.9	52.9	166.8	91.2	0.1	91.3	258.1	2,950	20.5	8.7
1968	158.8	59.9	218.7	117.3	13.8	131.1	349.8	2,878	21.1	12.2
1969	207.8	225.6	433.4	89.3	33.5	122.8	556.2	3,851	46.6	14.4
1970	499.5	409.6	909.1	191.6	29.3	220.9	1,130.0	5,621	38.8	20.1

Sources : CBN i Economic and Financial Review - various years
ii Annual Report and Statement of Accounts, December 1980

Table 8.4 **Current and capital expenditures**

Year	(Million naira)								(Percentages)	
	Current Expenditure			Capital Expenditure						
	Expenditure on goods and services	Transfer payments	Total current expenditure	Expenditure on goods and services	Transfer payments	Total capital expenditure	Grand total expenditure	GDP at current prices	Transfer payment as per cent of total expenditure	Total expenditure as per cent of GDP
1971	390.2	528.4	918.6	134.6	39.2	173.8	1,092.4	7,098	52.0	15.4
1972	574.0	838.4	1,412.4	283.7	167.6	451.3	1,863.7	7,703	54.0	24.2
1973	537.8	675.3	1,213.1	423.7	142.0	565.7	1,778.8	9,001	45.9	19.8
1974	724.7	1,986.2	2,710.9	1,092.5	456.9	1,549.4	4,260.3	16,962	57.3	25.1
1975	1,474.7	3,265.4	4,740.1	2,989.9	528.3	3,518.2	8,258.3	20,405	45.9	40.5
1976	1,786.6	3,673.0	5,459.6	3,926.5	315.4	4,241.9	9,701.5	25,449	41.1	38.1
1977	1,600.6	4,652.4	6,253.0	4,962.9	479.4	5,442.3	11,695.3	28,015	43.9	41.7
1978	1,995.4	5,144.7	7,140.1	5,030.6	166.4	5,197.0	12,337.1	28,737	43.0	42.9
1979(2)	2,900.0	3,127.2	6,027.2	8,907.6	815.4	9,723.0	15,750.2	40,333	25.0	39.1
1980(2)	10,431.4	1,389.5	11,820.9	7,454.1	536.4	7,990.5	19,811.4	50,599	9.7	39.2

Notes : (1) The current expenditure excludes statutory appropriations to Regions

(2) Figures are from estimates and not actual expenditure and 1980 was for 9 months

In the 1960s public savings were negative. For instance, during the six year period 1965-70 Government budget registered deficits of almost ten-fold increase, rising from 48 million naira to 465.6 million naira (Olaloku, 1975, p.141). By 1972, as a result of oil revenue, the budgetary deficits had been wiped out and by 1974 public saving had become the main contributor to Government expenditure. However, the public savings have never been enough for needed Government expenditure. The general picture thus still remained that of revenue lagging behind expenditure, and the revenue gap has even been widening in recent years with the enormous increase in defence expenditure in relation to which no statistics are available. By way of comparison, Adler (1964) has given the unweighted average of the ratio of revenue to the GNP for all low-income countries as 14.7 per ent while the corresponding average ratio of expenditure to the GNP is 16.1 per cent leaving an average gap of 1.4 per cent of the average GNP to be recovered by borrowing. (See Obinna 1973). The Federal Government has resorted to internal borrowing and external loans to augument the public savings. We are interested in the domestic sources of financing the public expenditures to see how the banking system and particularly the commercial banks, have contributed to such financing. This method of financing the public sector has given rise to the public debt.

8-3 THE COMPOSITION, SIZE AND GROWTH OF THE NIGERIAN PUBLIC DEBT

8-3.1 Composition of the Public Debt

The Nigerian public debt may be classified between funded or floating and unfunded debt. The funded debt usually refers to the public debt incurred through the sale of Government paper or financial instruments such as the issue of Treasury bills, Treasury certificates or other loans like Development Stocks issued through the markets and the "Ways and means Advances", given by the CBN. The unfunded debt, on the other hand, generally consists of those loans which are redeemable at a definite date with or without an option for repayment at an earlier date. Such debt is made up of liabilities that are incurred without the market e.g. deposits in the savings banks, provident fund and similar mobilization of funds.

The other method of classification is to group the de t instruments according to maturity structure. The distinction is drawn between short-term, medium-term and long-term liabilities. The short-term instruments are generally Treasury bills and "ways and means advances" and those not exceeding one year. While those debt nstruments exceeding one year but not exceeding five years are medium-term; and long-term debts are those debt instruments exceeding five years. The interest rates on these liabilities also represent time dimension. Accordingly we classify the Nigerian public debt as shown in Table 8.5.

The table shows that the Nigerian domestic debt consists largely of debts raised through the issue of Treasury bills, Treasury certificates, National reconstruction and development savings certificates (NRDSC), National savings certificates and premium bonds and Development stocks. Treasury bills are traditionally short-term loans issued for only sixty or ninety days. The issue rate of interest has varied from 3.5 per cent to 5 per cent. Treasury certificates which were introduced in December 1978 are of two types;

one maturing within one year and carries a slightly lower interest rate while the other has a life of two years and carries a rate of interest slightly higher.

National savings certificates and premium bonds were medium-term instruments with a maturity of five years. They were introduced in 1962 as a means of encouraging small savers to invest directly and voluntarily in Government debt. Consequently the savings schemes were channelled through the post office. With the distribution of post offices covering the whole country penetrating into the rural areas, opportunity was afforded to a substantial percentage of Nigerians to participate in the scheme. The savings certificates carried an average of 5 per cent simple interest per annum while the yield on premium bonds was earned in form of prize of winnings in quarterly lottery draws with the total prize being not more that 5 per cent per annum on accumulated investment. This meant that the holder of premium bonds who was unlucky not to win in any of the draws throughout the life of his bond simply had his bond redeemed at par on maturity (Adewumni, 1974, p.57). Both savings certificates and premium bonds are no longer in use.

The long-term public debt instruments comprise the national reconstruction and development savings certificates (NRDSC), the Federation of Nigeria development stocks and some bilateral loans. The NRDSC is a direct mandatory borrowing scheme by the Federal Government introduced in 1968 to help mobilize funds for both the successful prosecution of the civil war and to finance the post-war reconstruction programme of the 1970s. The contribution was based on the level of income of each individual. Each contributor's share was 5 per cent of taxable income or one naira per annum in case of flat rate tax payers. The contribution earned an annual interest rate of 3 per cent. The loans were meant initially to be redeemed by 1977 but the Government decided in 1972 to redeem most of the loans.

The Development stocks were one of the earliest group of debt instruments used by the Government to mobilize funds for financing public sector expenditures. They were first used in 1946 and have been issued since then. They are currently the most important long-term debt instrument at the disposal of the Government. Development stocks are not redeemable until maturity but can be sold before maturity subject to market conditions. The maturity structure of the stocks ranges from five to twenty-five years and the interest rate structure ranges from 5 per cent to 6 per cent depending on the maturity of the stocks. The longer the life of the stock the higher the interest rate.

Table 8.5 Structure of public debt instruments in Nigeria

Type of Instrument		(Years) Maturity	(Percentage) Interest Rate Structure
A	Short-Term:		
	1 Treasury bills	1/4	5.0
B	Medium-Term:		
	1 Treasury certificates	1-2	5.5
	2 Savings certificates*	5	5.0
	3 Premium bonds*	5	Prize
C	Long-Term:		
	1 NRDSC*	9	3
	2 Development stocks	5-25	5-6
	3 Bilateral loans	15-40	-

Source : CBN Annual Report and Statement of Accounts - various years

Notes : * Has been phased out

Finally the other long-term debt is the one incurred through bilateral loans. This was popular in the 1950s when there were no formal impersonal borrowing instruments. It is usually a direct negotiation leading to a contractual agreement between the Government as a borrower and an individual organisation as a lender. For instance, most of such loans were raised from the marketing board and the University of Ibadan. The amount of loans raised by the Federal Government through each of the various instruments is shown in Table 8.6.

The Table shows that throughout the period 1960-80 Treasury bills, development stocks and bilateral loan schemes constituted the major Government debt instruments. By 1968, however, Treasury certificates were introduced and it has since become an important Government debt instrument for medium-term loans. The amount of loans raised through the Treasury bills rose from 22 million naira in 1960 to 2,119 million naira in 1980. In terms of proportion of total loans, it declined from 42 percent in 1960 to 25.8 per cent in 1980. The decline was accounted for by the introduction of Treasury certificates in 1968. The loans raised through the Treasury certificates increased from 20 million naira in 1968 to 3,027.6 million naira in 1980 thus rising from 3.9 per cent of total domestic debt in 1960 to 36.8 per cent in 1980. There was a decline in the value of Treasury certificates' contributions to the domestic debt in 1975 due to the suspension of the new issues of the certificates in April 1975; this was, however, resumed in 1976 and that accounted for the tremendous increase from 219 million naira in 1975 to 652 million naira in 1976. Bilateral loans' contribution has declined drastically from 24.9 million naira in 1960 to 14.8 million naira in 1970 and to

1.4 million naira in 1980. It is gradually being phased out. In recent years, the major source of this type of loan has been the Marketing Board. The contribution of the development stocks has shown as increasing trend throughout the period. It rose from 5.3 million naira or 10.2 per cent of total domestic debt in 1960 to 3,069 million naira or 37.3 per cent of total internal debt in 1980.

It is necessary to point out that up to 1977 only the Federal Government could borrow from the public. The state Governments could arrange financing by banks and other financial institutions by private placement of their paper. However, the Committee on the Nigerian Financial System in their report recommended (and it was accepted by the Government) that the right to raise funds in the Nigerian capital market through public issue and sale of Government papers should be extended to the state and local governments. The Report states:

> Each state can be allowed free access to the capital market to issue and redeem its own bonds subject to nationally fixed specifications and conditions (para. 7.31, p.102)
>
> Local Governments whose areas of jurisdiction cover Nigeria's major urban centres (e.g. the Federal and State capitals) should be allowed to publically issue project-tied bonds guaranteed by the Government funds in those areas where the pressure on Local Government finances are highest. Also, Local Governments would be exposed to the financial discipline generated by public flotation. (para. 7.39, p.103).

Although these recommendations have been accepted by the Government, only one state - Bendel - has been courageous enough to take up the opportunity. Bendel state in 1978, issued 20 million naira, 7 per cent, First Bendel State of Nigeria Development Stock maturing in 1988. So far the experiment has been successful.

Table 8.6 Internal public debt of the Federal Government

(Million naira)

Year	(Short-term debts) Treasury bills	Ways and means and advances	(Medium-term debts) Treasury certificates	Savings bonds and certificates	NRDSC	(Long-term debts) Bilateral loans	Development stocks	Total
1960	22.0	-	-	-	-	24.9	5.3	52.2
1961	34.0	-	-	-	-	23.9	24.7	82.6
1962	50.5	-	-	0.02	-	22.9	38.7	112.12
1963	60.9	-	-	1.9	-	23.4	68.7	154.9
1964	68.0	-	-	0.2	-	24.4	107.9	200.5
1965	80.0	-	-	0.3	-	22.8	137.9	241.0
1966	128.0	-	-	0.4	-	20.2	161.9	310.5
1967	168.0	-	-	0.4	-	17.6	197.9	383.9
1968	240.0	-	20.0	0.2	6.9	16.0	233.9	517.0
1969	340.0	-	142.0	0.2	9.9	14.8	262.7	769.6

Sources : CBN i <u>Annual Report and Statement of Accounts</u> - various years

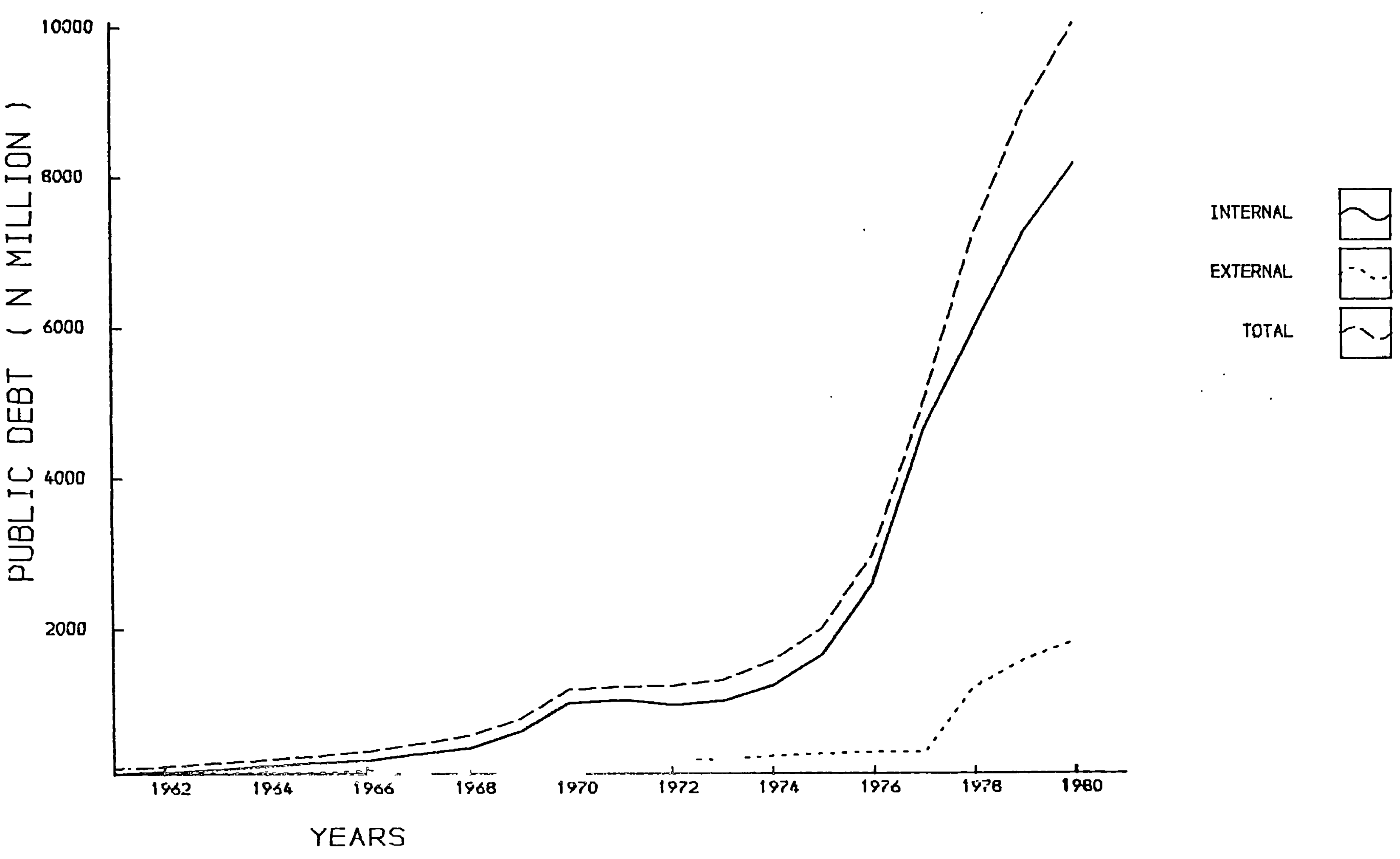
ii <u>Economic and Financial Review</u> - various years

Table 8.6 Internal public debt of the Federal Government (continued)

