

POSITIONING NIGERIAN SERVICE SECTOR TOWARDS VISION 2020: STYLIZED FACTS FROM BANKING SUB-SECTOR

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Abstract. The paper investigates the relationships between institutional enactments and the challenges of Nigerian commercial banks survival (1980-2006) towards policy option for realizing vision 2020. The divergence between government expectations and banks' reality coupled with macroeconomics, and competitors' activities could create failures in the sector. Using statistical data, the authors elucidate the impact of re-engineered interventions on banks' survival over the period. The empirical results, among others, indicate that the high level unemployment rate in Nigeria poses a threat to banks' survival. The statistical output also shows that government interventions could lead to a counter-productive effect on commercial banks' strength, if not properly guided. Thus, for commercial banks to be well positioned as the nation approaches the year 2020, efforts to reduce the level of unemployment and ensure that government policies in the sub-sector are consistent and well articulated, would be rewarding.

I. INTRODUCTION

Over the past decades, the Nigerian banking industry has experienced progressive governmental interventions. The interventions have engineered unprecedented transformations with far-reaching implications on the sector's population density, the industry's structure, practices, and operational profitability. Tactfully, some banks adopted strategic merger, some scaled through with involuntary acquisition in order to sustain operational continuity, and others untimely liquidation. Therefore, identifying and distinguishing principal variables that ignited such systemic transformation

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and discontinuity involves an empirical insight. Thus, this paper examines the determinants of banks' survival in Nigeria from 1980 to 2006 towards deepening scholars' and practitioners' insight and to generate policy option for the banking sector towards the realization of 'Vision 2020'.

Vision 2020 is a government strategy initiated via the instrumentality of the Central Bank of Nigeria (CBN) with the objective of integrating and consolidating the nation's socio-economic reforms. The core aims are to make Nigeria one of the focal points in Africa's financial system, as well as to be among the top 20 largest economies in the world by the year 2020 (CBN, 2006; Soludo, 2007). The policy instruments to achieve the objectives revolve around economic, structural, legal and political reforms. To assist the CBN, other Financial Services Industry Regulators and Operators towards attaining superior financial services by 2020, the following fundamentals, among others, were highlighted: to think in a proactive, comprehensive, and consistent manner and to approach the process of the reforms with the need to grow the size of the nation's financial system and the sectors to be comparable to other emerging economies; and Industry and Regulatory Scope change from Nigeria to West Africa and Africa. The above issues gave birth to Financial System Strategy 2020 (FSS 2020), which was launched in 2006 with these issues, *inter alia*, provide one of the top 50 mega banks, and develop a consistent strategic vision for the financial system (Soludo, 2007; Financial Standard, 2008: March 20).

Historically, the Nigeria banking sub-sector has received over protection due to the indigenization policy which was instrumental for its under performance. Prior to bank capitalization reform framework, the Structural Adjustment reform was inward-looking which exerted a profound neglect of financial institutions' task in financing economic activities. This unguided reform directly sheltered and transformed the banks into somewhat 'money-changing restaurants', which Ojo (2007) referred to as 'round tripping'. To recalibrate the banks' catalyst role towards financial stability and economic growth, a fundamental capitalization and consolidation policy was instituted, which took effect by 31st December 2005. As a consequence, the number of financial institutions, 58 in 1990, increased and climaxed to 89 thereafter dropped drastically to 25 in 2005, after observed closures, mergers, and acquisitions (Asogwa, 2005; Osabuohien and Duruji, 2007).

Along this, notable econometric models and perceptual-base documentations have been achieved in developed and some in developing countries. Some of the perceptual-based documentations previously generated to investigate banks' failure attributed the episodic observation to financial

institutions' deteriorated capitalization (Alawode, 1992). Others that deliberately examined failure among firms identified legal enactment/government's interjection (DiMaggio and Powell, 1983; Scott, 1987), managerial ineptness (Porter, 1985) industry-specifics (Altman, 1983), macroeconomics (Friedman and Schwartz, 1963), and competition (Porter, 1980 and 1985).

