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Bank Regulation and Reforms: For What? Rural Areas Transformed? *(Pp. 104-115)*

Amadasu, David Evbayowieru **FCNA, FIMC** - Banking and Finance Department, University of Benin, Benin City, Nigeria.
Email: davidamadasu@yahoo.com
GSM: 08055477864

Abstract

Regulations and Reforms in Nigerian Banks to enable social banking are desirable. The problem has been banks' stunted growth from arm-chair banking to social banking. The recent recapitalization and merging of banks for bigger business, risk and profit is a step in the right direction. But the problem remains if the erstwhile 89 Nigerian banks equal numbers 2 and 3 South African banks or the current 24 recapitalized Nigerian banks equal number 2 South African banks. Nor is this all. More importantly, social banking which is mainly the development of rural or poor areas has not been met. Therefore, there is the need to test the hypothesis that there is no relationship between regulation or reforms and transformation of the rural areas. Regression method is utilized. The major findings include low ACGSF loans/Advances and low agricultural GDP. Therefore, it is recommended that the government should direct its budget to capture more banks' loans/Advances for the real or rural sector proxied by agricultural development.

Introduction

Regulations and reforms in Nigerian banks is supposed to transform into growth from arm-chair banking, low risk, low profit and small assets. Examples of such regulations are in appendix A. The problem has been that of weak corporate governance, insider credit abuse, poor disclosure, poor reporting, fraud, forgeries, lop-sided branch networking, non-performing loans, financial indiscipline, high borrowing or interest rate, insider money laundry or manipulation of loan repayment to include exorbitant administrative charges and above all of them is the lack of social banking and economic reforms to develop the rural areas (NDIC Research Dept, 1996; Okonjo-Iweala 2006; Amadasu and Iyoha 2006). If it is regulation that is needed to correct all these, there have been such regulations before 1954 in Nigeria. But banks still failed before the 1954, 1991, 1994 and 2004. Again, social banking is yet to take effect. Then what is needed should go beyond regulation apart from regulation itself. Therefore, there is need to test beyond regulation of banks i.e. social banking, and its relationship with the development of the rural areas. The Literature review, model specification, analysis and the concluding part follow.

Literature Review

Bank regulation and reforms include the 1952 Banking Ordinance amended in 1958 and 1962 and repealed in 1991, Company and Allied matters Decree 1990; Banks and other institutions Decree (BOFID) of 1991 (appendix A). Others are regulations from agencies of government like Central Bank of Nigeria (CBN), the Nigeria Deposit Insurance Corporation (NDIC), the Securities and Exchange Commission (SEC), the Federal Ministry of Finance and the Financial Services Regulatory Coordinating Committee; and the reforms.

The 1950s regulation of banks was to prevent a repeat of bank failure earlier experienced in Nigeria. It was also to direct the banks to goals of the economy apart from their profit- seeking streamlining their competition with each other to face their risks and to sustain public confidence to ensure the growth of savings and investments. The BOFID of 1991 enhanced the capital base of banks which recently was ₦25billion subject to upward review. A minimum of 8% of total risk-weighted assets of a bank is to be maintained as capital funds (capital Adequacy) (Ilaboya, 2005; Okoh and Unugbro, 2003; Amadasu and Iyoha, 2006). Also, not less than 50% of a bank capital should be tier 1/primary capital (paid up capital plus reserves) and adjusted capital to loans ratio should be in 1:10 minimum. To have unempaired losses banks should transfer 35% of yearly distributable profits to reserves, if this is below the paid up share capital. A ceiling is placed on the loan a bank can grant without prior CBN approval. Banks must make returns. The CBN governor can revoke a valid bank license (Ilaboya, 2005).

The CBN is to provide stable monetary policy and sound financial structure of the economy. Monetary examples are regulation of the supply of money, cost and direction of credit, the composition of the portfolio of assets/liabilities, changing the total volume of high – powered money (currency plus bank reserves) to control nominal variables like price level and interest rates and influence real variables like output an employment. (Fridman, 1968). Financial example are changes in the composition of the portfolio of Assets and Liabilities, financial regulation and bank supervision, rediscounting commercial paper, making loans to banks with funds realized from the sale of securities, management of external reserves and exchange rates and the provision of elastic currency. There is also the issuance of stabilization securities (to influence the amount of credit to various sectors of the economy by direct qualitative and sectoral control) of bank lending (Ojo, 1986, Jhingan,1997, Anyanwu,1993 Udegbunam,2003). In addition, there is the financial deregulation (of interest rates, exchange rates and financial institutions to expand into other products). CBN decree No.24 of 1991 and Banks and Other Financial Institutions Decree (BOFID) No.25 of 1991 expand the powers of CBN to prescribe the minimum ratio of loans to total loans to be given to indigenous borrowers, banks cash reserve, banks special deposits, banks liquid asset ratio, Banks amount of stabilization securities and supervise non-Bank financial institutions (Unugbro,1998: 2007).