(Million naira)

Year	(Short-term debts) Treasury bills	Ways and means and advances	(Medium-term debts) Treasury certificates	Savings bonds and certificates	NRDSC	(Long-term debts) Bilateral loans	Development stocks	Total
1970	480.0	52.8	236.0	0.1	10.5	14.8	300.7	1,094.9
1971	526.2	-	210.4	-	11.8	13.2	356.7	1,118.3
1972	369.4	-	207.9	-	11.9	1.5	410.8	1,001.5
1973	401.9	-	262.4	-	2.5	1.5	392.9	1,061.2
1974	616.0	-	268.6	-	2.7	1.5	377.8	1,266.6
1975	616.0	-	219.0	-	2.0	1.4	840.5	1,678.9
1976	616.0	-	652.0	-	1.7	1.4	1,358.9	2,630.0
1977	691.0	1,226.2	900.0	-	1.7	1.4	1,815.7	4,636.0
1978	816.0	1,166.4	1,800.0	-	1.4	1.6	2,197.7	5,983.1
1979	2,119.0	65.4	2,310.0	-	1.5	1.4	2,785.0	7,282.3
1980	2,119.0	-	3,027.6	-	1.5	1.4	3,069.0	8,218.5

FIG 8.2 GROWTH OF THE NIGERIAN PUBLIC DEBT 1961 - 80



8-3.2 The Size and Growth of the Nigerian Public Debt

Table 8.7 is an attempt to measure the size and the growth of the Nigerian public debt in the period 1961-80. It is shown that in 1961, the total Nigerian public debt (internal and external) was 141.6 million naira and it increased over 71 times to 10,085 million naira in 1980, thus registering an annual average growth of 26.2 per cent over the period 1961-80. The growth rate was highest in the periods 1976-80, with an average annual growth of 39.1 per cent, and in th period 1966-70 with a recorded average annual increase of 30.6 per cent. The reason for the high growth rate of public debt in 1976-8 was the decline in the revenue from crude oil exports (as a result unfavourable demand in the world crude oil market) which has becom ince 1970, the most important determinant of the flow of funds into the public sector. To make up for the decline in the revenue, th Federal Government stepped up its domestic borrowing. Similarly the high growth rate in the period 1966-70 was owing to increased war-time financial needs of the Government. With the end of the war in 1970, he proportion started to decline from 48.2 per cent in 1970 to as low as 3.1 per cent, 0.9 per cent and 5.9 per cent in 1971, 1972 and 1973 repsectively. The average annual growth rate during the period 1971-75 was 11.3 per cent. Another important reason for the decline in public debt during the period was that the end of the war coincided with the emergence of the crude oil export earnings as a major revenue source for the public sector. As observed by the Committee of the Nigerian Financial System (1976):

> From the mid-1960s to the end of the civil war, the Government borrowed increasingly from the financial system. But the situation changed dramatically since the early 1970s. Frombeing a net debtor to the financial system, Government became a net creditor. Not only was the

Government reluctant to increase its level of Treasury bill borrowing, it actually decided in 1975/76 to phase out Treasury certificates and even discouraged the purchase of Treasury bills by reducing its interest rate from 4 to 2 per cent (CNFS, para. 7.05, p.95).

Fig 8.2 shows the long run growth trend of the Nigerian public debt and depicts that the public debt consists mainly of internal debt.

The Nigerian public debt is again classified between internal and external debt in Table 8.7. An examination of the Table shows that while internal debt was rising steadily over the period 1961-80, external debt as a proportion of the total was declining. For instance, in 1961 the proportions of internal and external debt were almost equal being 50.8 per cent and 49.2 per cent respectively. In 1964 the percentage of internal debt had risen to 70.2 per cent as against 29.8 per cent for external debt. External debt was 14.4 per cent in 1970 as against 85.6 per cent of total debt for internal debt. After recording a low level of 7.3 per cent in 1977, external debt rose to 18.5 per cent of the total in 1980. The proportion of internal debt was consequently highest in 1977 with a share of 92.7 per cent.

It could be seen, therefore, that the growth of the Nigerian public debt over the period under discussion was explained largely by the growth of internal debt. The reason for this is attributable to Government deliberate policy to rely on domestic sources of funds to finance its development programmes because of the failure to realise the expected foreign resources in the various development plans. This is why the Second National Development Plan 1970-74 stated explicitly:

> The changing pattern of the world economy and the increasing concentration of the world's economic and political power poses a great challenge for Africa which Nigeria cannot ignore. Nigeria will therefore quicken its

> pace of development through the use of her own resources instead of relying unduly on external aid. This is the only way for an inspiring nation like Nigeria to develop at a rapid rate and in the right direction. (p.33).

Besides, external debts unlike internal debts which are loans repayable in local currency and from that point of view represert a transfer payment, are owed to non-residents and to that extent have to be paid for from the foreign exchange resources of the country. Since they have to be paid for by some part of exports of the country, they consequently represent real limitation of the consumption possibility of the residents. There is thus the need to restrict external debt to the barest minimum.

We attempted to measure the size of the public debt in relation to the GDP which as Okigbo (1981) argued indicates the capacity of the economy to bear the burden of wiping out public debt. A further examination of Table 8.7 shows that the ratio of public debt to the GDP was increasing between 1961 and 1970. It was 6 per cent in1961 and rose steadily to 10.8 per cent in 1966 and to 21.6 per cent in 1970. This means that the capacity of the economy to bear the burden of paying off the debt has continued to decline. The reason that can be offered for this situation is that the period 1961-70 represents a period of political and economic instability in the country culminating in the 1967-70 civil war with increased borrowing by the Government to finance the (unproductive) war. The situation improved significantly since 1970 with the decline in the ratio of public debt to the GDP from 21.6 per cent to 9.9 per cent in 1975. Two factors account for the decline: the increased government earnings from the crude oil exports and the high rate of inflation in the economy. It rose to 25.2 per cent in 1978 before falling to 19.9 per cent in 1980.

Table 8.7 The size and growth of the Nigerian public debt 1961-1980

Year	Internal debt	External debt	Total debt	GDP at current prices	Exports
	(Million naira)				
1961	72.0	69.6	141.6	2,378	347.0
1962	98.8	85.9	184.7	2,516	334.2
1963	134.8	92.3	227.1	2,946	378.6
1964	192.4	81.5	273.9	3,145	429.2
1965	232.4	93.1	325.5	3,361	536.1
1966	263.2	126.1	389.3	3,614	568.2
1967	346.8	140.5	487.3	2,950	483.6
1968	426.0	170.6	596.6	2,878	422.2
1969	648.4	171.7	820.1	3,851	636.4
1970	1,040.0	175.4	1,215.4	5,621	885.4
1971	1,074.8	178.5	1,253.3	7,098	1,293.4
1972	1,000.7	263.4	1,264.1	7,703	1,434.2
1973	1,061.2	276.9	1,338.1	9,001	2,278.4
1974	1,266.4	322.4	1,588.8	16,962	5,794.8
1975	1,678.9	349.9	2,028.8	20,405	4,925.5
1976	2,630.0	374.6	3,004.6	25,449	6,751.1
1977	4,636.0	365.1	5,001.1	28,015	7,630.7
1978	5,983.1	1,252.1	7,235.2	28,737	6,064.4
1979	7,282.3	1,611.5	8,893.8	40,333	10,836.8
1980	8,218.5	1,866.8	10,085.3	50,599	14,077.0 (1)

Note (1) : Provisional

Table 8.7 **The size and growth of the Nigerian public debt 1961-1980 (continued)**

Year	Internal debts as percentage of total debt	(Percentage) External debt as percentage of total debt	Total debt as percentage of GDP	External debt as percentage of exports
1961	50.8	49.2	6.0	20.1
1962	53.5	46.5	7.3	25.7
1963	59.4	40.6	7.7	24.4
1964	70.2	29.8	8.7	19.0
1965	71.4	28.6	9.7	17.3
1966	67.6	32.4	10.8	22.2
1967	71.2	28.8	16.5	29.5
1968	71.4	28.6	20.7	40.4
1969	79.1	20.9	21.3	27.0
1970	85.6	14.4	21.6	19.8
1971	85.8	14.2	17.7	13.8
1972	79.2	20.8	16.4	18.4
1973	79.3	20.7	14.9	12.2
1974	79.7	20.3	9.4	5.6
1975	82.8	17.2	9.9	7.1
1976	87.5	12.5	11.8	5.5
1977	92.7	7.3	17.9	4.8
1978	82.7	17.3	25.2	20.6
1979	81.9	18.1	22.1	14.9
1980	81.5	18.5	19.9	13.3

Sources : 1 CBN Annual Report and Statement of Accounts - various years

2 Agu, C C (1981), The Financing of development plans, the role of the financial sector, Planning in Nigeria : Proceedings of the Nigerian Economic Society

3 Table 8.4

The size of the external debt was separately examined in relation to that part of the national product that will be seriously affected at the maturity of the debt and during the servicing of the debt. Since external debt can only be paid for by some part of the country's exports, the proportion of external debts to the value of exports reflects the size of the burden of external debt on the domestic economy. The proportion was 20.1 per cent in 1961; it declined to 17.3 per cent in 1965. But because of the civil war when productivity and exports declined and the imports increased, theratio started rising reaching a high level of 40.4 per cent in 1968. However, with increased revenue from oil exports in the 1970s, the proportion decreased to 5.6 per cent in 1974 and further to 4.8 per cent in 1977. With the recent unfavourable demand in the world market for crude oil the ratio started increasing again recording 20.6 per cent in 1978 before declining to 13.3 per cent in 1980.

We have so far seen that the increase in public debt is explained by the growth of the internal debt, we are therefore interested in knowing the sources of the internal borrowing of the Government.

8-4 OWNERSHIP OF THE PUBLIC DEBT

The structure of ownership of domestic public debt is shown in Table 8.8. It is seen that although the Government borrowed increasingly from the banking system in the mid-1960s, the major source of such borrowing was the CBN and the non-bank public. (See Fig 8.3). The contribution of the commercial banks to the public debt was very low in the period 1963-67. It was 2.7 per cent in 1963 and increased to 9.5 per cent in 1966. This low proportion is accounted for by the low level of commercial banks investment in Treasury bills

FIG 8.3 OWNERSHIP OF NIGERIAN INTERNAL PUBLIC DEBT 1963 -80

in the period 1962-67, and this was because of the banks' preference for Marketing Board bills and other bills to the other debt instruments. As we noted in Chapter Seven, commercial banks' lending to the Agricultural sector was highest in the period 1962-66 because of their interest in financing the marketing end of the sector through the Bill Market Scheme introduced in 1962 to finance the Marketing Board.

Since these bills are fully guaranteed and secured on the season's produce, and in addition are eligible for discounting by the CBN at any time and therefore are part of the specified assets f r satisfying the CBN liquidity requirements, they (Marketing Board bills) offer more direct competition to Treasury bills (Adewumni, 1974). In addition, apart from being a comparable liquid asset to Treasury bills, Marketing Board bills yielded higher return than Treasury bills. For instance in 1962, when the Marketing Board bill was introduced, commercial banks' discounting rate of the bills was 5.5 per cent while the interest rate on Treasury bills was 3.5 per cent. In 1964 when the Treasury bill rate was increased to 4.5 per cent, the Marketing Board bills discount rate was similarly raised to 6 per cent. Consequently during the period 1962-67 when the Marketing Board bill was in operation commercial banks preferred the bills and held less of Treasury bills and more of the Marketing Board bills in their portfolios.

When the Scheme was abandoned by the banks themselves as a result of uncertainties and increased risks created by the war and the financing of the Marketing Board was taken over by the CBN in 1968, the commercial banks increased their investment in Treasury bills hence they accounted for over 44.4 per cent of the total domestic public debt in 1968. Another factor accounting for the increase in the proportion of public debt held by commercial banks was the introduction of Treasury certificates in December 1968. The introduction of Treasury certificates provided an alternative investment instrument for the banks' funds which were hitherto invested in the Marketing Board bills. The banks were also quick to welcome the introduction of the Treasury certificate because, although it was not as liquid as the Treasury bills, with a maturity of 1-2 years it was short-term or medium-term enough for their needs and besides, it carried higher yield rate than the Treasury bill.

Thus while the proportion of public debt held by non-bank public declined from 69.9 per cent in 1964 to 37.2 per cent in 1968, that held by commercial banks increased from 2.7 per cent in 1963 to 44.4 per cent in 1968. In 1974 commercial banks became the main source of internal borrowing by the Government. The Federal Government was thus indebted to commercial banks to the tune of over 60 per cent of its total domestic borrowing in 1974. The non-bank public accounted for 37.8 per cent of the debt in the same year which implies that the CBN held virtually nothing that year. Although the proportion of total domestic public debt contributed by commercial banks declined in the subsequent years the banks continued to maintain the dominant position as the major source of Government domestic borrowing between 1968 and 1977. The average annual proportion of domestic debt accounted for by commercial banks was 37.3 per cent in the period 1968-77. There was a drastic decline in the proportion from 36.4 per cent in 1977 to 18.3 per cent in 1978; in that year (1978) the CBN became the dominant lender to the public sector. In 1980 the proportion held by the commercial banks was 32.5 per cent.

Table 8.8 **Ownership of the Nigerian domestic public debt 1963-80**

(Million naira)

Year	Central bank	Commercial banks	Non-bank public	Total domestic debt
1963	36.4	3.4	87.6	127.4
1964	40.6	11.8	121.9	174.3
1965	63.1	14.1	139.1	216.3
1966	100.4	27.3	160.5	288.2
1967	155.8	33.4	176.2	365.4
1968	90.5	218.5	183.1	492.1
1969	185.4	314.6	274.0	774.0
1970	231.7	459.0	380.1	1,070.8
1971	342.6	328.0	447.7	1,118.3
1972	194.3	387.4	419.0	1,000.7
1973	222.4	387.8	451.0	1,061.2
1974	22.2	766.0	478.4	1,266.6
1975	313.7	801.3	563.9	1,678.9
1976	459.7	1,196.8	973.5	2,630.0
1977	1,683.1	1,685.2	1,267.7	4,636.0
1978	3,197.3	1,096.5	1,689.3	5,983.1
1979	2,549.2	2,416.4	2,316.7	7,282.3
1980	3,125.9	2,667.2	2,425.4	8,218.5

Source : CBN Annual Report and Statement of Accounts - various years

Table 8.8 **Ownership of the Nigerian domestic public debt 1963-1980 (continued)**

(Percentages of total debt)

Year	Central bank	Commercial banks	Non-bank public
1963	28.6	2.7	68.8
1964	23.3	6.8	69.9
1965	29.2	6.5	64.3
1966	34.8	9.5	55.7
1967	42.6	9.1	48.2
1968	18.4	44.4	37.2
1969	24.0	40.6	35.4
1970	21.6	42.9	35.5
1971	30.6	29.3	40.0
1972	19.4	38.7	41.9
1973	21.0	36.5	42.5
1974	1.8	60.5	37.8
1975	18.7	47.7	33.6
1976	17.5	45.5	37.0
1977	36.3	36.4	27.3
1978	53.4	18.3	28.2
1979	35.0	33.2	31.8
1980	38.0	32.5	29.5

Thus it is seen that apart from the CBN which was the dominant source of funds to the Government in 1978-80, commercial banks were the most important single lender to the public sector in the period under discussion.

