A Review on the Role of Commercial Banks to Economic Growth in Nigeria

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Abstract

This study attempted to review the roles played by financial institutions especially commercial banks toward economic growth of Nigeria. Literatures on financial institutions and economic growth (1971-2020) were reviewed in order to appreciate the relationship that exists between commercial banks and economic growth. It is found that commercial banks as financial intermediaries play a significant role of intermediation between lenders(surplus) and borrowers(deficits) of funds in Nigeria. However, this is not without some challenges. Social-political and economic instabilities were found to be major obstacles blocking the route to Nigeria's economic growth. It is therefore recommended that, a concerted government effort is needed in order to control the looming macroeconomic instabilities in Nigeria thereby creating enabling environment for financial institutions to contribute to the growth and development of the economy.

Keywords: *Commercial Banks, Economic Growth, Financial Intermediaries, Nigeria.*

I. Introduction

One of the most fundamental economic issues that have received extensive attention in the economic literature to date centers on: what causes economic growth? Why do countries grow faster than the other? What are the causes of disproportionate rates of growth across countries? Are factors causing differential growth rates country-specific? Attempts at answering these questions have spawned an avalanche of reasons as factors, ranging from economic, social, cultural, political and more recently, institutional reasons have been included (Kazeem, 2014). What can be inferred from the diverse causative factors as highlighted in the literature aptly accentuates lack of consensus and general inconclusiveness of growth causal factors. Despite these divergences, the impact of foreign direct investment (FDI, hereafter) on growth remains in large part an empirical regularity. The channel through which FDI impacts is transmitted has also stimulated another round of queries that has consequently added a new strand of literature into FDI-growth repository.

Economic growth and development are two major goals of every society around the globe. Attainment of economic development is reliant on country's ability to achieve a sustained economic growth. More so, country's need for a sustained economic growth largely depends on its ability to maintain a sound financial system. In line with this, Schumpeter (1911) put the role of financial intermediation at the center of economic development. He argued that financial intermediation through the banking system played a pivotal role in economic development by affecting the allocation of savings, thereby improving productivity, technical change and the rate of economic growth. With the recent GDP rebasing of some African economies, Nigeria's GDP rose from $270 billion (N42.4trillion) 2016 to $510 billion (N80.2trillion) in 2013. This development revealed not only that Nigeria's economy surpassed South Africa's to become the largest in Africa, but that its share of sub-Saharan Africa GDP grew from 21.3 percent to 31.7 percent2014. Important and worrisome point to note here is that, this sudden increase in GDP did not make Nigeria richer overnight. In fact, the sudden expansion has no immediate impact on the vast majority of the country's citizens,poverty rates remain high, and performance in social development indicators has not changed. (Amadou, 2015). Of all these, what role did the financial sector played in boosting Nigeria's GDP? This paper therefore reviewed the role of financial institutions in Nigeria in relation to economic growth. A critical look at the contributions of the financial sector to the real sector of the economy will be made with a view to identify obstacles surrounding Nigeria's path to economic growth.

2. Review of Empirical Studies

Khan, Qayyum, & Saeed (2005) investigated the link between financial development and economic growth in Pakistan over the period 1971-2004 employing the autoregressive distributed lag approach and found that financial depth exerted positive impact on economic growth in the long run but the relationship was insignificant in the short run. The ratio of investment to GDP exerted positive influence on economic growth in the short run but also insignificant in the long-run. The study also showed a positive impact of real deposit rate on economic growth. In their study, Sanusi and Salleh (2007) examined the relationship between financial development and economic growth in Malaysia from 1960-2002. They use ratio of broad money to GDP, credit provided by the banking system, and deposit money banks to GDP to measure financial Development. Using Autoregressive Distributed Lag Approach, the study found that ratio of broad

money to GDP, and credit provided by the banking system have positive and statistically significant impact on economic growth in the long-run. Yakubu and Affoi (2014) examined the impact of Commercial Banks' Credit on Economic Growth in Nigeria using the Ordinary Least Square method. Their study found that commercial bank credit has a significant impact on the economic growth in Nigerian, but a concerted effort is needed in order to maintain and sustain it. They recommended that; better and stronger credit culture should be promoted and sustained; strong and comprehensive legal framework that will continue to aid in monitoring the performance of credit to private sector and recovery debts owed to banks should be put in place; banks should share among themselves information on bad debt; and sectors such as agriculture and manufacturing should be given priority in terms of granting loans. In a similar Vein, Shittu (2012) examined the impact of financial intermediation on economic growth in Nigeria. Time series data covering 1970 to 2010 were used. Using unit root test, co integration test and Error Correction Model using the Engle-Granger technique, the paper established that financial intermediation has a significant impact on economic growth in Nigeria.