In achieving the research objective, this paper investigates empirically the contributions of institutional enactment, industry competition/macroeconomic components to the challenges in the banking sub-sector. Thus, government intervention through institutional promulgations was considered with a critical involvement of managerial efficiency and financial ratios. In this context, the research work represents among others, an attempt to establish the relationship between banks' survivability along with government interjection, macroeconomics, and industry dynamics. This becomes very crucial in this present time, when the government is canvassing and pronouncing across the globe the need to lurch Nigeria into the top 20 performing economies in the world-the core of Vision 2020. The envisaged results constitute modalities for overhauling existing policies and alternatively crafting technical measures that will reposition the banking sub-sector. The paper is structured into five sections. Next to this introductory part is the literature review and theoretical framework, followed by the methodology, analysis of data, and conclusion in that order.

II. LITERATURE REVIEW AND THEORETICAL FRAMEWORK

LITERATURE REVIEW

The financial intermediary has been identified as a vital vehicle of complimenting the supply of financial resource needed to ignite investment towards kick-starting economic growth (Adam, 2005; Osabuohien and Duruj, 2007; Asogwa, 2005). This task induces a high density of firms and the inflow of new entrepreneurs into the business environment. Also, the banking sub-sector is capable of creating job opportunities for the citizenry within and outside the sector through trickle-down effects. However, the ability of banks to actualize these social-economic goals depends on legal regulatory framework and engineered interventions by the government. If neglected, banking sector low performance could send over-stretching effects capable of destabilizing and roll-backing a nation's economic growth. From the aforementioned, the task of the banking sub-sector is germane for economic growth.

The literature on banks' failure has concentrated on explaining its causes and consequences. Some studies (Uribe and Vargas, 2002) with the exception of Wheelock and Wilson (1995), and Whalen (1991), use duration models to explain bank failure in the United States. However, Carree (2003) argues that the process of bank liquidation that occurred in Russia during the period 1995-1998 can be explained by the period of ease in financial regulation policies that took place during the early 1990s. More so, Ebholdaghe (1994) illustrates that the variable often identify as banks discontinuity determinant in Nigeria is government interjection. Bennett and Loucks (1996) propose an empirical model to demonstrate that political influence affects the length of time from initial undercapitalization to banks' ultimate failure (survivability). Taking cognizance of government intervention in financial intermediary role, government enactment was designed into the empirical work.

Others have observed in likewise manner that macroeconomic variables determine and or contribute extensively to banks' survivability. The proponents of this thesis are Friedman and Schwartz (1963) they connected banks' failure to economic decline/decline along national income and Kaufman (1998) to economic depression. Also, the findings of Demirguc-Kunt and Huizinga (2000) linked annual growth rate of GDP and GNP per capita to establish bank failure. Further, Bikker and Hu (2002) used macroeconomic variables along GDP, unemployment rate, and interest rate differential to substantiate bank failure. In similar perspective, Molyneux and Thornton (1992) and Perry (1992) indicated a positive relationship between inflation and bank profitability which concluded that inflation exerts a strong negative impact on profitability. Others are Lowe and Rohling (1993), Laker (1999), and Gonzalez-Hermosillo, Pazarbasoghe, and Billing (1997).

In light of the above, it is imperative that managerial weaknesses' contribution to banks' failure because managerial proactiveness could have curtailed the discontinuity emanating from macroeconomic underperformance. Thus, Mintzberg (1987) asserts that detecting discontinuity in any industry is through cycles of strategic convergence and divergence. This implies a strategic manoeuvring during environmental instability to avoid bankruptcy. The challenge therefore, is detecting subtle discontinuity that may undermine a banks' operation in the future. This approach was first proposed by Hussey (1980) and sustained by Porter (1985) that managerial proactiveness, allocative, and technical efficiency desensitize the organization from environmental ambiguity. Within the Nigeria context, Oluranti (1991) and Ibe (1992) identify premature hand-over of banks management to local people and Mamman and Oluyemi (1994) identified

inexperienced managers as the primary reasons for banks' failure. Also, Oluranti (1991) and Ibe (1992) observed improper accounting practices as promoters of banks insolvent in Nigeria. The study of Ebholdaghe (1994) identified undermine quality management, lack of prudent lending (Mamman and Oluyemi, 1994), and diversion of loan to non-viable borrowers as the root causes of banks failure.

