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Evaluation of the Financial Performance of Banks In A Deregulated Banking Environment: A Focal Study Of First Bank Of Nigeria PLC.

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Abstract
This study was undertaken basically to evaluate the financial performance of banks in a deregulated banking environment using an ordinary Least Square (OLS) method of regression analysis to analyze the results of First bank of Nigeria plc. The data set for this research constitutes an annual time series data spanning from 2001 – 2010. The selection of this timing was informed by the era of bank consolidation in Nigeria and from the fact that the banking sector has already been liberalized even before this period. The objective of this research is to find out the effect of the nominal lending rate, the exchange rate and the credit volume on banks financial performances in terms of their profitability. The data sources were mainly from a ten year financial summary of First bank of Nigeria Plc and CBN Statistical Bulletin, various years. The empirical evidence of the study revealed that the nominal lending rate and credit volume impacted positively to the profit of first bank Nigerian Plc, while the Exchange rate showed a negative significance. In summary, it was garnered that the variables employed are statistically significant as over 98 percent of them were explained at the long run. The researcher, therefore, submits that greater policy sensitivity towards the creation of credits and regulation of exchange rate volatility is urgently needed so that enough funds will be made available for potential investors in the Nigerian banking system.
Key words: Deregulation, Financial performances, Banking environment, Exchange rate, Nominal Lending rate, Credit Volume.

1. Introduction

Banks occupy a significant place in the economy of every nation as the prime movers of its economic life. It is therefore not surprising that their operations are perhaps the most heavily regulated of all businesses. Prior to the liberalization of the various sectors of the economy, the financial sector had been the most heavily regulated. According to Ghosh (2005), financial deregulation or liberalization refers to measures directed at diluting or dismantling regulatory controls over the institutional structures and activities of agents in different segments of the financial sector. Financial Liberalization is the deliberate and systematic removal of regulatory control, structures and operational guidelines which may be considered inhibitive to orderly growth, competition and efficient allocation of resources in the financial system. In Nigeria, financial sector reforms began with the deregulation of interest rates (Obamuyi, 2009). Prior to this period, the financial system operated under financial regulation and interest rate were said to be repressed (Obamuyi, 2009). The relevance of the financial sector is justified by the fact that they not only provides the intermediation used in pooling funds from savers but at the same time redirects them to investors. It also provides the payment system that facilitates trade and exchange. The financial system also provides a platform for the working out of the monetary policies which provides macroeconomic stability for all economic agents (Adegbite, 2005). The importance of Nigerian banks is also exemplified by their prominence in the Structural Adjustment Program (SAP) embarked upon by the nation in July 1986.

Prior to the institution of the structural adjustment program in Nigeria, the Nigeria financial system faced interventionists' policies and virtually all the sectors of the economy were strictly regulated. There were statutory interest rate ceilings, directed credits, accommodation of government borrowing, exchange rate controls and informal modes of intermediation (Umejiaku, 2011). One of the policies of the structural adjustment programs was the reform of the financial sector. The sequence of the reforms in the financial sector shows that it started with liberalization. The first being the liberalization of the lending and deposit interest rates aimed at guaranteeing efficient allocation of resources. This was followed by the deregulation of entry barriers into the banking sector which was necessitated as a result of the influence of the three largest banks namely First bank, Union Bank and United Bank of Africa, which dominated the banking sector as at then (Umejiaku, 2011). Liberalization led to astronomical increase in the number of banks from 34 in 1987 to 90 in 2003, before the recapitalization policy that was undertaken in 2004 which reduced the number of banks to 24 bigger banks compared to what they were earlier. The aim of this was to encourage healthy competition in the banking sector and thus break the existing monopoly (Umejiaku, 2011). Also, the scope and coverage of the operations of banks was seen as appropriate for the implementation of monetary policy and the intended financial reform. Jerome et al, (2003) in their submission, revealed that in the context of the structural adjustment program (SAP) that took place in July 1986, Nigeria undertook a broad program of financial liberalization. Interest rates and entry into the banking system was liberalized, and credit allocation quotas were also loosened. This led to the quick entry of many new players into the banking system, especially merchant banks. The government also brought out new rules for setting up banks and issuing licenses that favoured new entrants most. This consequently led to a sudden upsurge in the number of banks which invariably increased from 56 in 1986 to 120 in 1993 (Okpara, 2010).