Among the non-bank public, the major investors in Government debt are the savings institutions. Individuals held practically no Government paper. This is hardly surprising given the factors which condition the investment attitude of the private individuals in Nigeria. They are usually interested in investment in real property. As Obinna (1973, p.180) put it, 'they either hold land assets where investments are traditionally safe in the form of elaborately constructed residences or indulge in the consumption of imported luxuries'.

The above analysis emphasises the Nigerian commercial banks' insistence on the traditional short-term self-liquidating commercial loans even when opportunities to lend long are available. Consequently, the banks have not played any significant role in providing the long-term financial needs of the public sector. For example, as shown in Table 8.9, commercial banks' investment in Government development stocks was negligible. The average annual proportion for the period 1962-74 was 1.9 per cent, and in no year within the period except in 1966 was the proportion more than 2.7 per cent. The proportion, however, rose from 1.8 per cent in 1974 to 7.3 per cent in 1975 and was 10 per cent and 13.4 per cent in 1976 and 1977 respectively. The commercial banks' holdings of development stocks reached the highest proportion of 17.1 per cent in 1980.

It is seen from Fig 8.4 and Table 8.9 that the national provident fund, pension funds and savings type institutions were the major holders of long-term public debt instruments. The proportion of their holdings averaged 55.4 per cent for the years 1962-74. Although their holdings of development stocks declined from 56.7 per cent in 1974 to 38.8 per cent in 1975 and to 27.8 per cent in 1980, the proportion was never below 27.3 per cent. Central Bank's holdings of development stocks increased significantly in 1975 with a ratio of 30.2 per cent and in 1979 when it recorded 50.7 per cent. It was 45 per cent in 1980.

Table 8.9 **Holdings of outstanding development stocks 1962-1980**

(Percentages)

Year	Central bank	Commercial banks	Insurance companies	National provident fund, pension funds and savings type institutions
1962	-	2.4	1.2	66.4
963	7.5	1.6	0.8	61.8
1964	25.8	1.0	1.1	53.0
1965	27.9	0.8	1.6	51.3
1966	26.5	3.0	1.8	53.5
1967	30.9	2.4	1.5	52.1
1968	35.3	1.4	1.4	52.2
1969	29.6	1.5	1.3	55.0
1970	25.4	2.4	3.3	55.8
1971	28.6	2.5	3.0	56.1
1972	29.6	2.7	3.1	55.0
1973	13.3	1.1	2.7	51.2
1974	0.01	1.8	3.2	56.7
1975	30.2	7.3	2.9	38.8
1976	41.8	10.0	2.7	34.6
1977	47.8	13.4	3.2	31.6
1978	37.6	6.5	3.2	31.0
1979	50.7	9.8	2.6	27.3
1980	45.0	17.1	2.7	27.8

Sources : CBN i Economic and Financial Review - various years
ii Annual Report and Statement of Accounts, December 1980.

FIG 8.4 HOLDINGS OF DEVELOPMENT STOCKS 1962 - 80

The level of Government dependence on the banking system for its financial needs can further be measured by examining the percentage of commercial banks' holdings of Government outstanding instruments (Treasury bills and Treasury certificates) to internal public debt, and to Government expenditure. This is shown in Table 8.10. The proportion of Government total current expenditure financed through Treasury bills and Treasury certificates increased from 18.6 per cent in 1961 to 72.2 per cent in 1966. The proportion was highest in the years 1967-71 with an average share of 104.6 per cent. This is the war years period. The average proportion for the pre-war period 1961-66 was 47.7 per cent and for the post-war years up to 1980 the average annual proportion was 48.7 per cent. The high proportion for the war period was due to increased war time financial needs of the Government. With the end of the war and the increased revenue from the crude oil exports, the public sector became less dependent on the banking system. Hence the proportion of Government borrowing through Treasury bills and Treasury certificates declined drastically from 94.9 per cent in 1971 to 17.8 per cent in 1975. As noted earlier, this was the year the Government refused to issue new Treasury bills and discouraged their holdings by reducing the interest rate on them; it also stopped the issue of Treasury certificates. On the whole the proportion of public sector borrowing from the commercial banks through Treasury bills and Treasury certificates has shown an upward trend as is clearly shown in Fig 8.5.

However, with a dramatic decline in oil revenue the expected Government surplus turned into deficit and there was a frantic search for new revenue sources as lack of funds once again posed a major constraint to the implementation of the Third National Development

Plan, 1975-80. There was thus increased borrowing from the banking system, hence the proportion of Government debt instrument to current expenditure rose from 17.8 per cent in 1975 to 73.5 per cent in 1979. It however, declined to 43.5 per cent in 1980.

It could be seen from the Table that most of the indebtedness of the public sector to the banking system was financed by the commercial banks. Although not very important in the early 1960s because of the reasons noted earlier, the banks became an important lender to the Government since 1967. For instance in 1968, 1969 and 1970, the proportion of Government debt instrument holdings by commercial banks to Government current expenditure was 98.4 per cent, 77.2 per cent, and 55 per cent respectively. When the proportionate holdings of the entire banking system (CBN and commercial banks) fell to 17.8 per cent in 1975 that of the commercial banks alone was 15.3 per cent. It was 35.6 per cent in 1979 and declined to 20.6 per cent in 1980.

Table 8.10 further indicates that a larger proportion of total internal debt is financed through the banking system than through other avenues. This is shown by the ratio of Government instruments to total internal debt. This ratio increased from 25 per cent in 1961 to 76.2 per cent in 1970 and the proportion was highest in the period 1968-75 when it recorded an average annual share of 73.7 per cent. The average internal debt financed by the banking system through Treasury bills and Treasury certificates for the period 1976-80 was 49.9 per cent.

Table 8.10 **Commercial banks' holdings of Government instruments as a proportion of Government expenditure and internal debt 1961-1980**

(Million naira)

Year (Dec)	Total Government outstanding instruments	Commercial banks holdings of Government instruments	Total current expenditure	Total internal
1961	18.0	-	96.8	72.0
1962	48.0	6.7	103.6	98.8
1963	60.0	2.4	119.6	134.8
1964	68.0	10.7	142.6	192.4
1965	80.0	12.9	156.9	232.4
1966	128.0	22.5	177.3	263.2
1967	168.0	28.5	166.8	346.8
1968	260.0	215.1	218.7	426.0
969	482.0	334.5	433.4	648.4
1970	792.0	500.2	909.1	1,040.0
1971	872.0	290.9	918.6	1,074.8
1972	902.0	376.3	1,412.4	1,000.7
1973	902.0	382.0	1,213.1	1,061.2
1974	902.0	755.4	2,710.9	1,266.4
1975	844.0	726.9	4,740.1	1,678.9
1976	1,268.0	1,054.7	5,459.6	2,630.0
1977	1,591.0	1,104.6	6,253.0	4,636.0
1978	2,616.0	953.2	7,140.1	5,983.1
1979	4,429.0	2,144.0	6,027.2	7,282.3
1980	5,146.6	2,434.8	11,820.9	8,218.5

Sources : 1 CBN i <u>Annual Report and Statement of Accounts</u> - various years
ii <u>Economic and Financial Review</u> - various years
iii <u>Nigeria's Principal Economic and Financial Indicators</u>, 1970-79.

2 Tables 8.4 and 8.7

Notes : Government instruments refer only to Treasury bills and Treasury certificates.

Table 8.10 **Commercial banks' holdings of Government instruments as a proportion of Government expenditure and internal debt 1961-1980 (continued)**

(Percentages)

Year (Dec)	Commercial banks holdings/ Government instruments	Commercial banks holdings/ internal debt	Government instruments /current expenditure	Government instruments /internal debt	Commercial banks holdings /current expenditure
1961	-	-	18.6	25.0	-
1962	14.0	6.8	46.3	48.6	6.5
1963	4.0	1.8	50.2	44.5	2.0
1964	15.7	5.6	47.7	35.3	7.5
1965	16.1	5.6	51.0	34.4	8.2
1966	17.6	8.5	72.2	48.6	12.7
1967	17.0	8.2	100.7	48.4	17.1
1968	82.7	50.5	119.3	61.0	98.4
1969	69.4	51.6	111.2	74.3	77.2
1970	63.2	48.1	87.1	76.2	55.0
1971	33.4	27.1	94.9	81.1	31.7
1972	41.7	37.6	63.9	90.1	26.6
1973	42.4	36.0	74.4	85.0	31.5
1974	83.7	59.6	33.3	71.2	27.9
1975	86.1	43.3	17.8	50.3	15.3
1976	83.2	40.1	23.2	48.2	19.3
1977	69.4	23.8	25.4	34.3	17.7
1978	36.4	15.9	36.6	43.7	13.3
1979	48.4	29.4	73.5	60.8	35.6
1980	47.3	29.6	43.5	62.6	20.6

Commercial banks' role in financing public internal debt has been significant. The proportion of commercial banks' holdings of outstanding Government debt instruments increased over the period. The increase was, however, sluggish in the early 1960s, but there was a dramatic rise in 1968 from 8.2 per cent in 1967 to 50.5 per cent in 1968. In the 1968-76 period, the proportion of internal public debt financed by commercial banks through holdings of Treasury bills and Treasury certificates was never below 36 per cent except in 1971 when the ratio was 27.1 per cent. The proportion was as high as 59.6 per cent in 1974. It declined from 40.1 per cent in 1976 to 29.6 per cent in 1980.

Table 8.11 shows commercial banks' credit to the public sector. A cursory look at the Table reveals that the same pattern as examined above emerges. The banks' credit to the public sector has been increasing over the period 1963-70, rising from 7.6 million naira in 1963 to 509 million naira in 1970. It declined to 294.4 million naira in 1971. Thereafter, it fluctuated recording 819.6 million naira in 1976 and by 1980 it was 2632.4 million naira. Proportionately commercial banks credit to the public sector was 40 per cent of the total banking system's credit to the public sector. This proportion declined to 17.7 per cent in 1967 but rose to 63.4 per cent in 1968. From then the proportion fluctuated, but apart from 1974, 1975 and 1978 years when the CBN's credit to the sector were negative, it never declined below 55.9 per cent. In 1976 almost all credit to the public sector were from the commercial banks. A pairwise examination of Figures 8.5 and 8.6 points to great similarities in the growth pattern of commercial banks' credit to the public sector and the banks' holdings of government debt instruments. The conclusion therefrom is

FIG 8.5 COMMERCIAL BANKS' HOLDINGS OF GOVT. INSTRUMENTS 1962-80

that almost all commercial banks credit to the public sector consists of banks' holdings of outstanding Treasury bills and Treasury certificates.

Table 8.11 Banking system's credit to the public sector 1963-80

Year	(Million naira) Total	By Commercial Banks (Million naira)	(Percentage)
1963	18.6	7.6	40.9
1964	38.8	13.6	35.1
1965	59.6	11.0	18.5
966	94.4	25.6	27.1
967	160.6	28.4	17.7
1968	311.4	197.4	63.4
1969	495.2	337.4	68.1
1970	657.4	509.0	77.4
1971	526.8	294.4	55.9
1972	514.6	390.4	75.9
1973	492.5	377.2	76.6
1974	-1,538.8	650.9	42.3
1975	-1,287.6	571.1	44.4
1976	192.7	819.6	425.5
1977	2,086.4	1,071.2	51.3
1978	3,230.5	943.9	29.2
1979	3,438.5	2,358.8	68.6
1980	3,589.2	2,632.4	73.3

Source : CBN Annual Report and Statement of Accounts - various years

8-5 CONCLUSIONS

The analysis has shown that the commercial banks have performed their role of financing the public sector creditably. It is observed that the amount of credit advanced to the public sector is dictated by the sector's demand for funds which since the 1970s has become a

FIG 8.6 COMMERCIAL BANKS' CREDIT TO THE PUBLIC SECTOR 1963-80

function of revenues from crude oil exports, and the reliance of the sector on the banking system. Of the sources of finance for financing internal public debt commercial banks provided the most important and reliable source. Most of the advances to the public sector by the commercial banks were through Government short-term debt instruments. The banks have virtually rejected holding the long-term debt instruments and therefore contributed practically nothing to the long-term financial needs of the public sector.

With the extension of the right to borrow from the public to the state and local Governments, commercial banks will have a crucial role to play when the states and local Governments start issuing their securities. As a mobilizer of savings, the banks could ensure that the economy is always in a desired state of liquidity necessary for absorbing new issues of the state and local Governments securities Commercial banks are also in a privileged position to assist in the maintenance of a ready resale market for such securities. Although, as observed by Ejiofor and Okafor (1980) the state and local Government securities issue will not make the banks hold "long positions" in long-term securities, commercial banks could provide some meaningful market support if the issues have serial maturities, high coupon rates and are of medium-term securities.

CHAPTER NINE

ANALYSIS OF THE DETERMINANTS OF THE NIGERIAN BANKING SYSTEM'S PROFITABILITY AND LENDING PERFORMANCE

9-1 INTRODUCTION

The objective of this chapter is to discuss and analyse one of the subsets of the hypotheses outlined in Chapter One : the economic performance of a banking system is a function of its market structure, policy and demand variables.

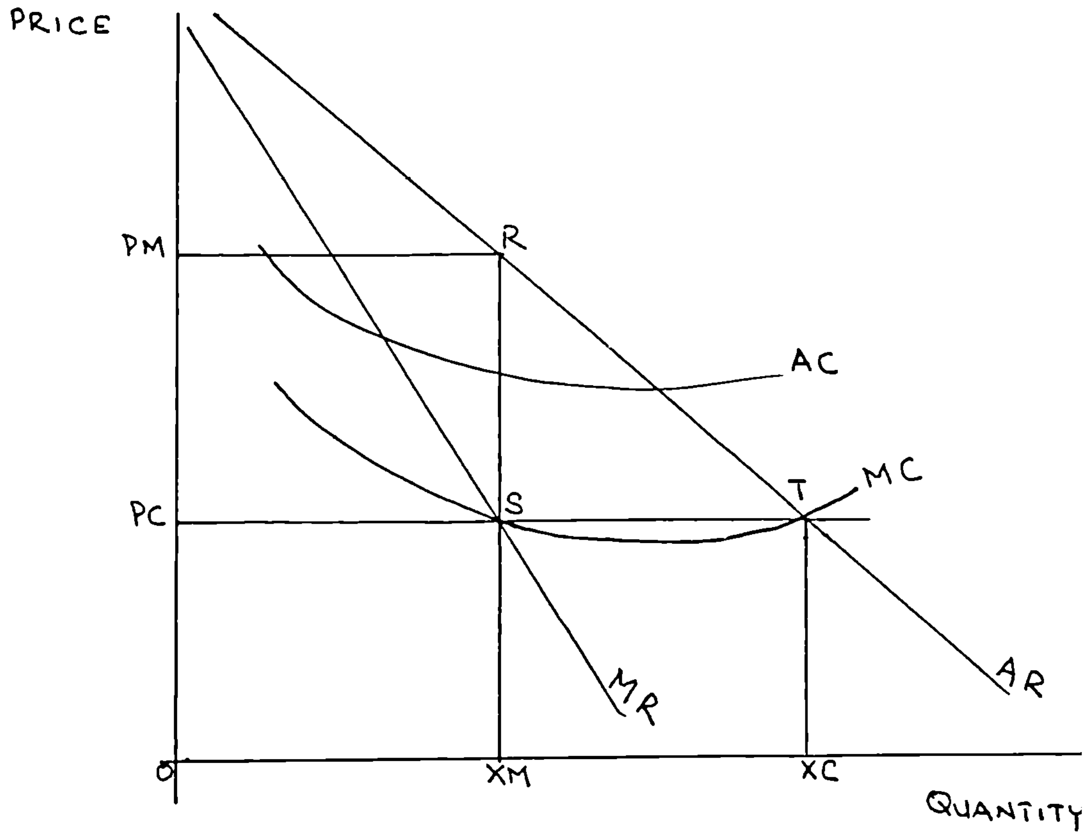
The research task here is simple in concept but difficult in practice. This is due to lack of adequate data and information. The information at hand is flawed and incomplete. These imperfections are more severe in the early years of the period covered by the present study, but even for recent years, they are serious. The present chapter is undertaken because to wait for perfect data and information would be futile, and the research itself might stimulate the interest of the monetary authorities and the institutions concerned to pay greater attention than hitherto to systematically publishing detailed information. Besides, this study is considered a framework from which, it is hoped, will spring more sophisticated techniques for handling the conceptual difficulties encountered here.