2.1 Functions of Financial Institutions:
Financial institutions as used in this paper, comprises of banks, brokerages, investment companies, insurance companies, and pension funds among others, whose main function is to direct the flow of surplus funds between borrowers and lenders for a pay. Attention was given DMB_S in particular. The role played by DMB_S toward the development of an economy cannot be over emphasized. Banks allocate fund from savers to borrowers in an efficient manner. As financial intermediates, banks direct funds from surplus unit to deficit unit. Financial intermediation and banks are often used interchangeably. Financial intermediation is viewed as combination of financial institutions (banks, insurance companies, credit associations, pension funds etc) whose functions are to accumulate money of citizens and legal entities and then give it to borrowers on credits terms. However, financial intermediaries has become very complex, and banks' balance sheets are now less reflective of actual intermediation procedures (Nicola, Benjamin, and Lindsay, 2012).

The banking sector helps to make credits available by mobilizing surplus unit of the economy who have no immediate use of such funds and thus channel such funds in form of credit to investors who have investment opportunities on how to create additional wealth in the economy but lack the necessary capital to execute the ideas (Yakubu and Affoi, 2014; Nwanyanwu, 2010). Commercial banks perform two basic functions which are; primary and secondary functions.

2.1.2 Primary Functions of Banks:
The primary functions of commercial banks are divided into two major categories;
a) Accepting deposits One of the most important activities of a DMB_S is financial intermediation through mobilization of deposits from the public. Individuals, business organizations, governments, financial institutions who have surplus funds find it convenient to deposit the amounts with banks. This process earns the depositor a reward called interest. Thus, deposits with the bank grow along with the interest earned. The higher the interest rate, the more people are influenced to save. Major among the types of deposit accepted by banks are the traditional current account (demand) deposits, savings deposits and fixed (time) deposits. Banks contribute to the economy by mobilizing savings from the surplus economic unit and making these funds available to the deficit economic unit. By so

doing, banks are able to finance investments (Ekpenyong, 2011). Banks should therefore Promote trade and industry, promote capital formation, promote the development of agricultural sector, resuscitate infrastructural decay, influence economic activity by making available credit at moderate interest rate
.

b) Grant of loans and advances
These are loans and advances given to members of the public and to the business community at a higher rate of interest than allowed by banks on various deposit accounts. Depending upon the purpose, the rate of interest charged on loans and advances varies, in terms of period and the mode of repayment. The difference between the rate of interest allowed on deposits and the rate charged on the loans is the main source of a bank's income.

2.1.3 Secondary functions of commercial banks:

DMB$_s$ perform other functions apart from granting loan and accepting deposits. These are regarded as secondary functions. Among them are; Issuing letters of credit, travelers' cheques, circular notes, undertaking safe custody of valuables, important documents, and securities by providing safe deposit vaults or lockers, providing customers with facilities of foreign exchange, transferring money from one place to another and from one branch to another branch of the bank, standing guarantee on behalf of its customers, for making payments for purchase of goods, machinery, vehicles, collecting and supplying business information, issuing demand drafts and pay orders and, providing reports on the credit worthiness of customers (Smriti, 2015). In a similar vein, Ekpenyong (2011) quoted Levine (1997) establishing a link between financial development and economic growth, where he used a functional approach. He attributed the need for financial intermediaries to market frictions in form of information costs and transactions cost. He proceeded to identify five functions of financial institutions through which they aid economic growth, these are:

I. Facilitating trading, hedging, diversifying and poling of risks
ii. Allocating resources
iii. Monitoring managers and exerting corporate control
iv. Mobilizing savings
v. Facilitating exchange of goods and services He added that “these functions performed by these institutions affect steady-state growth by influencing the rate of capital formation”. He further stated that “financial system affects capital accumulation either by altering the savings rate or by reallocating savings among different capital producing technologies.

2.2 Economic Growth:

Economic Growth is said to occur if an increase in an economy's productive capacity, sustained over a reasonable period of time, leads to a greater output of goods and services in the economy as a whole to the extent that there are more goods and services available per person on the average (Satope, 2014). Economic growth entails increase in per capita Gross Domestic Product (GDP) or other measures of aggregate income over a given period. A surprising and undeniable fact about economic growth is the large variation in the growth experience of different countries in recent history. Countries like the United States or Western Europe experienced sustained economic growth over a long period of time, so by historical standards these countries are now enormously wealthy. In line with this, Rostow (1960) identified five stages of economic growth undergone by countries through history. The stages are; traditional societies, pre-conditions for takeoff, takeoff, drive to maturity and age for high mass-consumption. Economists developed many theories and models on

economic growth. Among these models were the neoclassical growth model of Solow and Swan, post Keynesian growth model of Harrold-Domar, W.W Rostow stages of economic growth, balanced and unbalanced growth models, endogenous and exogenous growth theories among others. Satope, 2014brings out other characteristics of modern economic growth. He noted the rapid rate of structural transformation, which includes shifts from agriculture to industry and to services. This process involves urbanization, shifts from home work to employee status, and an increasing role for formal education. He also argues that modern growth involves an increased role for foreign commerce and that technological progress implies reduced reliance on natural resources. Economic growth entails increase in GDP of a country. Growth is measured by the GDP per capita known as per capita income. Growth is usually calculated in real terms (i.e. inflation-adjusted terms) to eliminate the distorting effect of inflation on the price of goods and services produced.