Given the key position of the financial system especially the banking sector, the government rigidly controlled every aspect of their activities. In the banking sector for instance, the government regulated how much loans that go to different sectors of the economy and the amount of loans that banks could give to their customers. Government controlled how much interest that could be paid on their deposits and at what rate their credit could grow. There were rigid regulations guiding entries into the banking system. At the end, the financial sector was repressed, especially the banking sector which constituted the greatest proportion of the sector and so could no longer generate enough savings at the prevailing rate of interest, nor find enough investment for meaningful capital formation and development, (Adegbite, 2005). This simply depicts that before the introduction of the structural adjustment program (SAP) in Nigeria in July 1986, the Nigerian financial sector was repressed and characterized by fixed and relatively low interest rates, continuous changes and volatile exchange rates, mandatory allocation of bank credit, and quantitative ceiling on bank credits to the private sectors, all of which resulted in distortions and inefficiencies (Adegbite, 2005).

The principal aims of financial deregulation were to stabilize the economy in the short-run, induce the emergence of a market-oriented financial sector for effective mobilization of financial savings and efficient resource allocation, to increase competition, strengthen the supervisory role of the regulatory authorities and streamline public sector relationship with the financial sector. The universal banking reform in 2001 freed banks and broadened their horizon to operate both banking, securities and insurance businesses, so as to ensure sufficient delivery of all financial services at reduced costs and also improve bank risk return profile through diversification (Asogwa, 2005). The introduction of the structural adjustment program assigned greater responsibilities to the market forces of demand and supply in allocating its resources and removed certain controls which were originally used by the Central Bank of Nigeria (CBN) to regulate the economy. However, in August 1987, all controls on interest rates were removed and banks were subsequently given an enabling environment to fix their deposit and lending rates. Several modifications were made by the Central Bank of Nigeria between 1989 and 1990 in order to maintain the interest rate at the desired level in accordance to different economic situation, basically to avoid discrepancies in the interest rate structure (Jerome et al, 2003). Under the structural adjustment program (SAP), banks were given a great measure of discretion in their operations.

The consequences of financial deregulation/liberalization as a result of the introduction of structural adjustment program into the Nigerian economy was the quick entry of many new players into the banking system especially merchant banks that specialize in foreign exchange operations (Lewis and Stein, 2002). The number of banks tripled from 40 to nearly 120 in the years following the liberalization exercise, employment in the financial sector doubled and the contribution of the financial system to the nation's Gross Domestic Product almost tripled (Lewis and Stein, 2002). The financial liberalization policy came as a major component of the broad economic restructuring program. In the early periods of the implementation of the program and policy, so many banks, including the merchant and commercial banks, gained entry into the sector. Even since this period, other non-bank financial institutions such as finance companies, securities firms, community banks, Agricultural banks and lately mortgage banks, have become part of the financial system. However, the commercial banks still hold the bulk of financial system deposits, provide the most appropriate channel through which monetary policy can be effectively coordinated, monitored and assessed, and serve as bankers to other economies (Lewis and Stein, 2002).

The underlying premise of this study is the McKinnon - Shaw (1973) financial repression theory. Financial repression according to McKinnon-Shaw is said to exist when governments tax and otherwise distort the domestic financial market, keeping real returns on financial assets low and shifting the nexus of decision making on credit allocation from the market to the government. The McKinnon-Shaw financial repression theory states that financial repression impacts adversely on economic growth through high negative effects on the quality and quantity of real capital accumulation. According to them, the remedy to financial repression is embedded in its conceptual framework, ''financial liberalization'' or ''financial deregulation''. This theory corroborates the work of Ahmadu (2013) which states that the abolition of financial market distortions imposed on the government of developing nations will enhance capital accumulation, financial system development, availability of non loanable funds, and in turn, more and better quality investment and growth (Ahmadu, 2013).