The main hypothesis of this chapter is that bank market structure has a significant influence on bank performance after holding other determinants constant. This hypothesis is consistent with and based on the acceptance of the relevance of the 'structure-conduct-performance hypothesis' (S-C-P) to the commercial banking industry. The S-C-P hypothesis states that the structure of the market will influence the conduct or behaviour of the firms in the market and that the resulting behaviour will be reflected in the price and profit performance of the firms in the market. More explicitly, the smaller the number of firms and more concentrated the market structure, the greater is the probability that firms in the market will achieve a joint price-output configuration that approaches the monopoly situation. Monopoly, therefore, is the ability of firms to control the market outcomes, particularly prices, profits and product attributes and innovation (Kaysen and Turner 1959, Scherer 1980, Shepherd 1975). A market is competitive when the leading firms lack the ability to control it; they are instead themselves controlled by the market (Shepherd, 1982).

Specifically, microeconomic theory holds that competitive economic structure results in allocationally efficient use of resources by competitive firms through cost minimization, and an efficient level of output by firms at the point of average revenue (AR) - marginal cost (MC) equality. An industry with an imperfectly competitive structure may, all things being equal, achieve cost minimization, but not efficient level of output and it may require regulations to achieve maximum efficiency (Leland, 1974). Thus as shown in standard microeconomic text, the output under monopoly market conditions (XM) (See Fig 9.1) in an industry will be less than competitive output (XC), ceteris paribus, with a resultant loss of consumer surplus of RST. (See Henderson and Quant, 1958, p.164-198).

Conventional neoclassical theories of the firm would, therefore, predict that the monopolist firm would produce lower quantity at a higher price and operate at the lowest possible cost, just like the competitive firm. Consequently following economic theory a banking industry with a competitive structure is the banking system consisting

Fig 9.1 Output under imperfect and competitive market conditions



of many competing banks, and therefore, such a banking system will perform better in terms of output and prices than a banking system consisting of only a few banks.

This chapter is divided into five sections. The next section is concerned with the literature review. Most of the studies in this area were on the United States banking system and some of the major ones are reviewed. A few related studies done on the Nigerian banking system are also reviewed in this section. In section three, the factors determining the profitability performance of the banks are analysed. The fourth section discusses the determinants of the lending activity of the Nigerian banks. The last section is the conclusion.

9-2 LITERATURE REVIEW

The S-C-P hypothesis has been tested extensively with data obtained from the industrial sector. The results of this body of empirical work provide substantial evidence that market structure does seem to influence firm behaviour in the hypothesised manner. As in the industrial sector, the relevance of the S-C-P hypothesis to commercial bank behaviour has been the subject of a large number of empirical studies.

9-2.1 Studies on the US Banking System

The unique and paradoxical structure of, and the intensively regulated banking industry as well as public concern in the United States have aroused greater interest in the structure-performance of commercial banks in the United States than in the United Kingdom or any other developed industrial country. There has been quite a number of studies (over 40 published studies; see Heggestad 1979, Rhoades 1977 for reviews) of the impact of market structure on the performance of the commercial banking industry. These studies generally fall into two groups. One group has focused on the examination of the operating efficiency of the commercial banks as reflected in the economies of scale and their implications for the banking industry. For example the studies by Alhadeff (1954), Guttentag and Herman (1967), Benston (1965), Daniel, Longbrake and Murphy (1973), Bell and Murphy (1968), Murphy (1972), Millineaux (1978), Murray and White (1980), Benston, Hanweck and Humphrey (1982) have consequently utilized the theory and estimation of cost function as an analytical framework.

The consensus of these studies is that there exists a U-shaped average cost curve for the United States' banks, and that the economies of scale are statistically significant and are constant across different sizes of banks. As Benston, Hanweck and Humphrey (1982) observed, with 1960s data a scale economy value of 0.93 to 0.95 would be representative of the best known studies. These studies suggest the need for promoting economic efficiency in banking. This is because the production function for all banks is characterised by increasing return to scale, and atomistic competition forces firms to operate at the lowest point of their average cost curves in the long-run where operating efficiency is highest.

It is important, however, to note that without the assumption of "cost minimization" behaviour, the average cost curves estimated by these studies do not reflect potential firm efficiency (Bhatia, 1978). Generally speaking, larger banks stand the chance of achieving greater economies of scale than smaller banks mainly because of the greater disability of the latter to spread overhead costs, pool risks and specialise among employees, as well as their higher transaction costs of moving funds in smaller amounts than in the former. However, if the managers of larger banks are risk avoiders rather than profit maximizers as Heggestad (1977) and Caves (1970) have shown in their studies, and as, we have noted in Chapter Seven, seems to be the case of the Nigerian banking system, or if the managers maximize their own utility rather than attempting to maximize profits (See Williamson's (1974) expense-preference theory and Leibenstein's (1976) X-inefficiency theory), the cost and output data reported by the firms cannot be used to measure economies of scale and economic efficien y Some of the banks because of their size may be leading a quiet life rather than minimizing their operating costs (Edward and Heggestad, 1973).

Furthermore, most of the studies suffer form a common shortcoming, namely the failure to take account of the influence of technology on economies of scale. Input-output relationship in an industry does not only depend on the proportions to which the factors of production are employed and the scale of production but also upon the level of technology. Changes in technology may, consequently, make earlier studies irrelevant for present concern. Only few recent studies such as those of Daniel, Longbrake and Murphy (1973), Murray and White (1980), Millineaux (1978) and Bell and Murphy (1967) explicitly examined the influence of technology on bank costs and economies of scale. These studies noted that significant economies of scale were sensitive to the technology employed as well as the size of the firm. Daniel, Longbrake and Murphy (1973), for instance, found that the cost advantage of small banks vis-a-vis large banks is reduced by adoption of computer technology. However, for the Nigerian banking system, which continues to be labour-intensive in the present computer age, technological change is not significant, but for the US banking system, where the computer and electronic funds transfer system are in use, their impact on costs and economies of scale must be significant.

A second set of the studies on the structure performance in the US banking system has attempted to isolate the concentration dimension of the market structure and determine its impact on prices and profits. These studies are concerned with the effects of the banking structure as presented by the number of bank offices and the concentration ratio on the performance of commercial banks. Principal works in this area include Edwards (1964 and 1973), Kaufman (1966), Brucker (1970), Vernon (1971), Emery (1971), Bryan (1972), Fraser, Phillips and Rose (1974), Yeats (1974), Fraser and Alvis (1975), Mingo (1976), Scott (1977), Heggestad (1977) to name but a few. A few of these studies are summarized in Table 9.1.

These studies have evaluated performance of the banks by employing cross-sectional data drawn from many sets of markets and carrying many time periods. In general, these studies found a statistically significant relationship between some measures of performance but the effect was generally small in magnitude. Specifically the concentration variable was found to be not an important determinant of performance since the impact was less predictable than other variables.

Author (Year)	Performance Measures	St u tural Meas res	T t Me h	Data Source	Findings
Kaufman (1966)	Average loan rates; profitability; average savings rate	3 banks concentration ratio of total deposits, or number of banks	Regression	Balance sheet and incomes statement	Structure significant
Brucker (1970)	Ratio of gross income/ loans; loans/assets	3 banks concentration ratio of total assets	Regresssion	Balance sheet and income statement	Structure significant
Emery (1971)	Difference between actual and expected rate of return	5 banks concentration ratio of total deposits	Tabular with difference in means	FDIC	Structure is not significant
Jacobs (1971)	Business loan rates	3 banks concentration ratio of total deposits	Regression	Special survey	Structure is significant
Vernon (1971)	Average rate of return on invested capital	3 banks concentration ratio of total deposits	Regression	Moody's Banks and finance manual	Profits fall significantly with concentration
Ware (1972)	Average loan rate; average savings rate, profitability; portfolio selection	4 banks concentration ratio of total deposits	Regression	FRB Functional Cost analysis program	Concentration never significant
Bryan (1972)	Profitability	Number of competing banks	Regression	Condition income + undivided report	Not significant
Edwards (1973)	Profit after tax/stock holders' equity	3 banks concentration ratio of total deposits	Regresssion		Concentration has no effect
Fraser, Phillips and Rose (1974)	Loan/asset, pretax earnings/ capital and other balance sheet items	1 bank concentration ratio of total deposits; Number of banks	Canonical correlation analysis	Balance sheet and income statement of banks	No significant effect
Yeats (1974)	Income/assets; Income/ capital; Interest on deposits; Interest on loans	Herfindahl index on total deposits; the change in herfindahl index	Regression	Not specified	Small effect on structure

Source : See the Bibliography

Author (Year)	Performance Measures	Structur as r s	s	ta	s
Beighley and McCall (1975)	Lerner index; average loan rates	3 bank concentration ratio of instalment loans	Regression	FRB Functional Cost Analysis Program	Concentration is significant
Fraser and Alvis (1975)	Average loan rates; average savings rates; portfolio selection	High vs low concentration markets based on deposits	Regression	Condition income and dividend report	No effect on structure
Mingo (1976)	Average loan rates; profitability, portfolio selection; leverage	Herfindahl index of total deposits	Regression	Conditon income and dividend report	No effect on profitability but impact on leverage and portfolio
Fraser and Rose (1976)	Average loan rates; average savings rates; portfolio selection	Several alternative measures of concentration	Regression	Condition income and dividend report	Structure significant
Heggestad (1977)	Profitability; risk adjusted profits	3 bank concentration ratio of total deposits	Regression	Condition income and dividend report	Structure is significant
Heggestad and Mingo (1977)	Demand deposit service charge; new car loan rates	Herfindahl index of total deposits	Regression	Special survey	Structure is significant
Scott (1977)	Interest rates on small business loans	3 bank concentration ratio; Herfindahl index	Regression	Special survey	Structure is significant

In a number of these studies the unit of observation is the individual bank as opposed to the entire banking system. The use of the banking market is consistent with a priori reasoning and theoretical framework. Theory provides support for a direct relationship between market structure and performance while the relationship between market structure and a firm's performance is more inferential in nature and as Rhoades (1977) contends, focusing on the firm creates measurement problems since a firm's performance may reflect unique policies or circumstances.

The overall results of these studies indicate that the banking market structure influences prices and profit performance of the banks, but for practical policy purposes, this influence is quantitatively small, and the conclusions are not by any means unanimous. Thus unlike the supportive results obtained from the industrial sector where a positive and statistically significant relationship between market concentration and profits has been consistently found, the empirical results from banking studies have been rather heterogenous. It is because of the inconclusive and, to a substantial degree, contradictory results that Kaufman (1966, p.439) pointed out in his study that 'the experiment should be replicated for other states and other types of bank organisations before the results may be considered sufficiently persuasive for determining policy'. This view was supported by Fraser, Phillips and Rose (1974) who observed that it would be of great interest to see results of similar studies conducted in state-wide branch banking and limited branch banking states.

The study attempted in this chapter differs from these studies ir a number of ways. First, as noted in the introduction to thi: chapter, the dearth of reliable data and information has made it ifficult and unnecessary to replicate the experiment using the sam methodology. Consequently a simplified methodology of discussior and analysis of the factors that influence the performance of the igerian banking system is undertaken. Second, the unit of observation is the entire Nigerian banking system and thus the conomy-wide branch banking system of Nigeria provides a different kind of setting from the unit and limited branch banking of the Unitec tates. Third, some of the studies have examined the issue of hieving economies of scale relative to branch versus unit banking systems with conflicting results. The issue does not apply to this udy because in the economy-wide branch banking system of Nigeria there does not exist any legal restriction on branching between or within states. Fourth, in the United States where most of the studies were conducted the concentration problem is not significant enough tc warrant the study of the kind attempted here. If, for instance, bank deposits outstanding are taken as a universe, then large banks do not dominate the banking system in the United States as they do ir Nigeria. As Bhatia (1978) noted, the top ten banks in the Unitec States held around 18 per cent of all deposits while the top 183 banks accounted for less than 50 per cent of deposits in 1971. In Nigeria, on the other hand, by 1973 the top three banks controlled about 70 per cent of the aggregate deposits of the banking system. However, the differences notwithstanding, the studies reviewed form the antecedents of some of the determining factors discussed in this study.

9-2.2 Studies on the Nigerian Banking System

Studies of the factors that influence the operating performance of the Nigerian banking system have received very scanty attention and in particular studies on the impact of structure on performance of the banks are virtually non-existent.

A start in this area has been made by Ojo (1979). In his study he discovered the possibility of the existence of economies of scale for the Nigerian banks. He compared rates of return on investment or profit earnings of individual banks and came up with the following conclusions:

(i) Commercial banks in Nigeria have been performing satisfactorily well in terms of their profitability and growth, however, most of the banks are still far from realising the great potential scale economies and therefore are yet to bring about the greatly desired improvements in their services and performance.

(2) Although the effect of size on profitability is not yet defined in any precise manner in favour of large or small banks, the possibility of greater certainty of profits of large banks may make greater size more attractive than smaller size.

(3) There has been no conclusive finding about the extent to which scale economies are present in banks of different sizes because the optimum bank size could be relatively small or large. The difficulty of obtaining details of costs of the banks' operations has imposed a limitation on the study.

Another important effort in this branch of study was made by Soyode and Oyejide (1975). Their study touched on structure-performance of the Nigerian banks. The study was, however, restricted to the impact of the branch network on bank profitability. With cross sectional data on the 14 commercial banks then in existence in Nigeria for the year 1973/74 the impact of the branch network on bank profitability was estimated using standard regression technique. The estimates were of three types. One measures the general relationship between bank profitability and the size of the branch network (measured in a number of ways). The second type of estimate examined the rural urban pattern of branch locations and the third made a distinction between expatriate and indigenous banks. These estimates are shown in Table 9.2.

The number of observations is not stated, nevertheless, regression results (1) and (2) confirmed a positive and statistical significant relationship between average net profit and absolute as well as relative size of banks' branch network, implying that it pays for commercial banks to have a wide branch network. Similarly regression results (3), (4) and (5) indicated that profitability tended to increase with the number as well as the proportion of large city branch offices operated by banks.

The limitation of the study is that from planning perspective the desired size of branch networks cannot be deduced from the results. Depending upon how banks compete with each other, some of the potential economies and benefits often associated with branch network expansion could be frittered away through competitive duplication of branches.