The NDIC, by Decree No.22 (Federal Government printer, 1988) provides financial guarantee to depositors especially the small ones in the event of a failure and more importantly, to ensure financial stability. In addition, it surprises banks, provides financial and technical assistance for Distress resolution of failing insured banks in consultation with the CBN. It has responsibility for orderly and efficient closure of failed banks as a last result as well as assisting in the formulation and implementation of banking policies. The corporation can also apply sanctions and corrective measures where lapses are observed and assumes control and management of failing banks where needed and when accommodation facilities cannot hold. It is also involved in preventing fraud, holding actions, temporary take-over, acquiring, restructuring, selling to new investors and closing options with respect to banks (Sheng, 1990, Awenliomobor 1992, Ebhodaghe, 1992, NDIC Research Dept, 1996).

The security and exchange commission (SEC) was established by Act No. 71 of 1979, following investment and security Act (ISA) No.45 of 1999, the

SEC Decree has been renewed several times. At the apex of the Nigeria capital market, SEC is a regulatory and supervisory agency to protect the gullible investing public. It ensures proper reporting by market operators and users, market surveillance, registering of securities, stock exchanges /floors /registrar/ security dealers/agents and developing the Nigerian capital market (Osaze,2007).

The federal ministry of finance is saddled with the direct regulation of some Nigerian financial institutions, overseeing SEC, regulating activities of insurance companies and licensed bureau de change.

The Financial Services Regulating Coordinating Committee of 24^{th} may, 1994 deals with matters of mutual interest to the regulatory/supervisory agencies in the Nigeria finance sectors and address the persistent distress syndrome in the banking sector.

Finally, the reforms included the recapitalization of Banks to the tune of ₦ 25 billion; the code for corporate governance; the adoption of risk- based banking supervision; the adoption of stringent application of the contingent planning framework; the adoption of zero-tolerance posture of banks; the establishment of the Financial Intelligence unit and enforcement; establishment of Micro-Finance Banks (MFBs) and private-sector led economy with democracy, no rigging of elections, respect for private property, the rule of law, creditors' rights, contract enforcement and good accounting practices (Amadasu and Iyoha, 2006; webstite,2005 ; Iloboya,2005; Osaze,2007)

Model Specification

Regression analysis is employed to test the significance of the hypothesis that the Nigerian banks despite regulation/ reforms are not transforming the rural areas. That is: ___

$$Y = ACGSF + Labor \_\_\_\_\_\_\_\_\_\_ (1)$$

Where Y = output of Agriculture in the rural areas. This is proxied by the total food crops; total cash crops and total livestock.

ACGSF = Agricultural credit guaranteed scheme fund.

Labor is proxied by the number of loans or persons or farm workers granted

Equation (1) is re-expressed as:

$$Y = \beta_0 + \beta_1 \text{ ACGSF} + \beta_2 \text{ labor} + e \ldots\ldots\ldots\ldots (2)$$

Where β_0; β_1; $\beta_2 > 0$ for a priori expectations and e, the error term. The type of output, loan and labor associated with the rural areas. The loan and the labor where they are in the right proportion are expected to stimulate the output. Such output is assumed to constitute about 70% of Nigeria's agricultural output, about 70% employment for the working population, about 20-30% of the GDP as well as about 20% of the nation's foreign exchange.

The data for the study is presented in Appendix B, while the analysis is next.

Analysis

In this study, banks regulations/ reforms have been focused to test rural transformation in Nigeria in terms of agricultural output, loans given and employment given to the people to generate income, savings and capital to engage in entrepreneurial or industrial activities to improve their standard of living. The result of the hypothesis test- that banks regulations and reforms have not impacted on rural transformation is analyzed below (and in appendix C and D):

Regression Result

GDP = 179.3196 + 994.5072 ACGSF + 0.0026611 Labor

(1.1148) (7.7775) (0.92426)

$R^2 = 0.74067$ $\bar{R}^2 = 0.71812$

F- Stat. $F(2,23) = 32.8458$

DW- Statistic = 1.5013 (reduces self or serial correlation)

T- ratios in parenthesis

Interpreting the regression result there is agreement with a priori expectations that the independent variables are positive or greater than zero. So that whatever happens to the independent variables also happens to the dependent variable in the same direction, together up or together down. How big is the interaction of the autonomous part, ACGSF and the labor with the agricultural GDP? The autonomous part is not accountable by ACGSF and labor factors of which, the Banks (by virtue of their regulations/reforms) are expected to affect. Therefore, this autonomous part may be import, land, technology, rural area or society development, etc. still needed to accelerate the agriculture GDP or development. This autonomous part is 18% of

ACGSF factor and 60,000 times the labor factor. Its T-ratio is 1.1148, less than T critical at 5%, 1.7109. That is, it is not significant and the null hypothesis that Banks' regulation/reforms have not impacted on the rural areas proxied by agricultural GDP, is accepted. This is understood as the Banks are not accountable on account of the autonomies part as noted earlier.