Therefore the main focus of this study is to evaluate the performances of banks in a liberalized banking environment, using first bank of Nigeria Plc as a focal study. This research is divided into five segments. Chapter one is the introductory part which is meant to set the stage for the entire research work, chapter two reviewed related literatures and works of scholars in similar research areas, the research design and analysis is presented in chapter three, chapter four examines the analysis and interpretation of results while the summary, conclusion and recommendation concludes this research.

1.1 Statement of the Problem

Before the Structural Adjustment Program was introduced in Nigeria in July 1986, the Nigerian commercial banking sector was characterized by fixed and relatively low interest rates, mandatory allocation of bank credit and quantitative ceilings on bank credits, all of which resulted in distortions and inefficiencies in the performances of these banks. The mid 1980's was characterized by over regulation of the banking sector in Nigeria and despite that; the issue of bank distress and failure were rampant. There was also period of deregulation and guided deregulation, yet the banking sector did not efficiently perform well and this to a very large extent was tantamount to disruption of the economy. Experiences have shown that any disruption in the financial sector can create substantial problems that can reverberate not only on the entire financial sector but also on the economy as a whole. This effect can indeed plunge the economy into recession.

Thus the problems which the financial sector encountered before the introduction of financial liberalization and which this study intends to analyze are summarized as follows:

1. There was fixed and relatively low interest rates (Deposit and lending rates) as a result of strict regulation by the government. This means that prices were fixed by the government authorities instead of the forces of demand and supply and this to a very large extent hindered efficient allocation of resources.

2. There were continuous changes and volatile exchange rates as a result of government's interventionist policies and this considerably reduced the value of Naira when compared to other nation's currency.

3. There was statutory and directed ceilings imposed on the volume of credit that could be given to other sectors of the economy and at the same time huge and unexplained government borrowings were accommodated.

4. There was strict regulation of entry requirements into the banking sector which posed difficult entry barrier to prospective key players in the sector.

2. Literature and Empirical Reviews

Many studies have evaluated the financial performance of banks in a liberalized banking environment prior to 1986 when the government adopted the Structural Adjustment Program as a liberalization process in the financial sector. Obamuyi (2009) studied the relationship between interest rate and economic growth in Nigeria. The study employed co-integration and error correction modeling techniques and revealed that lending rate has significant effect on economic growth. The study then postulated that investment friendly interest rate policies necessary for promoting economic growth needs to be formulated and properly implemented. Albu (2006) studied trends in the interest rate, investment and GDP growth relationship. The study used two partial models to examine the impact of investment on GDP growth and the relationship between interest rate and investment in the case of the Romanian economy. The study found that the behavior of the national economy system and interest rate-investment relationship tend to converge to those demonstrated in the normal market economy. Obute, (2001) in evaluating the nominal and real rate of interest from 1960 to 1981 showed that the real interest rate in Nigeria for the past decades were negative, this confirmed what McKinnon and Shaw (1973) said "that negative real interest rate over a period of time contributes to financial repression". This indicates that the Nigerian economy has been financially repressed from 1960 to the early 1980's before the introduction of the structural adjustment program that ushered in the liberalization exercise to salvage the economy in July, 1986. Felicia (2011) used regression analysis to investigate the determinants of commercial banks lending behaviour in Nigeria. The study discovered that commercial bank deposit have the greatest impact on their lending behaviour.

Rasheed (2010) used error correction modeling (ECM) to investigate interest rates determinants in Nigeria. The study found out that as the Nigeria financial sector integrates more with global market, return on foreign asset will play a significant role in the determination of domestic interest rates.

Bakoulas et al., (2002) examined the impact of exchange rate fluctuations on the volume and variability of trade flows and they concluded that exchange rate volatility discourages expansion of volume of trade thereby reducing its benefits. Eichengreen and Lablang, (2003) carried out a research on twelve countries over a period of 120 years and found strong inverse relationship between exchange rate stability and economic growth. They concluded that the results of each estimates strongly depend on time period and the sample. Schnabel (2007) identified robust evidence through panel estimation that the exchange rate stability is associated with more growth in the European monetary unit (EMU) periphery. The evidence according to him is strong for emerging Europe which has moved to more stable environment. David, Umeh and Ameh (2010) examined the effects of exchange rate fluctuations on the Nigerian manufacturing industries. They employed a multiple econometric tools which revealed a negative relationship between exchange rate volatility and the manufacturing performance.