Table 9.2 Regression results

Profit measure	X_0	X_1	X_2	X_3	X_4	X_5	Dummy	R^2
1 ANP	0.0182	0.0661 (3.8598)						0.6078
2 ANP	0.0604		0.2160 (3.3949)					0.6076
3 ANP	-0.0471			0.1271 (2.5871)				0.5846
4 ANP	1.3173				0.0122 (2.8625)			0.1042
5 ANP	-0.0516					0.2135 (4.8625)		0.2413
6 ANP	0.7663						-0.8831 (3.4510)	0.6260
7 ANP	0.5843		0.0779 (2.2633)				-0.5921 (2.2393)	0.6590

Source : Soyode, A and Oyejide, T A. 'Branch network and economic performance - a case study of Nigeria's commercial banks' The Nigerian Journal of Economic and Social Studies, 1975

Notes :
1 The number of observation was not stated
2 ANP is the average net profit
3 X_o is the constant
4 X_1 is each bank's number of offices
5 X_2 is each bank's percentage share of total number of branch offices for all banks
6 X_3 is each bank's number of large city branch offices
7 X_4 is each bank's large city branch offices as a percentage of its total number of offices
8 X_5 is each bank's percentage share of the total number of large city offices for all banks
9 The dummy equals 1 for indigenous banks and zero for expatriate banks

9-3 FACTORS DETERMINING THE NIGERIAN BANKING SYSTEM'S PROFITS AND PROFITABILITY PERFORMANCE

Data availability and the hypothesis of this chapter dictate that the following factors be considered as determinants of bank profit and profitability performance.

1. Market structure variables which comprise total assets, deposits concentration ratio and number of bank offices
2. Policy variables which include time plus savings deposits to total deposits ratio, loans and advances to total deposits ratio
3. Demand variable which is proxied by per capita income

Before discussing these factors it is pertinent to question the profit maximization assumption of banks. In fact it has been argued that one possible explanation for the weakness of the S-C-P relationship is the identification of the rational behaviour of banks with profit maximization (Clark, 1980, p.8). A profit objective is only one of a potentially large number of objectives which might reasonably be pursued by bank management. Thus the assumption that banks behave as if they are profit maximizers may be an inappropriate or inadequate explanation or description of commercial bank behaviour. Bank management reasonably pursue multiple objectives some of which may be in conflict with the goal of maximum profit. Should any number of multiple objectives conflict with profit maximization, bank profits will probably be less than the maximum the bank could potentially earn (Clark, 1980).

In fact recent studies have begun to view banks as entities which maximize utility rather than profits. One approach which has received considerable attention is the expense-preference theory which envisages banks as maximising utility through the pursuit of non profit maximising policy. (See Rees, 1974 for theoretical discussion and Edwards, 1977 for empirical results).

9-3.1 Profit-Asset Relationship

Total assets represent an important and generally used dimension in which the size of a bank is measured and is also a very important factor in the operational efficiency of any economic unit. There is no doubt that large banks enjoy an advantage in market power compared to small banks. This is because of the theoretical possible and often available economies of scale. Their size, for example, permits them to bargain more effectively, "administer" prices and in the end realise significantly higher prices for a particular product. More importantly the size of total assets should, to some extent, indicate the ability or capacity to assume risk. A bigger bank, because of the sheer size of its assets is better cushioned for, and can better absorb "shocks" resulting from the risks inherent in portfolio management. This confidence-giving attribute should make the big bank more risk-accepting and less risk-averting than small banks (Adewunmi, 1981, p.349).

Another important advantage of economies of scale which is relevant here is that because of large size big banks will invariably be more disposed to employ and maintain well-informed and experienced management staff. At the same time it is just as true that to management and other personnel large banks are more attractive in many regards. Higher salaries, better training opportunity domestically and abroad, many fringe benefits and last but not least the perceived high social prestige of large banks are reasons for this. Crosse and

Hampel (1980, p.105) have observed that high productivity reflects among other things the effectiveness of personnel training and that both big and relatively small banks have demonstrated that the greatest savings in cost are to be found not in machinery alone but in more efficient procedures and more efficient management organisation.

An examination of Tables 9.3 and 9.4 shows that the total assets of the Nigerian banks and bank profitability maintained upward trends. While the annual average growth rate of assets was 27.8 per cent for the period 1970-81 that of profits was 28.3 per cent for the same period. For the two variables, the rate of increase was highest in the period 1974-77; an explanation being the increased monetization of oil exports during this period. The influence of inflation on these variables was also very high. The growth of total assets and profits of the Nigerian banks during this period (1974-77) averaged 48.4 per cent and 46.2 per cent respectively. In 1978 when the total asset growth rate dropped to 6.7 per cent from 33.9 per cent in 1977 that of profits declined similarly from 89.9 per cent in 1977 to a low of 7 per cent.

When the relationship in the growth trend between total deposits and loans and advances on one hand, and bank profits on the other is examined, the picture remains the same. Both loans and advances and total deposits of the banks maintained similar upward trends with banks' profits. The annual average growth rate of 34.5 per cent for loans and advances is higher than that of 28.3 per cent and 29.3 per cent for profits and total deposits respectively. Furthermore, in 1978 when the growth rate of loans and advances declined slightly from 45.3 per cent to 33.4 per cent, profits declined substantially from 89.9 per cent to 7 per cent. An explanation may, perhaps, be that the banks were not earning as much as they should from their loans and advances. It seems rather that the banks earn more from their investment in government securities (which, because of their risk averse attitude, most of them prefer to lending to agricultural services) and services charges.

Table 9.3 Profits, number of banks offices, assets and deposits of the Nigerian banking system 1970-81

(Million naira)

Year	Net Profits (current prices)	Total assets	Total deposits	Time and savings deposits	Loans and advances	GDP (current prices)	Number of bank offices
1970	14.6	1,152.0	625.8	336.8	351.3	5,621.0	318
1971	18.9	1,275.9	657.2	371.8	502.0	7,098.0	340
1972	27.8	1,437.5	776.2	461.2	619.5	7,703.0	358
1973	35.6	1,772.0	1,013.0	582.3	753.4	9.001.0	383
1974	43.5	2,811.2	1,693.9	973.2	938.1	16,962.0	403
1975	67.0	4,308.0	2,839.1	1,302.3	1,121.5	20,405.0	433
1976	79.5	6,371.4	4,164.2	1,979.1	2,122.9	25,449.0	450
1977	151.0	8,530.9	5,235.2	2,255.1	3,074.6	28,015.0	508
1978	161.6	9,105.7	5,302.6	2,601.7	4,109.7	28,737.0	585
1979	156.1	11,238.6	6,967.8	3,702.1	4,618.7	30,862.0	672
1980	157.2	13,717.4	8,842.7	5,111.9	6,379.1	51,156.0	740
1981	184.1	15,548.1	10,677.0	5,796.1	8,582.9	57,567.0	740

Sources : Tables 6.2, 6.5, 6.8 and 4.7

The problem, however, is that the CBN specifies the rates to be charged on loans and advances to the preferred sectors of the economy such as agriculture and manufacturing. This, nevertheless, does not mean that the banks cannot adopt a policy that will enable them make more as well as profitable loans. Banks do not charge the maximum rate of interest. Once the loan demand seems risky the application is rejected. Banks' loan policy should stress the importance of changing interest rates that reflect the risks involved and this could be done within the administered interest rate structure. But first this requires accurate evaluation of the business and financial risks present (Haslem, 1968).

Table 9.4 Annual changes in profits, assets, GDP, branches and deposits of the Nigerian banking system 1970-81

(Percentages)

Year	Net profits	Total assets	Total deposits	Time and Savings deposits	Loans and advances	GDP	Number of bank offices
1970							
1971	29.5	10.8	5.0	10.4	42.9	26.3	6.9
1972	47.0	12.7	18.1	24.0	23.4	8.5	5.3
1973	28.1	23.3	30.5	26.3	21.6	16.9	7.0
1974	22.2	58.6	48.7	67.1	24.5	88.4	5.2
1975	54.0	53.2	67.2	33.8	19.6	20.3	7.4
1976	18.7	47.9	46.7	52.0	89.3	24.7	3.9
1977	89.9	33.9	25.7	13.9	44.8	10.0	12.9
1978	7.0	6.7	1.2	15.4	33.7	2.6	15.2
1979	-3.4	23.4	31.4	42.3	12.4	7.4	14.9
1980	0.7	22.1	26.9	38.0	38.1	65.8	10.1
1981	17.1	13.3	20.7	13.4	34.5	2.6	0.0
Average annual growth rate	28.3	27.8	29.3	30.6	34.5	23.5	8.1

Source : Table 9.3

Like total assets and profits total deposits' growth rate was highest in the period 1974-77. The average annual growth rate for this period was 47.1 per cent compared to 46.2 per cent for profits. Banks' profits reacted also to the decline in the growth rate of deposits in 1978 to 1.2 per cent from 25.7 per cent in 1977 by a similar fall in their growth rate to 7.0 per cent in 1978 from 89.9 per cent in 1977.

9-3.2 Profit-Bank Branches Relationship

Another measure of structure of the Nigerian banking system used in this analysis which is of particular concern to the regulatory authorities is the number of bank offices. Economic theory implies that a banking system consisting of numerous competing banks will perform better in terms of output and prices than a banking system dominated by a few banks. This is based o the assumption that financial services do not differ from other commodities as far as the desirability of satisfying the marginal criteria of welfare economics is concerned. Barnes (1982), however, noted that because of problems of control or co-ordination, as well as to fixed costs at the branch level, high costs result if a given level of assets is split up among more and more branches. Nevertheless, a banking system in the process of expanding its branch network appears to attract more new business than might otherwise be expected (Wilson Committee, 1980).

As can be gauged from Table 4.7 the number of bank offices in Nigeria had increased 289.5 per cent in absolute terms over the period 1960-78. Annual growth rate for the entire period was 7 per cent and between 1970 and 1980 the annual average increase was 8.6 per cent. A close examination of Table 9.3 and 9.4 indicates that bank profits increased with increase in bank branches up to 1977. Between 1970 and 1977 the highest rate of increase in banks' profits was recorded in 1977 and the highest growth rate in bank branches of 12.9 per cent was recorded in the same year. The implication derived is that the branch expansion between 1970-77 might have been accompanied by significant expansion in the deposit base hence a positive contribution to banks profits is made through the expansion in the average size of assets holdings. In addition it may be presumed that the increased services and convenience resulting from a large number of bank offices during this period increased customer satisfaction and the spread of banking habit particularly in the rural areas and that the earning ability of the Nigerian banks was enhanced.

The situation was a bit different in the period 1978-80. While the average annual growth rate of bank offices during this period was 13.4 per cent that of banks' profits was as low as 1.4 per cent. In 1979 when the rate of increase in bank offices was 14.9 per cent that of banks' profits was negative, -3.4 per cent. An explanation which could be offered might be that the expansion in bank offices instead of being accompanied by a significant expansion in deposit base became a source of decreasing return due to problems of control or co-ordination as well as high input prices at the branch level. The branch banking literature suggests that any economies of scale which accrue through branch banking expansion will be offset by the greater cost of operating multiple facilities.

Overall Table 9.6 shows that there is a statistical positive association between the banking system's profitability and the number of bank offices. A high and significant statistical correlation of 0.53 implies that more branches are desirable to increase bank profitability.

9-3.3 Profitability-Concentration Relationship

One of the most tested relationships in industrial organisation literature is the profitability-concentration hypothesis. Economic theory suggests that other things being equal firms having significant market positions in a highly concentrated market will tend to restrict output, charge higher prices, earn higher rates of return and use their entrenched position to retard the competitive efforts of other firms (Allardice and Erdevig, 1981, p.4). Since the Nigerian banking system consists of many competing banks and yet a few large ones exert a great deal of influence on the market, there is the need for an index that measures the relationship between the number of firms and their share of the market. The index used in this study is the four bank concentration ratio calculated as:

$$CR = \frac{\sum_{i=1}^{4} Di}{D}$$

where CR = concentration ratio
Di = deposits of the leading ith bank
D = total deposits outstanding of the banking system

The four bank concentration is considered an appropriate index because it encompassed banks from the two groups of banks in Nigeria: foreign banks (now mixed ownership banks) and indigenous banks (now state government-owned banks).

One summary measure of concentration that takes into account the total number of firms in a market and their market share is the Herfindahl index. The index is constructed by summing the squares of the market share of all firms in the market. That is:

$$\text{Herfindahl index} = \sum_{i=1}^{N} (Xi/S)^2$$

where N = the number of firms
Xi = the absolute size of each of the firms
S = the total size of the market

One limitation to using the Herfindahl index is the frequent lack of information on the market share of individual firms, and this is particularly manifest in the Nigerian banking system where such necessary information on individual banks is not available. As Shepherd (1979a, p.165) put it 'Herfindahl "summary" indexes require far more information and their weighting among firms is controversial'. Because of this limitation it was not possible to use the Herfindahl index in this analysis.

No single measure, however, adequately describes market concentration. No satisfactory explanation of the size distribution of firms has yet been derived from economic theory (Curry and George, 1983). The concentration ratio, for example, can only suggest that the small number of large firms makes restrictive pricing and output decisions more possible than if there were many firms of equal size. It does not mean that large firms are actually engaging in anti-competitive conduct. The existence of a few firms may simply reflect economies of large scale (Salley, 1972, p.72). The shortcoming notwithstanding, the concentration ratio is regarded as one of the few general measures of structure available to the economist (Bain, 1959). Shepherd (1964, p.200) contends that 'for all its shortcomings the homely concentration ratio is a direct and fairly clear indication of industry structure'.

Traditionally the structure-conduct-performance hypothesis would suggest a positive relationship between market concentration and the profitability of a firm or bank. However, firms or banks in a more highly concentrated market where potential profits are high are in a position to forego some potential profits in the pursuit of potentially conflicting goals (two examples of which are sales and sales revenue maximisation (Clark, 1980).

On an a priori basis, therefore, the relationship between bank profitability and the degree of market concentration is less clear. It depends very much on the objectives the bank management wants to pursue. From Table 9.5 there is no clear relationship between bank profitability and market concentration in the Nigerian banking system. For instance, the sharp increase in market concentration in 1972 was not proportionately reflected in bank profitability in the same year. Similarly the gradual decrease in market concentration between 1977 and 1981 did not reflect negatively or positively in the behaviour of banks' profitability performance. However, from Table 9.6 it is seen that there is a negative and weak statistical relationship between the banking system's market concentration and its profitability performance. The statistical relationship of -0.278 implies that market structure has no apparent effect on the Nigerian banking system's profitability performance.

There has been a continual reduction since 1970 in the importance of large-scale banks in the Nigerian banking system. The market share of the few large banks has dropped from over 98 per cent in 1972 to 35.8 per cent in 1981. (See Table 9.5). From 1977 there has also been a fall, although a much smaller and a more gradual one.