An analysis of existing competitors within a concentrated niche can provide a significant insight into discontinuity in the banking industry's population. In responses, Berger and Hannan (1998) observed that banks not exposed to liberal competition exercised monopoly power and seem less efficient juxtaposed against banks subject to intense competition. However, a deregulation through government's enactment liberalizing competition could generate radical decline in some inefficient banks' profit. This assertion was demonstrated in the United States by Amel and Liang (1997) as earlier purported by Levine (1996) and recently sustained by Claessens, Demirguc-Kunt and Huizinga (2001). Further, Stiroh and Strahan (2003) observed that increase in competition due to banking sector liberalization could aggravate the weeding-out of the weak banks. Thus, this notion that competition could accelerate a decline in the population of banks in the banking sector is consistent with Porter (1985) model.

The interest rate dynamics of banks is also assumed to be affected by the degree of competition among banks. This position is generally summarized in the literature. In relative-market-power thesis, the assumption that banks with large market shares and uniquely differentiated products are capable of influencing market interest rate and loanable fund to generate significant profit (Berger, 1995). On a divergent approach, efficient-structure theory denotes that industrial concentration would intensify the general efficiency of the industry. This approach sees gradualism coming into play since efficient banks grow rapidly than inefficient banks or acquire the less efficient banks to become efficient. From the literature, it could be seen that theoretical/empirical works that bridge the gap between these variables are relevant for sufficient understanding of the problem.

THEORETICAL FRAMEWORK

The survivability of banks within Nigerian business context downplays home-breed theories to anchor the theoretical discussions. However, the research theoretical purview is not restricted to management field, rather a wide range of inter-discipline perspectives. The authors assessed population ecology theory (Hannan and Freeman, 1989) as a radical explanation of the dynamics in the banking industry. The proposition emanates from observed

intense struggle between banks for competitive dominance (Porter, 1985) and profit maximization within the domestic market. The competitive dominance relegates strategic adaptation to environmental uncertainty which sustains Darwin's concept of survival of the fittest. Although this philosophy differs proportionally from resources dependency and contingency theory, it does not negate managerial proficiency, technology, and banks' interdependency in resources utilization.

Also, another divergent propositional response to banks' survivability is the neo-institutional consideration (DiMaggio and Powell, 1983) shaping the structural density of firms in any industry. The institutional perspective (DiMaggio and Powell, 1983) prescribes normative compliance to governmental promulgation as strategic means of acquiring legitimacy. This compliance with institutional enactment is with the understanding that survival is not muscles flexing, rather strategic adaptation to a complex and rapid changing environment. As such, red-queen theory, gradualism theory, and vulgarized Darwinism take primacy, since co-evolution and compliance with legal enactments enhance survival. The co-evolution and retouched Darwinism encourages banks to evolve and adapt to institutional policy rather than justifying resources inequality and unequal competitive advantages as survivability determinants.

From the extinction and selection perspective, Drucker (1968) connects organizational discontinuity to competitive industry (market). The precept holds that different banks that operate fundamentally in the same niche cannot co-exist in equilibrium. In similar overlap, Porter (1980; 1985) attributes failure of firms to industry competitive forces resulting from core capabilities that fortified companies operations. Hence, the assumption that failure results from environmental instability (Pfeffer and Salanick, 1978) and competition are substantiated in (Drucker, 1968) age of discontinuity.

A bank's survivability could also be a derivative of manager's in-depth creativity and initiatives proactively established to facilitate operational continuity. Along this assumption, reasonable empirical documentations have connected survival to managerial proficiency. A perceptual-based comparative study within the context of Nigeria and Britain associated survival within the purview of managerial proficiency and efficiency (Nwankwo and Richardson, 1994). The assertion of managerial strategic manoeuvring (Hussey, 1980) and pre-start plan were both identified as survival facilitators. From the foregoing, the managerial rational optimization and allocative efficiency of organizational resources sustain survival. Therefore, the severity of managerial ineptness depends on rational ineffici-

ency, skills-locked and responsiveness, domestic competition, availability of alternative resources, diffusion of innovation, information, and technology.

The works of Christensen (1997) illustrate that organizational technology, agility, and (Porter, 1985) first-mover advantage promotes survival. While these approaches have the tendency of negating organizational inertia, banks have better habitual mechanism: innovation, procedure for choosing alternative mixes of operational factors, pricing, portfolio investment, interest rate, and systems for allocating resources. Therefore banks with these habitual mechanisms prosper and grow relative to other whose core capability, competencies, and managerial behaviours are less appropriate to the dictates of the competitive environment.