3. Methodology and Research Design

This study adopts a quasi-experimental research design. This research design is useful considering the fact that the researcher intends to analyze a time series data spanning from 2001 to 2010. This design, however, relates to the setting up of a particular type of an experiment or other study in which one has little or no control over the allocation of the treatments or other factor being studied. The key difference in this empirical approach is the lack of random assignment. Another unique element often involved in this experimentation method is the use of time series analysis.

However, the first part of creating a quasi experimental design is to identify the variables. The quasi independent variable will be the x-variable, the variable that is manipulated in order to affect a dependent variable. X-variable is generally a grouping variable with different levels. Grouping, here, means two or more variables fused together to form independent variables. The predictable outcome is the y-variable. In a time series analysis (as applied in this study), the dependent variable is observed over time for any changes that may take place. One of the merits of this design is that it minimizes threat to external validity as natural environments do not suffer the same problem of artificiality as compared to a well controlled laboratory setting. Finally, this design is efficient in longitudinal research that involves longer time periods which can be followed up in different environments. The objective of this study is to analyze empirically banks' financial performance in a liberalized banking environment.

3.1. Model Specification

The empirical analysis of bank financial performance in a liberalized banking environment is often accomplished using regression analysis which can be explicitly or implicitly stated based on a theoretical framework of endogenous models (King and Levine, 2004). Thus, the level of performance of banks in a liberalized banking environment is assumed to be influenced by several variables as 'y' which represents the Profit Before Tax (PBT) and 'x' which include among others, the Nominal Lending Rate (NLR), the Exchange Rate (ER), the Total Credit (TC). If these assumptions are right, then a multiple linear regression analysis could be adopted and specified thus;

$$Y = f(x) \qquad (1)$$

Where;

Y is the dependent variable and is represented as the proxy for the bank's annual profit before tax (bank's financial performance); and

X is the independent variable, and a vector of factors arising from the deregulated banking environment.

More specifically, equation (1) could be written in a non stochastic implicit form as;

$$PBT = f(NLR, ER, CV) \qquad (2)$$

Where;

PBT is the profit of the bank before tax;

NLR is the Nominal Lending Rate;

ER is the Exchange Rate

CV is the Credit Volume and;

Therefore, we could rewrite equation (2) in its stochastic explicit form based on the above functional relation as:

$PBT = b_0+b_1 NLR + b_2 ER + b_3 CV + u_t$ ……………………………………………... (3)

Where;

All variables are as previously defined

b_0 is the regression constant

b_1, b_2 and b_3 are the parameter coefficients; and

u_t is the stochastic error term.

Transforming equation (3) to the natural logarithm, we obtain:

$InPBT_1 = b_0+b_1InNLR+b_2InER+b_3InCV +u_t$ …………………………… ……… (4)

Where;

InPBT is the natural logarithm of the dependent variable; and

InNLR, InER and InCV are the natural logarithm of the independent variables.

Thus, the transformed log linear equation (4) will be estimated using the Ordinary Least Square (OLS) regression method. The use of the log-linear method improves the validity of the estimates. This method also reduces, if not completely removes the heteroscedasticity errors, which may result from unscaled magnitudes on both sides of the equation (Amadi and Osaro, 2000).

3.2. Data Requirements and Sources

The data set for this study constitute the annual time series data spanning from 2001 - 2010. The selection of this period was informed by the era of bank consolidation in Nigeria and from the fact that the banking sector has already been liberalized even before this period. However, the study concentrated only on first bank of Nigeria Plc.

The variables under consideration include the bank's financial performances which were represented by the bank's annual Profit Before Tax (PBT) and this constitutes the dependent variable. The independent variables are the Nominal Lending Rate (NLR), Exchange Rate (ER) and Total Credit (CV) which were proxied by factors arising from the deregulated banking environment. Banks profit before tax was obtained from the Statement of Accounts of the various banks used in this study for a period of ten years (2001-2010). The rest of the data were obtained from, CBN Statistical Bulletin, various years.