2.2.1 Determinants of Economic Growth:
A key determining factor of country's economic performance is its GDP over time. A number of other factors played significant role in determining growth and development of a country. Differences in per capita growth rates across countries are large and relate systematically to a set of quantifiable explanatory variables. As a subset of economic development, economic growth is an increase in the real GDP which means an increase in the value of goods and services produced in an economy. Several other factors are capable of influencing economic growths of a country among which are the following;

- Interest rate,
- Inflation, level of technology,
- Human capital, exchange rate,
- Lonsumer and business confidence,
- Levels of infrastructures,
- Political instability, poverty,
- Trade deficit,
- Limited financial market,
- Capital flight, conflict,
- Corruption and poor governance,
- Income and gender inequality

(Satope, 2014).

3. Economic Growth in Nigeria

In spite of the quantum of resources (both human and material) spent by Nigerian government over the years, the path, history and record of economic growth in the country when compared to other countries are nothing to write home about.

Referring back to history, Nigeria gain political independence as far back as 1960, yet economically, the country's economy's tied down to foreign control and domination by major world economies. After independence in 1960, the immediate challenge facing Nigerian economy was how to increase robust economic growth in order to reduce extreme poverty, improve health care, overcome illiteracy, strengthen democratic and political stability, improve the quality of the natural environment, reduce the incidence of crime and violence, and attract Foreing investments. Ceteris paribus (Ismaila and Imoughele, 2015). In the period 1960-70, the Gross Domestic Product (GDP) recorded 3.1 percent growth annually. However, in the 1980s, GDP had negative growth rate. In the period 1988-1997 (i.e period of SAP and trade liberalization), the GDP responded positively to the adjustment policies and grew at the rate of 4.0 percent per anum. However, Gross Domestic Product (GDP) in Nigeria expanded 2.57 percent in the second quarter of 2015 over the previous quarter. GDP growth rate in Nigeria averaged 0.54 percent from 2013 until 2015, reaching an all-time high of 8.99 percent in the third quarter of 2013 and record a low of -11.57 percent in the first quarter of 2015(Ekpo and Umoh, 2012). According to 2014 economic review by the

National Bureau of Statistics, Gross Domestic Product showed real year on year growth of 6.21% in the opening quarter of 2014, a rate that was 0.56% points lower than that of the preceding quarter, yet 1.76% points greater than that recorded in the corresponding quarter of 2013. At 6.54%, second quarter growth was 0.33% points higher than that of the first and was also over a percentage point greater than the rate of 5.40% recorded in the corresponding quarter of the previous year. The third quarter, relative to the second quarter, saw a slight slowdown in growth, of 0.32% points to 6.23%. Nonetheless, this remained 1.06% points greater than the year on year rate of 5.17% recorded in 2013. (NBC, 2014).

Growth Rate of GDP in Nigeria (in percentage), 1971-2020 at constant Prices

YEAR	NIGERIA	WORLD
1971	6%	4%
1972	9.1%	6%
1973	6	8
1974	2	8
1975	1	1
1976	10	5
1977	9	4
1978	-5	4
1979	1	4
1981	2	2
REAR	Nig. Cont.	World Cont.
1981	-2	4
1982	-2	.99
1983	-7	4.8
1984	-2	4
1985	11	3.8
1986	2	3
1987	-1	4
1988	7.8	4.9
1989	11	3
1990	10	2
1991	0	3
1992	3	2
1993	2	2
1994	1	3
1995	2	3

1996	4	3.4
1997	3	3.8
1998	3	3
1999	.4	3
2001	4	4
2002	21	2
2003	10	4
2004	10.3	4
2005	6	3.7
2006	6	4
2007	6.1	4
2008	6	3
2009	5	-2
2010	6	4
2011	5	3
2012	3.2	2.2
2013	5	2.3
2014	4	2
2015	3.5	2.1
2016	3.7	2.2
2017	4.2	2
2018	3	1.8
2019	2.98	17
2020	2.5	18