However, there is a goodness of fit as the independent variables explain about 74%, (R^2) of the happening in output or agricultural GDP or rural transformation. The ACGSF coefficient certainly has more contribution for the GDP (agric) proxy for rural transformation. The Banks therefore have more contribution to it. Its T-ratio is 7.7775 and greater than T critical at 5% which is 2.07. Therefore it is significant and the null hypothesis that banks regulations /reforms have not impacted on rural transformation is rejected. Then the Banks have been contributing to rural development in Nigeria by ACGSF (loan capital) given to farmers. But how big is this because there is still a big gap of underdevelopment (needs) to be stepped up not in an arithmetic progression but in geometric progression to increase the GDP to the desired level of rural development. For example, the year 2005 ACGSF loan/Advances divided by the Banks total loans/Advances to all sectors equal to 0.13%. That is the ACGSF loans was not up to 1% of total loans yet this is the real sector that should have been developed even before the oil sector.

The poor development of the rural sector proxied by agricultural GDP and which should have facilitated by increased ACGSF by virtue of the regulation/reforms of banks has implication for the economy. Employment is affected. Less people out of the working population will be employed. The rural areas should contain more people (57 million out of the Nigeria 1991 census of 89 million) and more employment {28.8 million out of the working population (15-64 years) of about 47 million}. Income, exports/trade, industrial and infrastructural development will be affected as output is dampened.

The labor proxied by the number of ACGSF loans is grossly inadequate as a unit change in it results in 0.002 changes in the dependent variable, agricultural GDP. The regulation/reforms of Banks are yet to facilitate employment in the real sectors or rural areas. What is more? The t- ratio of 0.924 is less than t-critical at 5% of 2.07 which means that the null hypothesis is accepted. That is, labour has not impacted on agricultural GDP or rural development. The number of people effectively employed in agriculture is small together with the lack of technology (bane of African or Third world development) to make any significant impact on output.

The overall goodness of fit represented by F-ratio can predict the dependent variable. The F-calculated 32.8 is greater than F-critical at 5% of 3.42 thus rejecting the null hypothesis. That is, the ACGSF and labor have impacted on the agricultural GDP at least towards the later years (appendix B for plotted values). However, this output is not sufficient for the level of development of today's 140 million people of Nigeria.

The findings of the study included low ACGSF loans/Advances, low employment, low output (agricultural GDP) and the banks need to step up loans/Advances given to the rural sector i.e ACGSF to reflect the regulation /reforms of the banks to aid the development of the economy. The autonomous effect on the agricultural GDP or economy i.e technology needs to be stepped up again through research funds supported by the banks too.

The policy implication of these findings is that the government needs to direct the budget to capture more loans and advances or credit of the banks to be given to the real sector or agriculture with its associated employment and technological involvement.

Conclusion

The study is on banks regulation/reforms for what? Part of it is to develop the economy or to increase output (agricultural GDP with its associated employment and technological utilization) in the rural areas. This was tested by regression of GDP (Agric.) on ACGSF and labor. The overall result was that though the regulations/reforms proxied by ACGSF have impacted on the economy proxied by agricultural GDP (1 unit of ACGFS to 0.002 change in output) yet it was not sufficient to transform the rural area or output to the desired level of the Nigeria's 140 million people today. It is therefore recommended that:

i. The government should correct its budget to capture more banks' Loans/advances for the real sector or rural sector proxied by agricultural development.

ii. The unemployment aspect has to be addressed by increasing credit to increase output and mobilizing people to help to produce such output.

iii. The banks regulations/reforms should do more in the economic Growth of Nigeria by government intervention or ceiling to ensure more credit to the rural sector.