Table 9.5 Profitability of the Nigerian banking system and its determinants

Year	(Percentages) Net profits / Capital	Net profits / Assets	Deposit concentration	Time and savings deposits / Total deposits	Loans and advances / Total deposit	(Million naira) Per capita income	Number of bank offices
1970	25.5	1.3	45.8	53.8	56.1	84.9	318
1971	26.9	1.5	54.4	56.6	76.4	104.7	340
1972	36.2	1.9	98.9	59.4	78.0	110.8	358
1973	41.4	2.0	73.1	57.5	74.4	126.3	383
1974	43.5	1.5	49.9	57.5	55.4	232.0	403
1975	52.6	1.6	47.5	45.9	54.1	272.4	433
1976	50.6	1.2	45.0	47.5	51.0	331.4	450
1977	74.9	1.8	53.1	43.1	58.7	356.0	508
1978	60.5	1.8	50.8	49.0	77.5	356.5	585
1979	47.6	1.4	45.3	53.1	66.4	373.6	672
1980	41.6	1.1	47.9	57.8	69.6	604.0	740
1981	56.2	1.2	35.8	35.6	52.8	662.5	740

Sources : Tables 6.5 and 9.3

If from this point of view, it can, therefore, be affirmed that the degree of market concentration of the Nigerian banking has for some time been falling, it must imply that at the same time there has been a substantial growth in the importance of smaller banks and that there has been a continual increase over the years in the total number of banks and bank offices operating in the system. (See Chapter Four). On the whole, it can be said that the dimension of banking structure is becoming more balanced partly because of the controls exercised by the authorities on entry and the encouragement given by the CBN to the banks to open new offices in the rural areas. The smaller banks have benefited from the rural expansion because they have the local advantage (most of them are indigenous banks) and protected as they were by, among other things, the criteria adopted by the CBN for the opening of new offices. The biggest banks, on the contrary, which own most of the bank offices in the large cities and by the fact of operating in an environment where industrial and commercial activities are already flourishing, have scaled down their desire to grow and have therefore increased deposits less quickly.

The possibility cannot be excluded that the negative and weak association between market concentration and bank profitability and the more sluggish growth of the large banks partly reflect the centralisation and rigidity of the banks' management, particularly that of the big banks, which deprive them of the flexibility needed to exploit their geographical structure (for example the big banks refused to expand to the rural areas by the simple device of refusing to open new urban branches) and to meet the ever increasing demand for bank services. Implied, therefore, is that the Nigerian banking system is non-competitive and banks therefore operate under conditions of less risk than their counterparts in more competitive markets. Thus Nigerian banks tend to restrict output not by charging high prices for their services but by fixing low prices and avoiding risk and consequently they do not earn as high rates of return on their equity as they would otherwise have. In his study Caves (1970, p.284) in examining Galbraith's The New Industrial State, has suggested that one of the most important of Galbraith's arguments is the 'oft-ignored aspect of the large firm's behaviour: that a significant portion of the potential profits latent in its position of market power is taken in the form of avoiding uncertainty'. If, therefore, as this study and our analysis suggest that the degree of risk aversion is greater for banks in more highly concentrated markets, that further provides at least a partial explanation for the weak and negative statistical relationship between the bank market structure and profitability performance of the Nigerian banking system.

Table 9.6 Correlation between the Nigerian banking system's profitability and its determinants

	Deposit concentration ratio	Time and savings deposits / total deposits	Loans and advances / total deposits	Number of bank offices	Per capita income
Net profits / capital	-0.27	-0.77	-0.16	0.53	0.55
Net profits / assets	0.11	-0.13	-0.28	-0.42	-0.54

Source : Computer print out

9-3.4 Profitability and Policy Variables

According to the portfolio balance model of asset diversification, the optimum holding of each asset in a wealth holder's portfolio is a function of policy decisions determined by a number of factors such as a vector of rates of return on all assets held in the portfolio, a vector of risks associated with the ownership of each financial asset, the size of the portfolio (Bryant 1975, Yang and Grehrmann 1982). Consequently portfolio diversification and the desired portfolio composition of commercial banks are the result of policy decision of the management. The desired portfolio composition involves the exact mix of business which is necessary not only to ensure that the banks maintain their respective desired market profile but also because the relative profitability of their different services changes with interest rate movements.

On a priori grounds, therefore, the deposit mix i.e. time and savings deposits to total deposits ratio and the level of intermediation indicated by loans-deposits ratio are considered appropriate policy variables influencing a banking system's performance. In a study of medium size banks Bryan (1972) found that the most important single factor explaining profitability was the ratio of time plus savings deposits to total deposits. The deposit-mix by determining the liquidity needs of the banking system affects the volume of earning assets - the proxy variable for output (See Chapter Six). The intermediation ratio reflects the credit policy formulated by the banking system.

The relationship between time plus savings deposits to total deposits ratio and bank profitability seems uncertain. There are two sides to the argument. The first is that the ratio of time and savings deposits to total deposits may be expected to exhibit a negative relationship with bank profitability. An increase in the proportion of time and savings deposits to total deposits implies a low level of real output of the banking system. Besides time and savings deposits require explicit interest cost to attract. Because they are a more costly source of banks deposits, the greater the proportion of time and savings deposits to total deposits, the greater the interest cost of funds and thus the lower the profit rate. It is further argued that the stability in the banks' deposit base is accounted for mainly by total demand deposits. This may be due to the often observed fact that in Nigeria the small savers who are the main holders of savings deposits display a more erratic deposit and withdrawal behaviour than firms which are the principal holder of demand deposits. Therefore, the more the banks have a higher proportion of more erratic time and savings deposits in their deposit portfolio, the higher will be the cost and thus the lower will be the profits.

On the contrary, the ratio of time and savings deposits to total deposits might be expected to be positively related to bank's rate of profits. Clark (1980, p.92) has argued that time and savings deposits represent a much more stable source of funds than do demand deposits. (See also Morrison and Selden, 1965, p.13). As a result, bank primary and secondary reserves may be reduced the greater the bank's proportion of time and savings deposits to total deposits (since with a stable source of funds the bank can meet unexpected cash withdrawals and also does not need to keep reserves as a hedge against penalty rate that would otherwise be incurred for a cash shortfall necessitating borrowing from the central bank) thereby leading to increased investment of bank funds and thus increased profitability.

As pointed out in Table 6.2, the absolute amount of time and savings deposits as well as their proportion in total deposits of the

Nigerian banks increased steadily during the period 1960-81. In absolute amount time plus savings deposits increased from 54.8 million naira in 1960 to 5,796.1 million naira in 1981. The ratio of time and savings deposits to total deposits increased from 40 per cent in 1960 to 54 per cent in 1970 and to 57.8 per cent in 1981. Although bank profitability increased from 25.5 per cent in 1970 to 56.2 per cent in 1981, (See Table 9.5) there seems to be no indication of any clear relationship between bank profitability and the proportion of time and savings deposits to total deposits.

Table 9.6, however, indicates that there is a negative statistical association between the deposit mix and bank profitability. The inverse significant statistical relationship of -0.77 between time and savings deposits to total deposits ratio and bank profitability implies that the banks have not been able to minimise their total resource costs by a clever combination of cost-effective sources of deposits.

Surprisingly, the loan-deposit ratio has a negative and weak statistical association with the profitability performance of the Nigerian banking system. The weak and inverse statistical relationship of -0.16 and -0.28 for both measures of profitability may imply that the banking system increased loans and advances by reducing interest charges. A further explanation may be in terms of the capital budgeting process used by firms. An increase in interest rate, an important element of the cost of capital, adversely effects the net present value of a project being considered for funding, and thereby, the demand of a firm for funds (Weston and Brigham, 1977, p.257-308).

9-3.5 Profitability and Demand Factor

Economic conditions within a market may be expected to influence bank behaviour through the demand for banking services. The demand for banking services should be greater, the greater the relative influence of the market. Per capita income is used here to provide an index for the demand factor for bank services. Thus higher per capita income might ordinarily be identified with a higher rate of return on equity. In addition to the effect of per capita income on the bank's rate of return on equity, market demand also has a direct effect on bank revenue and the size of bank earning assets. The greater the market demand for bank services (as captured by high per capita income), the greater one might expect the bank revenue on earning assets and bank earning asset size to be, hence the better the profitability performance of the banks.

Table 9.6 indicates that there is a positive significant statistical association between the demand for bank services and the bank profitability. However, given the CBN's ceilings on loan rates particularly to the preferred sectors of the economy, it is expected that returns to commercial banking assets will be inversely related to the level of economic development. This explains the negative statistical association of -0.54 between per capita income and the yield rate on assets.

9-4 LENDING PERFORMANCE ANALYSIS

The lending performance measure to be discussed here is the ratio of total loans to total assets. A priori, the greater the proportion of bank's resources placed in loans the better the bank's performance (Brucker, 1970). The ratio of total loans to total assets measures broadly the ability and the willingness of banks to convert their idle cash deposits into productive resources. It is in this way that the banks act as effective agents of capital formation (Moulton, 1981, p,869). For a developing economy there can hardly be rendered a better service by a financial intermediary than that of helping to organise capital resources internally. In addition the loans-assets ratio can be used as a proxy variable for the output performance of the Nigerian banking system.

As shown in Table 6.8, the ratio of total loans and advances to total assets of the Nigerian banking system fluctuated greatly during the period 1960-81. The proportion increased from 40.7 per cent in 1961 to 62.2 per cent in 1965. There was a noticeable decline in the proportion of loans and advances in the total assets between 1968, when it dropped from 61.2 per cent in 1967 to 40.3 per cent, and 1970, when it registered only 30.5 per cent. The ratio picked up again between 1971, when it rose to 39.3 per cent, and 1973, when it recorded 42.5 per cent. A second phase of decline in the loans-assets ratio started in 1974 with 33.4 per cent, reaching a low of 26.0 per cent in 1975 before picking up in 1976.

A number of reasons can be offered for these fluctuations in the proportion of banks' assets devoted to loans and advances. The first period 1960-67 was the period when the banks had few domestic investment outlets for their temporary surplus funds. The banks had to hold such funds as idle balances with the consequent opportunity cost in terms of interest income lost. This is because of the underdeveloped money market which could have provided investment opportunities for the banks. To avoid holding much idle balances, most of the funds available to the banks were devoted to loans and advances. The second period, 1968-70, was marked by uncertainty and greater risks arising from unstable political and economic conditions - a consequence of the 1967-70 civil war. The banks, consequently, were not prepared to direct their assets to loans and advances. An alternative investment opportunity was offered by the increased borrowing from the banks by the government in order to have resources to prosecute the war. Banks, therefore, diverted a greater proportion of their assets to investment in government securities. (See Chapter Four). The next period is 1974-76 - a period of economic boom in Nigeria because of the new-found oil wealth. The increased earnings and the consequent expenditures in the face of low productivity within the economy led to an unprecedented inflationary pressure. To deal with the rising prices, the CBN in its monetary circulars placed a limit on the margin by which loans and advances of one year should not exceed that of the previous year,thus reducing the proportion of bank assets devoted to loans and advances.

On the basis of the above analysis, it is correct to say that the Nigerian banking system has not performed efficiently in its lending activity. An excuse for the poor performance could be sort in the so-called financial repression policies of the regulatory authorities which manifest their effects on limited loan resources because of loan rate ceiling, limited financial asset portfolio diversification because of portfolio regulation and oligopolistic financial market. In addition the conservative banking operations in Nigeria, for example the inability of the banks to adopt innovations which have eased bank services elsewhere in the world help to explain the inefficient lending performance of the banking system.

9-4.1 Determinants of the Lending Performance of the Nigerian Banking System

The supply of credit made available by the Nigerian banks depends on the following factors:

- ratio of time plus savings deposits to total deposits
- number of bank offices
- ratio of interest received on loans to total loans

1 Ratio of Time plus Savings Deposits to total Deposits

The volume of bank loans and investments depends on the volume of deposits available to the banks. The deposit mix, therefore, is of particular interest in determining the lending capability of the banks. This is because some components of the total deposits seem to be more stable than others. It has been argued that the time and savings deposits to total deposits ratio, to some extent, in 'normal' times measures the volatility of the bank's deposit base (Morrison and Selden, 1965). Since banks grant loans on the strength of their deposits, the more volatile or unstable the deposits, the less confidence the bank will have in employing them on a long-term basis. Since in Nigeria, time and savings deposits constituted over 50 per cent of the total banks' deposits in 13 of the 21 years of the period covered by this study (See Table 6.2), it may be correct to argue that time and savings deposits not only represent the more stable and reliable portion of bank deposits but also constitute the core deposits of the banks.

Another advantage of the time and savings deposits is that they are relatively long-term deposits. Therefore, the longer the term of deposits, the more the banks should be confident and willing to part with them by way of loans. Since a large part of time and savings deposits represents the resources that can, in crisis-free business periods, be lent on a long-term basis, the bigger these deposits are as a proportion of total deposits, the better placed are the banks to make loans.

The ratio of time and savings deposits to total deposits is therefore expected to bear a positive correlation with the loan-asset ratio, our measure of bank lending performance. However, as shown in Table 9.7 the degree and sign of their statistical association is not as expected. The ratio of time and savings deposits to total deposits is statistically negatively associated with loan-asset ratio. The correlation coefficient is -0.37. The only reason which could be offered for this is as explained earlier that time and savings deposits require explicit interest cost to attract. Therefore the greater the proportion of time and savings deposits to total deposits, the greater the interest cost of funds and thus the less willing the banks are to put such funds into what they consider risky loans particularly to the preferred sectors of the economy such as agriculture and manufacturing.

2 The Number of Bank Offices

The dispersal of bank branches all over the country is bound to make a significant improvement in the lending performance of the banks. Branches are not only avenues for the mobilization of funds (particularly in the Nigerian rural communities, where large volumes of funds lie idle or underutilized because of lack of channels for their mobilization and investment), but they are also the outlets for the majority of bank loans in value and number (Adewunmi, 1981, p.325). This implies therefore that the greater the number of bank offices, the more loans the banks will be prepared to make since more financial resources will have been made available. Besides, the large number of bank offices will facilitate access to bank services thereby increasing demand for bank services. To the vast majority of bank customers, the most important single reason for patronising the banks is the hope of receiving financial assistance from the bank to take care of their difficulties and promote their business (Wadiri, 1981, p.164). Banks, on the other hand, thrive on the interest income derived from loans and facilities granted to their customers. It is to their mutual benefit, therefore, that the process of obtaining and granting loans should be smooth and prompt. A large number of bank branches provides this convenience. Therefore, the greater the number of bank offices, the more efficient will the bank lending be.

Table 9.7 Correlation between the Nigerian banking system's lending performance and its determinants

	Time and savings deposits / total deposits	Number of bank offices	Interest received on loans / total loans	Loans and advances / total deposits
Loans and advances / total assets	-0.37	0.72	-0.48	0.34
Loans and advances / total assets	0.52	0.12	-0.16	

Source : Computer print-out

On a priori reasoning, there should be a positive relationshi between the amount of bank financial resources devoted to lending anc the number of bank branches. As shown in Table 9.7, the statistical association between the number of bank offices and the loan-asset ratio is positive. The significantly high correlation of 0.72 supports the generally accepted hypothesis that the output performance of a bank is significantly affected by the bank market structure.

3 Ratio of Interest Received on Loans to Total Loans

As noted above, banks thrive, among other things, on the interest income derived from their lending activities. Therefore, the higher the loan rate, the more willing the banks will be to advance more loans. However, while the loan rate is an important source of income for banks, it could influence negatively the demand for loans. The higher the loan rate the less prepared will the bank customers be to demand loans. In Nigeria, however, because of the great unsatisfied demand for bank loans and because of the fact that banks exploit the situation by charging rates quite unrelated to the volume of and risk involved in loans, the monetary authorities specify for the banks the interest rate structure. Maximum rates to be charged for various loans are specified.