3.3. Presentation of Data

Table 1: Data for First Bank Nig. Plc

Year	PBT	NLR	ER	CV
2001	9,586	21.34	111.9433	796,164.8
2002	11,859	30.19	120.9702	954,628.8
2003	11,194	22.88	129.3565	1,210,033.1
2004	13,341	20.82	133.5004	1,519,242.7
2005	15,145	19.49	132.1470	1,899,346.4
2006	16,128	18.70	128.6516	2,524,297.9
2007	22,097	18.36	125.8331	4,813,488.8
2008	38,020	18.70	118.5669	7,806,751.4
2009	46,110	22.58	148.9017	9,667,876.7
2010	57,083	21.85	150.2980	8,344,204.5

Sources: Annual Report and Account of First Bank Nigeria Plc (2001-2010) and CBN Statistical Bulletin Vol. 16, Dec. 2010.

From tables 1 above, we can deduce that the modeling of the relationship between the variables employed in this study opens with the Profit Before Tax (PBT), which tries to capture the performance of Nigerian banks in a liberalized banking environment within the years under study. Specifically, the indicators of factors responsible for liberalized environment were proxied by various explanatory variables in order to achieve the objectives of this study. The proxied variables include the Nominal Lending Rate (NLR), Exchange Rate(ER), and Total Credit (TC). It is on the basis of this model as specified in chapter three that the empirical regression results were obtained.

4. Presentation of Empirical Results

Table 3: Result of First Bank Financial Performance in a Liberalized Environment

Dependent Variable: Lg (PBT)

Method: Least Squares

Sample (adjusted): 2001- 2010

Included observations: 10 after adjusting endpoints

Convergence achievement after 5 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	45.76288	7.563528	6.050467	0.0000
Lg(NLR)	237.8723	67.95232	3.500576	0.0001
Lg(ER)	-23.67932	4.786421	-4.947187	0.0000
Lg(CV)	4.795248	0.564863	8.489223	0.0056

R-squared	0.846597	Mean Dependent variable	75.57362
Adjusted R-squared	0.736793	S.D Dependent variable	87.76826
S.E. of regression	0.453682	Akaike info criterion	132.6848
Sum squared resid	42.76363	Schwarz criterion	132.2738
Log likelihood	-145.7865	F-Statistic	72.75843
Durbin-Watson stat.	2.064836	Probability (F-Statistic)	0.000000
Inverted MA Roots	.72		

Source: E-views Computer result

Tables 2 above, display a short run regression result of banks' financial performances in a liberalized banking environment of First bank of Nigeria Plc. The results were obtained using the Ordinary Least Square (OLS) method of estimation. From the empirical evidence, we can infer that the coefficients of the variables, standard error and the values of t -statistic have been shown. Other important statistical tools revealed include; the coefficient of determination (R^2) which tests the goodness of fit which is considered high in this study, the adjusted R- square, the Durbin-Watson statistic, the Akaike information and Schwartz criterion and the overall statistical significance of the entire regression plane - the F-statistic. All results were obtained empirically and the test conducted at five percent level of significance, which determines whether to accept or reject the null hypotheses as postulated in chapter one. At a glance, the estimated model using the regression results of table (2) as presented, gives credit to equation (5) as stated below:

PBT = 45.76288 + 237.8723NLR - 23.67932ER+ 4.795248CV ……………………………..……. (5)
(6.050467) (3.500576) (-4.947187) (8.489223)

$R^2 = 0.846597$
DW = 2.064836
F-test = 72.75843; and
P (F-test) = 0.000000

The values in parentheses are the asymptotic t-values. Also, note that the empirical results presented above are those of First Bank of Nigeria Plc.

From the empirical results, total credit variable is yet highly significant as the calculated $t^* > t$ (refer to equation 5), we therefore, reject the null hypothesis and conclude that there is a significant relationship between total credit and bank financial performance in Nigeria. The F-test is a test of joint influence of the estimated parameters at 4 percent degree of freedom for the numeration and approximately 23 percent degree of freedom for the denomination.