Nevertheless, different authors have raised the size question (Scott, 1987) within ecological perspective as survivability determinant. The assumption is that banks within the industry have common predetermined objective with respect to survival and profit maximization. As such, these banks depend on the same material and social-legal environment for technical and operational choices. This unitary characteristic permits similar environmental effects on banks' operations in the industry.

Also, the need to emphasize that poor investment climate as a dominant factor in banks' failure is vital. Over the years, economic mismanagement, pervasive corporate governance practices, hybrid of fraudulent activities and corruption (Egwakhe, 2007) among others have been observed to create pessimism in investors' perception in Nigeria. Acknowledging the comprehensive impact of this negative perception on the nation's economy, a cursory examination of the macroeconomic indicators shows poor performance. The CBN Statistical Bulletin (2005) illustrates aggregate fluctuation characterized by persistence macroeconomic volatility in inflation and unemployment, exchange rate, and poor infrastructure.

Although these are exogenous and fiscal policy determined, these factors authentically proxy for analyzing banks' failure. Further volatility in productivity, price, and monetary (lending/borrowing interest rate) could ignite banks' discontinuity. Macroeconomic sub-components: gross domestic product (GDP) and real interest rate can measure aggregate performance. Also, the quantity of loanable funds determines the dynamics of interest rate and how banks maximize profit. The cost of borrowing and the actual loanable funds demanded are inversely related due to the invisible hand.

The Nigerian banking sub-sector provides an excellent insight into the determinants of financial institution discontinuity in relation to government

intervention or regulatory dynamics. The system has undergone some transformations over the past decades. Other services sub-sectors like insurance, aviation, among others, have witnessed similar survival challenge. However, this paper is focusing on the banking sub-sector by drawing some empirical fact. From the 1980s, the banking sector has undergone significant changes through systemic abolition of indigenous policy to capital-base intervention. Some of the reforms were unguided in adoption and foreign imposed while others were home-crafted to overhaul the hiccups in the economy. In 2003, a further intervention in the industry framework engineered a drastic reduction in the population of existing financial intermediary. This act created voluntary acquisitions, mergers, cessation of operations, but kick-started efficient banking sector that operates today.

III. METHODOLOGY AND MODEL SPECIFICATION

A unique way of conceptualizing banks' survivability (which can lead to discontinuity in operation) is to examine the disappearance of banks from the population density. This approach revamps population ecology theory application to banks' survivability within a niche in relation to institutional enactment. Therefore, individual bank's survivability is considered as the appropriate unit of observation, with the understanding that their dynamics are partially autonomous. Hence, banks' failure categorization was anchored on: Disbandment (a complete dissolution/cessation of operation) and Absorption (a bank is absorbed or disappeared through merger and acquisition to a dominant bank respectively). These parameters permit comprehensive approach to the observed failure, merger, and acquisitions within the industry from 1980 to 2006.

This paper investigates the effect of Government policy interjection, industry-specific with macroeconomic variables on banks' survivability. The research utilizes data from CBN Statistical Bulletin and annual reports over the period 1980-2006. In crafting the model, hazard model (Cox, 1972; Kiefer, 1988; Hannan and Carroll, 1992; Baum, 1996; and Wheelock and Wilson, 1995) relevancy to the work was considered. However, Carree (2003) survival parametric model used in the study of banks in Russia was favoured. Anchored on previous empirical works and contextual differences between studied nations and Nigeria, the researchers adopted internal procedures to capture the industry dynamics and interventions that were catalytic to banks' failure.

The duration considerations along military and democratic dispensations policies differential, was cushioned with the assumption that in traditional

model duration is considered as being continuous (Davidson and Mackinnon, 2004). Towards achieving the research aforementioned objectives, a linear model was estimated. The model examines the effect of institutional enactment on banks population and sustained it with competition, macroeconomic, and other dummy factors as accelerators of banks' failure. Other variables observed from the literature that were included in the model include: real GDP growth rate, inflation rate, and unemployment rate.