While the institutionally administered interest rates structure acts as a constraint to bank lending, it does not mean that the banks are entirely in a strait-jacket. Nigerian banks could and should stimulate demand for their loans by adopting loan rate policies that allow them to take risks. The more available the loan facilities and the more articulate the loan rate to cover the volume of loans and risks involved, the more efficient the banks are likely to be in their lending performance.

Table 9.7 indicates that the statistical association between loan rate and loan-asset ratio is negative, -0.48. This implies that the Nigerian banks are risk avoiders. They restrict output by 'pegging' the loan rate at a low level in order to avoid risks. Loans are not granted to sectors or projects that involve some reasonable risks. It requires the regulatory authorities to 'force' the bank to grant a specified proportion of their loans to such sectors. On this basis it may be correct to say that the Nigerian banking system has not performed efficiently in their lending activities.

9-5 CONCLUSIONS

As a background to the analysis of the hypothesis that bank market structure, policy and demand variables affect to a significant degree the economic performance of the Nigerian banking system, some major previous studies of the banking 'structure-performance hypothesis' (mainly of the US banking system) were reviewed.

The evidence from our discussion and analysis indicates that market structure as measured by concentration ratio had no significant and statistical association with bank profitability performance. However, market structure as measured by the number of bank branches was found to be statistically significantly correlated with bank profitability performance and bank lending performance respectively. The implication of this, therefore, is that a relatively simple description of structure such as the number of bank offices matters. Expansion of bank branches is desirable for increased bank performance. There is, however, a limit to such expansion. The expansion will be tolerated as long as it leads to greater incremental revenue to the banking system than incremental expenses.

The significant statistical association of the number of bank offices with the bank profitability and lending performance notwithstanding, on balance, the impact of market structure on the Nigerian banking system's performance is not strong. There is, herefore, no strong evidence to accept 'the structure-performance hypothesis' in the experience of the Nigerian banking system. The licy and demand factors were important determinants of profitability id lending performance of the Nigerian banking system.

The implications of these findings for the banks and the r gulatory authorities are clear. For the banks there is the need to inimise its total resources cost by a clever combination of cost-fective source of deposits. This is necessary because expense ntrol is the most important factor in achieving high bank p ofitability and lending efficiency. In addition banks in a d veloping economy like Nigeria must stimulate demand for their loans by deliberate policies on core factors of demand for their services, s ch as the interest rates.

The regulatory authorities, on the other hand, should continue with the policy of expansion of bank offices particularly in the rural areas. Furthermore, regulators should, at least, be as wary of mergers in relatively unconcentrated markets as in relatively concentrated markets. This is particularly important since there have been suggestions from some scholars for bank mergers in the country. More generally, as Stigler (1950) and Hart (1975) have argued, mergers between firms of intermediate size may lead to increased competition for the larger existing firms. This is certainly a possible outcome, though not the only one. Mergers between firms of intermediate size could also lead to a more cohesive oligopoly group and thus more effective collusive behaviour. The analysis, while it does not confirm, certainly lends support to the argument that small shifts in the structure of the banking market such as through the merger of two competing institutions will not have any appreciable impact on performance. Because the banking system in Nigeria is more or less liopolistic, conventional bank regulation may be incapable of chieving a measurable gain in operating efficiency or performance.

Furthermore, regulatory emphasis should be more on policy factors. To regulate the policy variable optimally, the monetary authorities should create an encouraging environment to enable the anks to adopt policies that will enhance their performance, articularly in their lending activity. The monetary authorities hould, to a great degree release their firm control on interest rates cructure. Such a measure will lead to positive loan rate policy as ell as positive and dynamic portfolio policy decisions by the banks.

Finally, the findings here are suggestive of the fruitfulness of this analysis, the handicaps notwithstanding; but clearly the need for additional research in this area is substantial.

CHAPTER TEN

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

10-1 SUMMARY

The main trend of thought in this study is that the structure of the financial system and in particular the banking system and the way in which it performs its diverse functions will affect, for better or worse, the progress of economic development. Basically, it has been argued and attempts have been made to demonstrate that within the context of Nigeria's development effort financial development with respect to the banking system has quickened in recent years and that the banking system has aided investment and economic development to a greater extent than is generally recognised.

Discussion of financial markets and institutions often raises the question whether there is an optimum path for financial development in a country's progress towards rapid industrialisation and sustained economic growth. The problem, of course, is that the financial theorists have different criteria of optimality. Quite possibly they have not specified a general set of criteria of optimality because as Boreham (1980, p.8-12) contends, 'they cannot do so since it is conceivable that economies in different stages of development - or differing in other respects - will impose different requirements on their financial systems and hence will involve different standards of optimality'. Besides in a changing competitive environment there is no fixed blue print even within a country for a best or optimal bank structure. But whatever may be the status of a country, the mobilization of savings for productive investment is still one of the most important preconditions for accelerated economic growth.

The structure of the banking system in Nigeria and its contribution to overall economic development of the economy have been very much influenced by the country's economic, historical and political developments as well as its geographical features. It hardly needs to be said that banking is a service industry closely linked to the social, political and economic needs of the rural and urban communities. Nigeria's vast geographical extent and its widely dispersed population have posed a particular challenge for the economy-wide branch banlopment of the economy have been very much influenced by the country's economic, historical and political developments as well as its geographical features. It hardly needs to be said that banking is a service industry closely linked to the social, political and economic needs of the rural and urban communities. Nigeria's vast geographical extent and its widely dispersed population have posed a particular challenge for the economy-wide branch bant. These aspects of the banking structure were discussed fully in Chapters Two and Three. It has also been shown that ownership structure of the Nigerian banking system does matter in its progress towards optimum pattern of institutional behaviour in terms of the kinds of loans offered, kinds of credit and deposit instruments used, particularly since the indigenisation of the banking system. Except, however, that the state governments' take over of indigenous banks, while it helped these banks to weather through the initial problems imposed by the 1952 Banking Ordinance requirements, unhealthy competition from the expatriate banks, and their internal problem of mismanagement, is likely to constitute a hinderance to the banks' efforts to improve their performance. These banks are now involved actively in the politics of the respective owner state government, and while this may make good politics it makes bad banking because it narrows their scope of operation in terms of attracting deposits from all the segments of the economy, and attracting the best indigenous skilled manpower.

The Nigerian banking system has experienced tremendous growth and development during the period covered by this study. It has in its process of growth and development contributed significantly to capital formation. This was shown by examining the trends in bank deposits relative to money supply and the total banking system's assets relative to GDP as indicators of effectiveness of mobilization of financial savings; increases in bank credit to the public and private sectors as a percentage of gross domestic investment - a measure of the contribution of the banking system to the financing of capital formation; and the expansion of bank offices as an indicator of the problem and prospects of mobilization of savings by banks; and the density of banks in relation to population and therefore the banking habit attained in the economy. (See Chapter Four).

It is further shown that the Nigerian banking system has attained a higher degree of financial intermediation than is generally realised. The degree of financial intermediation attained by the banking system is usually obscured by comparing it with developed countries' banking systems. Such comparison can mislead. It may indicate, however, that the Nigerian banking system is still at the rudimentary stage of development, but since the development of the financial system should be seen in relation to the stage of the economic development of the economy, the inter-system comparison was limited to selected developing countries in comparable stage of economic development.

In analysing development finance, it is convenient to recall that the need to develop the banking system and indeed the domestic financial institutions and patterns of behaviour necessary to generate and mobilize scarce capital funds as a key condition for economic development originated in the classic work of Schumpeter in the 1930s and has since been unfolding in the studies of a small but growing band of economists such as Gurley and Shaw (1973), Gerschenkron (1962), Cameron (1967) and McKinnon (1973, 1976). This aspect of the analysis was undertaken in Chapter five because it is difficult to undertake this type of study satisfactorily without attempting to understand various theories to explain the behaviour of the financial institutions and the relationship between financial development and economic growth. Unfortunately, however, inspite of a vast literature on monetary theory and monetary policy, and inspite of the recent deluge of scholarly publications on various aspects of capital formation in the developing countries, economists are still wrestling with the formidable task of providing "a general theory" of financial institutions (Boreham, 1980).

Evidence available indicates complementary relationship between money balances, capital accumulation and economic development in Nigeria. While it is difficult to demonstrate unequivocally that there is a direct statistical relationship between financial and monetary development on one hand and economic development on the other, there is a strong indication that economic growth in Nigeria has been rapid to the extent that monetary and financial resources have expanded in real terms.

In discussing the performance of the banking system, it is argued that while the usual problem of specifying any industry performance characteristics is well known, banking adds a twist or two thus making it difficult to measure its output performance. However, using a series of surrogates such as volume of deposits, earning assets and the number of cheques processed, it was shown that the long-run output performance of the Nigerian banking system exhibited an upward trend in the period under review. The profitability performance of the banking system was examined with profitability ratios such as profits after taxes to capital and profits after taxes to assets. These ratios showed a long-run upward trend during the period 1960-80. (See Chapter Six).

Based on the analysis in Chapters Seven and Eight among others, few would dispute that the banking system played an important role in financing the growth of the Nigerian economy during 1960-80. But, it is equally clear that the banking system has not fully responded to the credit needs of the priority or preferred sectors of the economy, particularly the agriculture and manufacturing subsectors of the production sector. Indisputably, a comparatively small proportion of bank accommodation went to agriculture and manufacturing. Nevertheless, it is observed that the amount of loans and advances to these sectors has been increasing. It is important to realise that the nature of agriculture in Nigeria has not encouraged banks to extend loans and advances to it. Agriculture in Nigeria is traditionally carried out for the most part on a very small scale and its production is strongly influenced by uncontrollable natural conditions. Compared with modern manufacturing industries, agriculture is very inferior in terms of productivity and income.

These features of the sector are reflected as a matter of course in their finance. It is thus difficult for the agricultural sector to obtain credit from the banking system.

Most of the advances of the banking system are secured either by a pledge or hypothecation of goods, real estate and securities (stocks and bonds and life insurance policies). The reluctance of the banking system to stimulate demand for loans and to lend to the priority sectors has been attributed to their unwillingness to relax their traditional criteria of security 'rather than to the inherent unprofitability or deficient capacity of these groups to repay loans' (Boreham, 1980, p.9-1). Critics of the so called "banking collateral syndrome" point out that rigid insistence on approved securities as collateral inhibits the extension of credit to many legitimate small borrowers and also favours the affluent. In addition most of the loans and advances of the banking system to the private and public sectors are of short-term nature. The bankers, however, contend that while they restrict their activities mainly on short-term financing, in the legal sense, in reality the loans are renewed at the end of the contract and the credit is rolled over in many cases. In essence, the distinction between short-term and long-term is only theoretical. Even so, a formal term loan which has the advantage of regular repayment of instalments and current cash inflow into a bank appears to be a more appropriate method of financing for both lender and borrower than credit which though short-term in form is in effect medium- or long-term. It is argued that considering the composition of deposits with the banking system, the Nigerian banking system should not be in any way handicapped in its important role of transformation of short-term funds into medium-term and longer-term financial assets. Since the banking system finance the working capital requirements of industry and trade and since a certain core of funds always remains with the bank over long periods of time, a moderate amount of medium- and long-term lending constitutes no threat to the stability of the banking system. In brief there is no sound reason why the banking system should refrain from financing fixed capital formation. A recent study by Khatkhate and Riechel (1980) on the stability of the demand, time and savings deposits for a selected number of developing countries suggests that a surprisingly high percentage of such nominally short-term funds as demand deposits can be relied upon to remain available over more than one period. The percentage core is even higher for the average measure of future periods. This view was corroborated by the Radcliffe Report which concluded that 'individual balances go up and down, depositors come and depositors go, but the total on current account goes on for ever' (See CLCB, 1977).

To further complete the analysis on the performance of the banking system, an analysis of the determinants of the profitability and lending performance of the banks was undertaken in Chapter Nine. The basic hypothesis is that structure, demand and policy variables influence to a significant degree the economic performance of the banking system. As this relates to the "structure-performance hypothesis and since it has been variously tested in many studies of other countries particularly the United States, some of the major studies were reviewed as a background to the study.

Policy variables used are the loans to deposits ratio and time and savings deposits to total deposits ratio while the structure variables include deposit concentration ratio and the number of bank offices. The demand variable is proxied by per capita income.

The evidence of the analysis indicates that structure variable as measured by the number of bank offices rather than the concentration ratio is important in explaining the lending and profitability performance of the Nigerian banking system. On the whole, therefore, the impact of the market structure on the Nigerian banking system's performance is weak and unstable. It was suggested that the apparent weakness of the "structure-performance hypothesis" might be at least partly a result of the pursuit of multiple bank objectives such as increasing bank size and revenue and reducing bank risk exposure. If more highly concentrated and less competitive bank markets more easily enabled banks to satisfy the goal of satisfactory rate of return on equity, then banks in more highly concentrated markets would be more likely to pursue other objectives. Thus it was argued that the pursuit of such satisficing objectives could at least, in part, help to explain the absence of strong and significant positive relationship between market concentration and bank profit rates.

The policy variables, deposit-mix (time and savings deposits to total deposits ratio) and intermediation level (loans-deposits ratio), and the demand variable as proxied by per capita income were important determinants of profitability and lending performance of the Nigerian banking system. Loan rate has not influenced very significantly the lending performance of the Nigerian banks. The above evidence, however, does not suggest the acceptance of the structure-performance hypothesis in the experience of the Nigerian banking system.

10-2 REVIEW OF OBJECTIVES AND HYPOTHESES

The hypotheses of the present study were derived from the general objective of the study. The general objective of the present study states that within the context of Nigeria's development effort, financial development with respect to the banking system has quickened in recent years and that the banking system has aided investment and economic development to a greater extent than is generally recognised. On this basis the study was approached by a detailed examination of the historical pattern of growth, structure and operations of the Nigerian banking system as a service producing industry, the analysis of the determinants of the economic performance of the Nigerian banking system, and the investigation of the banking system's specific contributions to the process of general economic development. In addition the hypothesis which was stated in broad terms is examined under five manageable hypotheses as stated in Chapter One.

Hypothesis 1 is accepted. Generally the banking system's credit to the economy has shown a long-term increasing trend. It rose from 125.4 million naira in 1963 to 9,066.9 million naira in 1980. (See also Fig 4.7). Furthermore, the loans/deposits ratio which gives an impression of the extent to which the banking system used the resources available to it, maintained an annual average of 73 per cent for the period 1960-80. The proportion was as high as 113.8 per cent in 1967. It is also shown that the proportion of bank resources devoted to investment has been increasing over time. To further support the acceptance of hypothesis 1, the measurement of the banking system's output as a service producing industry indicates that the earning assets of the commercial banks have shown an increasing trend; and the number of cheques processed by the banking system exhibited an upward trend with an average annual increase of 14.5 per cent. The average clearing efficiency of the banks recorded an increasing trend too.

The volume of deposits held by the banking system recorded a sixty-four-fold increase during the period covered by this study. It recorded an average annual growth rate of 20.5 per cent. Even when deflated for price increase to take account of the effect of inflationary induced increase in deposits, there was a ten-fold increase in the deposits during the period 1960-80, with an average annual growth rate of 12.5 per cent. On the basis of these findings and available evidence, hypothesis 2 is accepted.