Since the calculated F value is equal to 72.75843, much higher than the theoretical value of 2.8, the joint influence of the variables are highly statistically significant. The Durbin-Watson Statistics (D-W) is a test of serial or autocorrelation among the residuals. This is also conducted at 5% level of significance. Since the calculated D-W is 2.06 and it falls within the region of acceptance of the null hypotheses, we conclude that there is little or no auto correlation among the variables in the model.

5. Findings

The econometric analysis of this study suggests that the overall diagnostic test of the stochastic properties of the model has a very high goodness of fit. The Augmented Dickey-Filler (ADF) statistic rejects the null hypothesis of normal distribution of the residuals at the 5% significance level. Generally, the explanatory power of the equation of the VAR model as reflected in the coefficient of determination (R^2) and F statistic is quite high and statistically significant as over 98% of the explanatory variables were explained at the long run. This implies that only an infinite decimal of 2% was unexplained by the explanatory power. From the empirical evidence, it can be observed that besides its lag, the NLR variable was statistically significant at the conventional levels of significance. This is, however, not surprising because its coefficient has a positive sign. Similarly, the coefficient of exchange rate has a negative sign, suggesting insignificant nature of the variable. This, however, contradicts with the last variable credit volume that exert positive signs at both the short and the long run.

As can be observed, almost all the variables are statistically significant and the signs of the variables were properly placed as expected. For instance, the coefficients of NLR, CV all have a positive sign as expected. This implies that an increase in total credit leads to a rise in banks financial performance in Nigeria. Overall, the results of the long-run relationship between the proxies of liberalized banking environment and banking performance in Nigeria are rather similar to the result of the short run as contained in Table 2. The inverse relationship between exchange rate variation and banks financial performance is rather not surprising since economic theory suggests that. This empirical evidence seems to contradict with the recent study of Obute, (2009) who in evaluating the nominal and real rate of interest from 1960 to 1981 found that the real interest rate in Nigeria for the past decades were negative. The analysis of his results concludes that nominal lending rate has a negative influence on the banks' financial performance within the periods under study.

6. Summary, Conclusion and Recommendations

The role of the financial sector in the economic development of countries cannot be over emphasized. Since the introduction of the Structural Adjustment Program in 1986, the Nigerian financial sector has been experiencing tremendous growth. This in turn positively influenced the rate of Nigeria's economic growth during the period under review. The adoption of financial liberalization reforms have been a very laudable initiative given the extent of financial repression that was prevalent prior to these reforms and the stifling effects of repression on both the financial sector itself and on the economy as a whole. Investigations into the impact of financial liberalization on the financial performance of banks show that the banking sector was affected by factors such as Exchange rates, Interest rates and Total credit. Despite the influence of the aforementioned factors however, the study shows that financial liberalization has significant impact on the financial performance of the studied banks. This to a very large extent shows that the financial sectors are achieving relative stability which is a veritable indicator of economic development. Another pertinent observation made from the survey of the bank's financial performance in a liberalized banking environment has shown that substantial and sustained private sector credit expansion is necessary if Nigeria is to achieve reasonable targets for improvement of banks' profitability which is a shorthand indicator of a wide range of improvements in financial growth. Growth cannot occur without finance, and Nigeria's financial sector needs to grow substantially, both in absolute volume and in relative terms as a proportion of the Gross Domestic Product. In Nigeria, the expansion of finance is constrained not mainly by the outright non-availability of finance to the business sector; the binding constraint in the expansion of finance is the unwillingness of companies to borrow, because of the non-affordability of the very high prevailing interest rates and a high inflation rate .This paper recommends that adequate and proper recognition be given to the nation's financial system and that improved financial sector liquidity and stability will in no small measure go a long way in boosting shareholders and investors' confidence in the financial sector; and this will invariably enhance the efficiency of the banking sector. It also recommends that the central bank of Nigeria which is the nation's apex bank should supervise and formulate polices that will encourage banks to reduce the stringent and rigorous processes in loan approval and accessibility. Also this work calls for further research using a panel of five banks and other research methods to analyze the financial performances of banks in a deregulated banking environment.

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