Appendix A

Table of Regulation and Reforms

Regulatory structure:- CBN No. 24 of 1991, BOFID No. 25 of 1991, CAMD 1990, NDIC No. 22 of 1988

To ensure: Deposit insurance, minimum capital 1requirement, supervisory/ monitoring/intervention, CBN as lender of last resort

CA

1
2
3
4
5

OBS

Appraising banks operations and performance using:

Camel parameters like c = capital adequacy, A = asset quality, M= management quality, E= earning quality, L= liquidity level. Also provisioning for bad debts write-off

List of Rules/ Financial or

Monetary policy Instrument:

NOTE:

Capital Adequacy (CA):-

Till recently Basel committee recommended CA measurement by Risk weighted assets instead of by size of bank:-

1. Nigeria measure of CA: Capital ratio by weighting of bank capital base against its portfolio of risk-assets carried so that 8% of the risk-weighted assets should be the capital Adequacy (capital funds).
2. At least 50% of bank capital as Tier 1/ primary capital OR paid-up capital plus reserves.

3. Ratio of Adjusted capital to loans = $^{1}/10$.
4. 35% of Distributable profits to be paid to reserves before paying dividends (or 15% where such reserves = paid-up capital).
5. Not more than 20% of shareholders' funds as loan to an individual.

OBS (off balance sheet): items to boost fee income and avoid stringent Capital Requirements as against on-balance sheet engagement. OBS has market/position risk, credit risk, operation/ control Risk. Banks pay third party their clients default in obligation.

List of Rules /Financial or Monetary Policy Instruments

1. Increase in minimum capital base for Nigerian banks from ₦2 billion (since 2001) to ₦25 billion (to be achieved by 31/12/05).
2. Supervision,
3. Examination
4. Open market operations
5. Sectoral guidelines
6. Moral suasion
7. Incorporation by Corporate Affairs Commission.
8. CBN approval of mergers to ensure that there is no giant monopolies.
9. CBN/NDIC to ensure that banks do not close shop against the customers' interest.
10. Failed bank tribunal Establishment from 1994 to take care of Fraud, failed distressed banks
11. Corporate Affairs commission registering companies.
12. Nigeria Bills of Exchange Ordinance 1958
13. Banks and Other Financial Institutions Decree.
14. NDIC Decree No. 22 of 1988

15. Decree No. 25 of 1995 (BOFID) – All regulating banks' business of current Account, Savings Account and other services as published in Gazette by the Central Bank Governor.

    Source: 1. Pilot study, 2. Various CBN publications

Appendix B

DATA

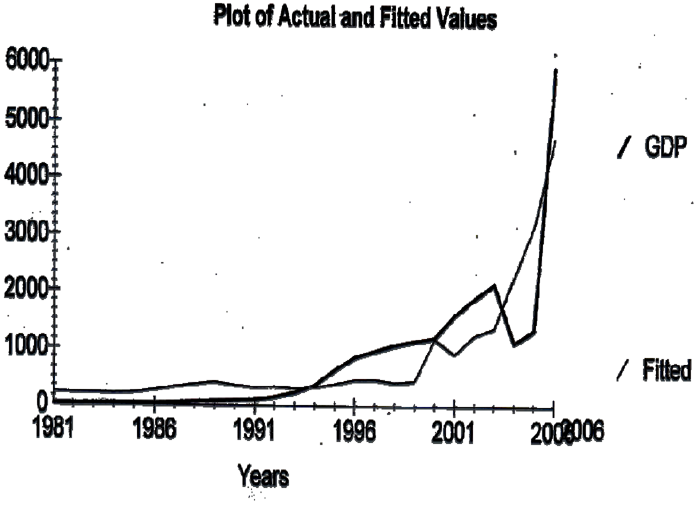
1981-2006 Nigeria's GDP (agriculture) ACGSF (loan, capital) and labor proxy (No. of loans or persons granted)

YEAR	GDP(output) ₦ b	ACGSF	LABOUR PROXY (No. of loans given)
1981	14	0.04	1295
1982	16	0.03	1076
1983	19	0.03	1333
1984	24	0.02	1642
1985	27	0.03	3337
1986	27	0.07	5203
1987	40	0.10	16209
1988	59	0.12	24538
1989	70	0.13	34518
1990	84	0.09	30704
1991	90	0.08	22014
1992	146	0.09	22454
1993	232	0.08	15514
1994	350	0.10	16572
1995	624	0.15	17871
1996	842	0.22	19438
1997	954	0.23	17839
1998	1,058	0.21	6428
1999	1,128	0.22	12857
2000	1,192	0.34	244495
2001	1,596	0.68	20298
2002	1,882	1.00	23681
2003	2,136	1.13	24304
2004	1,108	2.02	35035
2005	1, 337	2.92	37733
2006	5,940	4.40	54032

Source: (1) CBN (2006): Statistically Bulletin, Vol. 17 P. 142

(2) CBN (2005): Statistically Bulletin, Vol. 14, P. 216-219; 231- 234.

Appendix C



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