Source: Ivan Kushmir, World macroeconomic esearch & CBN Bulletin 1970-2020/

3.1 Banks and Economic Growth in Nigeria:

The financial system of any country provides the catalyst through financial intermediation for productive activities to ensure economic growth and development. Thus, the state of any economy is often a reflection of state of its financial system (Maiwada, 2013). Therefore banks play significant role in economic growth and development of a country In fact, banks may be considered as the back born of every economy. Banks in Nigeria create employment, generate revenue to government via tax, generate revenue to shareholders and create an avenue through which corporate entities transact business. As Ekpenyong (2011) cited Steiner, et al (1963) that banks are important to the economy because they influence the level of economic activities in two ways, namely: by expansion and contraction of loans and investment. These activities alter the nation's money supply, and by extension affect the size of loans, influence what is produced, how much is produced and where it is produced. Banks were identified as agents of economic development. Data from Financial Intelligence indicates that banks contribute little to the Gross National Product (GNP) and encourage high interest rates on lending, making credits inaccessible to the real sector. For example, out of a total of about N6.42

trillion and N7.18 trillion loans and advances from the banking industry as at December 2011 and third quarter, 2012 respectively, contributions to agriculture was 3.35% and 3.45%, whereas power and energy received got a mere 0.39% and 0.80% during the period 0f 2016 and fourth quarter of 2019 (FinIntell, 2020).

Banks invest directly in the economy (by buying the shares of other companies) and also grant loans to others for investment and purchase of securities (Ubom, 2009). They are able to finance investments through mobilization of savings which improves capital accumulation, expands output and consequently leads to economic growth. Maiwada (2013) cited Oteh (2010), that at its peak in 2008, the Nigerian banking sector made up more than 60% of total equity market capitalization. This explains how significant Nigerian banks were before the global financial crisis of 2008. Growth rate of credit often fluctuate, while actual credit has not reflected the proportionate contribution of banking sector to GDP.

3.2 Problems of Economic Growth in Nigeria:

Since independence in 1960, Nigeria's path to economic growth has been disturbed by many impediments. Factors such as unfavorable macroeconomic environment, poor record keeping , inadequate long-term finance, lack of data base on borrowers and infrastructures political and economic instabilities, business cycles, corruption, unemployment, and material resources, balance of payment disequilibrium, inflation are among others. In relation to the above, Rotimi, Obasaju,Lawal and Ise (2013) assert that corruption impedes growth and also erodes the already established economic value systems in Nigeria. Victor (2010) highlighted (8) factors capable of hindering economic progress of Nigeria. These are;

1 Human Development Challenge,
2 Leadership Challenges,
3 Governance Challenges,
4 Corruption Challenges,
5 Infrastructural and Institutional Challenges,
6 Lack of Technological Capability,
7 Macroeconomic Challenges, Market Challenges,
8 Political Parties without Ideology and Disrespect the Rule of Law. Until these problems are addressed, Nigeria's path to economic growth will continue to remain in shamble.

4. Conclusion

History has shown the drift ups and downs of Nigeria's economy went through as indicated by economic growth indices particularly GDP per capita and GDP growth rate. That the Banks as financial intermediaries have contributed immensely towards the growth process of Nigeria, particularly prior to global financial crisis of 2008 as seen from the work of Maiwada (2013). Therefore government should put a concerted effort(s) in order to motivate banks to promote growth process of Nigerian economy.

5. Recommendations

Identifying a problem is one difficult issue and solving the problem is yet another big problem. Containment of a problem depends on sincerity, commitment and approach with which the problem is addressed. In line with these, the paper recommends the following as possible solutions to the growth problem of Nigeria's economy;

1. Banks should be encouraged to direct their lending priorities to others sectors like manufacturing, agriculture, trade and commerce in order to achieve economic diversification and run away from the mono-cultural nature of the Nigerian economy. Government should invest

in infrastructural and basic amenities so as to attract both domestic and foreign investment in the country. This will generate revenue from within and outside the country, create employment, boost the confidence of local investors as well as encourage banks to lend to the manufacturing an agricultural sectors of the economy.

2. There is need for the government to develop sound monetary and fiscal policies in order to fight inflation in the Nigerian economy. This is so because the adverse effect of inflation does not only affect final consumers but cripple investment thereby resulting to low output, unemployment, economic dependence, poor national income among others.

3. To induce the growth and performance of the banking sector and stimulate the growth of the economy, government should formulate policies and programs that would ensure stabilization of macroeconomic variable such as price of goods and services, employment, etc.

4. With the introduction of Treasury Single Account (TSA), Government through e central bank should encourage commercial banks to see the policy as an avenue for them to invest in the real sector thereby creating employment so as to boost the real sector of the economy.

5. Corruption has been identified as a major enemy of progress in the Nigerian economy and this called the establishment of several anti-graft agencies such as the ICPC, EFCC, and Code of Conduct Bureau among others to address corruption. Government should ensure the independence of such agencies so as to enable them address corruption appropriately in the country.

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