Hypothesis 3 has not been conclusively proved or disproved. The credit and advances to the economy have shown an increasing trend and an inter-system comparison of the degree of financial deepening has indicated that with an average demand deposit to money supply ratio of 53.2 per cent and time plus savings deposits to money supply ratio of 60 per cent, the Nigerian banking system has a higher degree of financial intermediation than the other selected countries of Tanzania, Ghana and Kenya which share similar economic development characteristics with Nigeria. On the basis of these results, the hypothesis might be accepted. But the fact that the loans and advances particularly to the private sector are not suited or appropriate to the needs of the sector makes it difficult to justify the acceptance of the hypothesis. The loans and advances are short-term in nature as opposed to the greater demand for medium- and long-term credit by the private sector. Besides, by their strict adherence to the traditional criteria of loan security the banks discriminated in the loan accommodations against many legitimate small borrowers (particularly in agriculture and small scale industries) who have no "acceptable" securities to offer in favour of the big and affluent borrowers who, in any case do not need the "acceptable" securities in order to borrow from the banks since their "names" alone are enough acceptable securities by the banks.

Although the banking system has not fully complied with the CBN directives on loans and advances extension to the preferred sectors, there is absolute evidence as shown in Chapters Seven and Eight that the banking system's loans and advances to these priority sectors have increased more than it would have without the directives. In fact, the banking system's advances to the public sector is primarily dictated by the government's needs for funds which the banks have always been willing to accommodate albeit as far as short-term credit needs are concerned. Hypothesis 5 is, therefore, upheld. In investigating the "structure-performance" related hypothesis it is shown that there is no strong conclusive evidence to accept hypothesis 4.

10-3 RECOMMENDATIONS

> A spirit of vigorous, restless innovation in the financial system - of devising new ways to do new things rather than of justifying why they should never be done at all - can ordinarily best be achieved in conditions under which the participants are not prevented from responding to changed opportunities, in which there is relative ease of entry for honest men with ideas and imagination and in which different classes of institution can compete with each other on an equitable and open basis.
> (Report of the Royal Commission on Banking and Finance: The Porter Report, Canada, 1964, p.8-9).

Guided by the above philosophy, the objective in this section is to suggest recommendations which would further the existence in Nigeria of "a creative banking system" - a system which would not passively accommodate the usual but rather one in which active and inventive efforts are constantly being made to meet the sound requirements of lenders and borrowers regardless of how untried and unusual such needs may be. (See Porter Report 1960, Green 1971).

Recommendations put forward here are based on three main areas in an attempt to deal with the problems of:

(i) financial depending and/or repression;

(ii) greater risk averse-than-is-worthwhile attitude of the Nigerian banks;

(iii) credit to the agricultural sector and small scale enterprises and the rural banks.

1 Financial Deepening/Repression

It is observed that Nigeria is still under-banked because of the vast geographical extent and its widely dispersed population. It is, however, encouraging that the government and the commercial banks through the rural banking scheme are making commendable efforts to get the banks to expand to the rural areas. The government should in addition establish its own rural banks to speed up the expansion. The necessity of this cannot be overemphasized. It is usually argued that the problem of promotion and mobilization of savings in the developing countries is caused by inadequacies in the financial structure and the density of financial intermediaries (Lewis, 1955). Support for this contention has come form some empirical evidence that has shown savings to be responsive to the number, availability and efficiency of financial markets (Wai, 1972). In other words the available evidence suggests that saving is "institution elastic" and therefore a higher density of financial institutions evokes a greater volume of savings (Hitiris and Wiseman, 1981).

With reference to the financial activities of commercial banks, it is rightly asserted that whereas the increase in productivity in the economy determines the potential rate of growth of saving, the existence of an appropriate and adequate financial network determines the actual flow of such funds (Antonin Basch, 1964, p.72). Besides, it hardly needs to be said that banking is a service industry closely linked to the social and economic needs of rural, urban and 'even wilderness communities' (Papadopoulos, 1981). Thus government-owned rural banks should be tailored to the needs of each rural community and should serve as a model for the other more or less privately-owned rural bank branches.

It is however evident that the more basic causal link between savings and financial institutions is not so much through the number and variety of financial institutions and instruments as in the adoption of appropriate economic policies. This leads to another recommendation and that is: that interest rate which is institutionally determined and administered should be free of all strict controls. Commercial banks can play a more active role in the task of economic development if they are free from the "repressive" measures of rigid interest rate controls. Although the positive relationship between saving and rate of interest which classical theory assumed to exist has not been established by empirical research, the lessons of history are remarkably clear on this point: anti-market measures usually breed more controls, not more responsiveness on the part of those controlled.

It is not surprising therefore to find that major analytic studies of financial markets have clearly established that the consequences of regulation of interest rates in the developed countries have been to foster and sustain monopolistic profit making positions rather than to protect the financial system and the users (Boreham, 1980). Experience in developing countries shows that when interest rate is regulated the banks resort to non-price rationing of credit and the easiest criteria available to the bank managers for credit rationing are the quality of collateral, political pressures (as happens with the state government-owned banks) "name" and loan size and credit standing of the borrowers. These criteria not only tend to favour the affluent but also discriminate inefficiently between investment opportunities (Fry, 1979). In short, government intervention and regulation should not distort the working of the market mechanism too much.

It is significant that official inquiries into the financial systems of developed countries over the past 15 years - the Porter Commission in Canada (Report, 1964); the Hunt Commission in the United States (Report, 1971), the Bank of England document on competition and credit control (June , 1971) and the more recent Report on the Italian Credit and Financial System (June 1983) - have all emphasised the need for a more competitive financial order to promote efficient allocation of resources. In this respect, at least the experience of the developed countries is highly pertinent to the present day Nigerian banking system.

Implied therefore, is that the monetary authorities should adopt appropriate banking policies concerning depositors. The present policy whereby banks pay very low rate of about 4 per cent, for interest bearing deposits and at the same time charge as high as 11 per cent on their loans and advances is bound to be discouraging to savers. Even if Hitiris' and Wiseman's (1981) contention that the net impact of the real rate of interest on aggregate saving was found to be insignificant is accepted, one thing is not in doubt, that is that interest rates are at least as significant in determining where savings will be directed as in determining how much will be saved. It is also believed that the lack of simple intelligible and convenient financial instruments yielding a positive real return, has frustrated potential saving and rather encouraged consumption.

The wholly indigenous-owned banks will be better disposed to perform their functions more efficiently if they are insulated from the respective owner state government's politics. The banks will be able to compete in the labour market for skilled staff and broaden their operational base in attracting deposits and investments. Generally, banks should be provided with greater autonomy in management so that they might be able to develop a variety of savings instruments and enjoy greater freedom in the determination of interest rates and in investment of deposits, and the provision of credit.

2 Greater-Risk-Averse-than-is-Necessary Behaviour

The prevalence of greater-risk-averse-attitude than is necessary of the banks is responsible for the banks' refusal to lend on medium- and long-term basis and their inability and unwillingness to undertake innovative ventures. Medium- and long-term lending by the banks usually take the form of roll over credits which are however, generally inefficient from the point of view of allocation of resources, since the banks favour larger well established borrowers over new and smaller borrowers. There is a great need for more term transformation by banks. A number of measures can be undertaken to help the banking system re-shape and re-define its "canons of good banking" to reflect a dynamic banking system and be prepared to accept risk in its operations. These measures are examined below:

(i) Loan Guarantee and Discounting : The CBN and the government can do more than they are currently doing by broadening the credit guarantee scheme (ACGS) to meet the greater needs of the banks as well as bank customers. Re-discounting by the CBN can offer ample possibilities for encouraging commercial banks to gain experience in medium- and long-term lending operations and to channel savings into productive activities. A number of procedures can be adopted such as preferential discount rates, multiple discount rates or quotas favouring certain sectors or purposes. For example in some Latin American countries, the government or the central banks re-discount paper if the purpose of the operation is to finance a project included in the development plan or to promote the exportation of certain non-traditional products. Ordinarily the banks are requested to assume part of the non-payment in the re-discount operation, although in some cases a government guarantee may be justified, for example in financing of agricultural development plans.

(ii) Technical and Managerial Assistance. The banks themselves can ensure minimum risk of loan losses by providing technical and managerial assistance facilities of various kinds to their customers and not by shying away from innovative banking. With the CBN re-discount and guarantee scheme, the banks should emulate the experience of German banks and attempt to accompany industrial and/or agricultural enterprises "from cradle to grave, from establishment to liquidation, throughout all the vicissitudes of its existence' (Gerschenkron 1962, p.14; Pollard 1964). This would embrace direct assistance in project preparation and financing as well as management.

(iii) Personnel Training. For the banks to assume a dynamic and innovative role, they require special expertise. In fact in no economic activity is the use of personnel as important as in banking. Unlike industrial firms which are capital intensive, banking operations depend essentially on the quality of the staff. Furthermore, there can be no doubt in theory and practice about the truth of the prediction that in future the competition between banks will be carried out mainly in the personnel field. For these reasons there must be continued emphasis on providing the banks with all the resources and support that will foster the training and development of skilled banking staff. Both the banks and the government should join efforts to see that the training programme in banking is expanded in the short-, medium- and long-term to meet the demand for skilled manpower in the banking industry. In this regard, the Nigerian Institute of Bankers School should be equipped to take up the extensive manpower training for the banks. Training should not be limited to increasing the expertise of the personnel; it should embody the philosophy of modern firm and its social responsibility in the light of development requirements. This is where co-ordination between the expanded role of the Institute of Bankers as a bank personnel training centre and the universities and other high institutions responsible for training students of banking and finance is necessary.

(iv) Co-ordination of Monetary policy and Financial policy. The banking system must operate in a social and political framework that is regulated; it would not be able to play a dynamic role in the absence of a monetary and fiscal policy that is consistent and compatible with development and a monetary authority that tries to provide stability. The greatest contribution that a central bank can make to development process is through the maintenance of monetary and financial stability on agreeable climate in which savers and investors can continue supplying the economy with its basic development material. A high rate of inflation, for instance, discourages long-term bank lending. Beckhart (1965, p.86) has pointed out 'The basic test of a well-functioning financial system ... is its ability to finance credit needs, which contribute to economic growth, and to finance those needs in such a fashion that inflation and economic instability are not engendered'.

Furthermore, selective and innovative use of traditional monetary policy instruments can afford a suitable technique that will help the banks to play a more dynamic role in the national economic development. For example, legal reserve requirements can serve as a means of influencing the structure of bank lending in terms of maturity pattern, the conditions for which the loans are made, and the economic sectors to which the loans are directed. The aims of this policy would be to increase the proportion of lending to the basic productive sectors with longer maturities and to serve agriculture, small scale industry and other sectors not offering a high rate of return.

(v) Interbank Lending Market. Apart from the readiness to re-discount and guarantee bank loans and advances, the monetary authorities should assist in broadening the interbank lending market which can be used to offset potentially disruptive shifts of deposits among banks.

3 Credit to Agriculture and Small-scale Enterprises and the Rural Banks

A number of recommendations for improving bank loans and advances to agriculture and small-scale enterprises is necessary.

(i) Since the government with the co-operation of the banking system is vigorously embarking on a rural banking programmes, it is necessary that these banks are made to specialise in providing the special credit needs of the respective communities they are meant to serve. To do this effectively, there is the need for the existing and future banks to decentralise their control. Given the decentralised decision-making, local branches can provide credit of many different types with relative speed based on personal contact and on local management's knowledge of area, industries and business as well as farm conditions. This approach involves a more intimate link with the managements of small enterprises; the banks should not only provide much needed information about facilities but act more as management consultants, identifying problems and suggesting solutions (Revell, 1983). Thus like the unit banks in the United States, the branch bank offices in the rural communities should provide the individual knowledge and community "feel" of local management. If, for instance, a bank lends to members of the same economic and social group to which the savers belong, it thereby creates a constructive image of banking as an institution, and so helps to develop a more advanced economic behaviour pattern by making people directly aware of the role of saving in economic development (Masini, 1977).

(ii) One of the reasons banks are not keen in lending to the rural community is that their customers constitute one special category of borrowers: that of small enterprises in farming, industry, ıfts and trade who are scattered all over the economy. It is not y impractical to meet their financial needs individually but also ı administrative costs and risks may be very high. The bank can ch them easily only through co-operative societies. By operating ough co-operative movements banks can reduce the cost of processing l supervision since group lenders and co-operative officers could ist in preparing the loan application and farm planning. Besides, formation of the units into co-operative organisations with larger urces and increased creditworthiness will reduce the risk of loan ses to the banks. The various state governments should, therefore, w greater interest than hitherto in encouraging the formation of operative societies. Evidently this is one of the easiest ways of ilizing rural savings for capital investment in agriculture and ıer small enterprises because the banks will be in a position to ımand resources and thus strengthen the resource position of the co-ratives.

(iii) There seems to be much emphasis on extending credit to the mers with little recognition of the vital need to promote savings small enterprises. Existing and future rural banks should combine ings schemes for farmers with their credit programme. Such a eme would provide further means for financing the banks and create achment of the farmer to the banks. This should involve ease of osit and withdrawal, and attractive interest rates should be paid. erience shows that small family enterprises are more willing than st to save and more responsive to incentives to do so. To the ent that the banking system helps families to undertake a productive project, it tends to alter the pattern of income use in the direction away from consumption and hoarding and towards strengthening the enterprise.

Revell (1983, p.155) notes that in most developed countries, banks in their desire to attract new customers in sections of the community not previously involved with banks have moved towards "free" banking for personal customers with no charge for payment services to those who maintain balances of a specified level. This policy if tried in the Nigerian rural sector is likely to encourage saving and investment in the sector. The banks' profit level has been so high that the banks can afford to adopt the policy of "free" banking as well as that of "bundling" services to the small enterprises with a range of subsidies from the affluent and the large scale enterprises of the urban areas to the rural farmers and small scale industries 'none of which is necessarily contributing to the recovery of bank costs in proportion to the use made of services or necessarily receiving the correct price for the raw material, deposits, that it makes available to the bank' (Revell, 1983, p.155).

(iv) The CBN credit guidelines should be sufficiently articulated to show a more detailed classification of subsectors. As noted in Chapter Seven, a commendable beginning has been made by separating real estate from construction in 1975 and the removal of bills discounted as a subsector of general commerce in 1980, but this did not go far enough particularly in the agricultural sector. Agriculture should be broken down into a finer group to separate direct production from indirect financing. Processing should be separated from direct production and from food procurement. The industrial aspect of agriculture while important in stimulating raw material production stands apart from agricultural production proper.

Furthermore, in manufacturing which is an omnibus category, there is a great difference in credit needs of large- and medium-scale industries on the one hand and the small-scale industries on the other. Each of these categories requires a different orientation in terms of credit policy.

(v) The CBN should prepare a manual for guidance of bank managers in classifying loans and advances for the purpose of completing the returns to their head offices. More often than not, the bank managers use their discretion but without any further aid in deciding how to classify a particular transaction. For example, an advance for the importation of fish may be classified as an advance to the fisheries subsector of agriculture whereas it belongs properly to the import subsector of general commerce. The CBN manual should be available to all banks in sufficient quantity to be given to all branch management staff of each bank.

The results of this study raise some interesting questions for additional investigation. First is whether the bank's function in Nigeria for bank credit to the private sector is supply or demand constrained or determined by both? Whichever, what are the relevant determinant factors? Second is the need for more exhaustive investigation of the objective functions of bank management and the role of the pursuit of multiple objectives by bank management in helping to explain observed bank behaviour. The results presented in Chapter Nine suggest that the need for additional research in this area is substantial.

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