The model is stated functionally below:

$$\beta\kappa\text{Stren} = f(RGR, INFrt, INTrt, Urt, ENACT, \varepsilon) \quad (1)$$

Where:

$\beta\kappa\text{Stren}$ Banks' strength representing survivability

RGR Real domestic product growth rate

$INFrt$ Inflation rate

$INTrt$ Lending rate

Urt Unemployment rate

$ENACT$ Dummy variable measuring government policies in the sub-sector

ε is the disturbance or idiosyncratic error is *iid* and $N(0, \sigma^2)$.

This can be restated as:

$$\beta\kappa\text{Stren} = \psi_0 + \psi_1 RGR + \psi_2 INFrt + \psi_3 INTrt + \psi_4 Urt + \psi_5 ENACT + \varepsilon \quad (2)$$

The *a priori* expectations is such that $\psi_i > 0$ ($i = 0, 1, 3$) and $\psi_j < 0$ ($j = 2, 4$).

The dependent variable ($\beta\kappa\text{Stren}$) is proxied by the ratio of total commercial banks financial asset to GDP. This is because it could be conjectured that when the financial base of banks is "strong" the banks would be able to meet up with their obligations and hence the better the possibility of survival. And to bring it to the macroeconomic dimension of the economy, weakness could deflate the GDP. More so, this proposition was included amongst the new data-base for banks efficiency indicators by Thorsten, Demrguc-Kunt and Levine (2000). In addition, Soludo (2006) observed that the total asset of Nigerian commercial banks increased by 79.7% between 2003 and 2006, even though the number of banks drastically reduced from 90 to 25 within the same period. Thus, the use of total banks

financial assets as a measure of their strength appears better the use of number of banks.

Further, any significant growth in *RGDP* is expected to reduce the probability of closure. While a proportional decrease in inflation can also affect survivability rate. If otherwise, failure is expected to intensify over the period covered. The above estimated equation assumes government interventions to either strengthen the operational capital-base or deselect the inefficient banks in the population. Government intervention was dummy coded along a value of 1 if government interjects and 0 if otherwise with a failure option probability of \pm . *ENACT* represents institutional policy or government interventions to re-engineer the dynamics in the industry towards sector's efficiency. The dummy variable was obtained by representing the years that witnessed major reforms in the financial sector as 1 and 0 otherwise following the reform chronology of Osabuohien and Duruji (2007) and Asogwa (2005). The variable captures the socio-political environment in which the banks operate as well as the competitive aptness vis-à-vis investors' perception of the nation's banking sub-sector.

The *INFrt* examines the cyclical business cycle in the nation, which gives an indication of the macroeconomic environment that the banks operate. The researchers expect that a stable economy should have stable prices, which would enhance macroeconomic performance (Adegbite, 2007). While *Urt* gives an indication of the patronage that the banks receive from the banking public. The high unemployment rate reflects the low level of disposable income in the society. Therefore, it is expected that an increase in *Urt* would reduce the citizens' income earning prowess, which would lead to low propensity to save. Interest rate (*INTrt*) represents the attractiveness of banks loan, which illustrates their credit creation ability in the sector.

IV. ANALYSIS OF DATA

The data used to estimate econometric model was collected from CBN statistical bulletin (2005) and annual report (2006) on the stated variables, which permit comprehensive approach to the observed issues within the banking-sub-sector from 1980 to 2006. The variables (except the dummy) were logarithmically (log) transformed. The log-linear form is usually considered most appropriate for empirical studies. This is because the functional form gives elasticity coefficients directly. In addition, log-linear form reduces the problem of heteroscedasticity in an empirical analysis (Rehman, 2007; Osabuohien and Egwakhe, 2008). The data were subjected to econometric tests and the results are presented in Table 1.

TABLE 1a
The Regression Result (1980-2006)
Dependent Variable: LOG (β_k Stren)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Constant	2.3084	0.8286	2.7859	0.0111
ln (INFrt)	-0.0960	0.1048	-0.9166	0.3697
ln (INTrt)	0.8405	0.2428	3.4618	0.0023*
ENACT	-0.1153	0.1512	-0.7628	0.4541
ln (Urt)	-0.4120	0.2399	-1.91814	0.0905**
ln (RGR)	0.0094	0.0171	0.5504	0.5878
R-squared	0.651313	F-statistic		7.845178
Adj. R-squared	0.568292	Prob (F-statistic)		0.000268
S.E. of regression	0.331419	Akaike info criterion		0.822263
Sum squared resid	2.306608	Schwarz criterion		1.110227

* and ** means significant at 1% and 10 % respectively.

TABLE 1b
Some Standard Diagnostic Tests

J-B normality Test	0.1336 (0.6285)*
B-G Serial LM Test	1.9917 (0.6300)*
White Heteroskedasticity Test	2.4958 (0.1099)*

*denotes that the null hypotheses cannot be rejected at 10%.

Besides the use of logarithmic transformation to remove the possible errors in the results, the study carried out some diagnostic tests, which are reported in Table 1b. From the table, it is clear that Jargue-Bera (J-B) test of normality indicates that the error terms in the model were distributed identically independently. In a similar manner, the B-G (Breuch-Godfrey) serial correlation LM test emphasizes that the results obtained from the model were free from first order serial correlation. More so, the White's heteroskedasticity test revealed that the OLS' homoscedasticity assumption

was not violated by the regression results (See Gujarati, 2003 for details about their applications).

With regards to the chosen variables, the R-squared value shows that about 65.13% of the variations in the dependent variable was explained jointly by the explanatory variables. While the F-statistic, was statistically significant at 1%, apparently indicates that the formulated model had a high goodness of fit and would be useful in making inferences. This is equally stressed by the sum of error of regression, which points out that the errors were minimized in the estimation process.

On the respective individual independent variable basis, the results in Table 1a reveal that all the variables (government policy variable) came out with the expected sign. However, only two were statistically significant. The rate of unemployment with significant negative coefficient indicates that the prevailing unemployment level in Nigeria is a great threat to the strength (survival) of the Nigerian commercial banks. This is not out of place as it is expected that only those that earn income have income for patronage at the commercial banks. And when the level of 'bankability' of most citizens is reduced it would have negative impact on the banks' survival. The result equally shows that the growth rate of the economy had the potency of strengthening the commercial banks performance given the positive result. However, such potency had not significantly impacted them. This could mean that economies with higher performance in economic growth would have solid banks that propelled them into growth rather than the oscillation in the Nigerian phenomenon.

Another important finding from the result is that the lending rate had positive and significant influence on the strength of the commercial banks. The reason may be that as the leading rate increases, the more the returns banks can make from lending. This seems to contradict interest-investment relation, but the finding can be mirrored from macroeconomic viewpoint that a high rate of interest has the ability of attracting more portfolios (foreign capital inflow in general). The government policy variable had negative sign. This interpretation here is that government policy can lead to a counter-productive effect on commercial banks' strength in the long run (though it was not significant). This could also have resulted from the frequency of policy changes that is usually witnessed in most of the sectors in Nigeria especially the banking sector.

What the findings above inform is that within the period covered by this study, government policies need to be consistent and engineered policies change ought to be strategically essential. Most importantly, for the

commercial bank to be well positioned as the nation approaches the year 2020, efforts to reduce the level of unemployment would be highly rewarding. As a result the rate of 'bankability' of the citizens will be high, which augurs well for the sub-sector. This is becoming very obvious in recent times with the magnitude of patronage to the stocks and share purchased by ordinary Nigerians.

V. CONCLUSION

The Nigerian banking sub-sector like others in the service sector of the economy have experienced some measures of governmental interventions that engineered transformations with far-reaching implications on the sector's strength and survivability. The above motivated this paper to investigate the impact of enactments and to suggest policy options towards positioning the Nigerian commercial banks within the framework of vision 2020. The study subjected the data sourced from CBN statistical bulletin and annual reports to regression techniques.

The results from the study show that the unemployment rate had significant negative influence on the strength of commercial banks, meaning that the level of unemployment in Nigeria portends a serious challenge to the survival of the Nigerian commercial banks. Thus, it reduces the level of citizens' 'bankability' which would have negative impact on the banks. The study equally established that the lending rate of banks had positive and significant influence on the survival of the commercial banks. In addition, the government policy variable had negative sign, which means that government policy can be counter-productive, but induced efficiency in the system. The implication of the findings above is that government policies need to be consistent and strategically fashioned to kick-start positive change. Additionally, for the commercial bank to be well positioned especially along Vision 2020, efforts should be directed at reducing the level of unemployment.

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