Internal Lending Constraints and Deposit Money Banks’ Performance in Nigeria

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ABSTRACT

The banking business is full of both internal and external constraints that impede performance. This study attempts to empirically investigate the internal constrains to bank lending and performance. The paper adopts the major variables of volume of deposits, interest rates and shareholders’ Funds against performance. The study finds out that while all the variables are significant, volume of deposit is the most important of the entire set of variables because of its capacity to transmit growth to all other variables especially shareholders fund. The rate of interest displayed a fairly lower level of significance of the variables. The study recommends that banks should introduce new products that can encourage further savings in the financial system.

KEYWORDS

Bank Performance and Volume of Deposits, Interest Rates, Internal Constraints, Shareholders’ Funds, Volume of Loans

1. INTRODUCTION

In order to sustain economic growth and development of a country, commercial banks give out loans and advances to individuals, organizations, and also governments for investment purposes. The reasons for this role are: (a) the public (both customers and non-customers of the bank) use lending in assessing the strength of the banks. Banks that have the capacity and potential to lend out funds are supposed to be more stable than those that are controlled (Aliyu & Yusuf, 2014), (b) monetary authorities consider lending as part of a legal requisite which requires that a specific percentage of bank lending (that is 10% of banks’ profit previous to tax) go to small and medium scale enterprises (SMEs), (c) governments utilize lending as a means of monetary policies which affects money supply and demand and (d), lending adjusts production outline, entrepreneurship level, and total output and productivity (Aliyu & Yusuf, 2014). Consequently, regardless of how commercial banks source for their funds together with the unsteadiness of economic policies, they would also be occupied in providing loans and advances to the customers taking into account the three main objectives of the banks: growth, liquidity, and profitability. Yet, the choices of commercial banks to offer loans are subject to some situations such as the prevailing rate of interest, home and abroad investment levels, the deposit base, and their liquidity ratio (Olokoyo, 2011).

Before the implementation of the Structural Adjustment Programme (SAP) in 1986, bank credits were severely guarded by the Central Bank of Nigeria (CBN). The CBN also made sure that the single obligator limit is pragmatic. Other banks’ legislations pointed to those banks support loan to the real sector of the economy so as to augment the growth and development of the economy. Banks are
obliged to these rules to avoid failures and to develop their level of profitability through their lending activities. Even with their fundamental function of intermediation, they have not explicitly promoted the expected economic growth and development (Sanusi 2012; Aliyu & Yusuf, 2014). According to Sanusi (2012) banks’ minor contribution to the economy is due to the various challenges that are being encountered by the banks such as, high level of bad debts, lack of feasible investment outlets, consumer difficulties, insufficient disclosure, unsure business environment and precision about the financial position of the banks, uneven supervision and enforcement, and insufficient capital which has led to recurring suffering in the banking industry and the crash of some early banks.

The other reasons are barriers limiting the lending activity of the banks in terms of the volume of credit facilities to be approved to customers and to which business or sector(s). These barriers are considered as internal and external. Some of the external barriers are outside the management of the bank are statutory lending limit of banks, the economic condition of the country, government and Central Bank guidelines, political or social factors, and liquidity requirements of the banks. Aliyu and Yusuf (2014) specified that if loans are not given to the deficit units of the economy, growth in the business sector will be retarded and as a result the banks’ capability to yield income will go down. Additionally, if the rate of interest of the loan is high, it restricts the business sector from obtaining loan, thereby hindering growth and likewise banks’ performance.

The basic objective of this study is to examine how internal lending constraints impede the performance of the banks in Nigeria. The study encompasses five sections. Following after this introduction is the literature which details the conceptual and empirical framework. Methodology and model specification is covered in section three while section four discusses the results and outputs of the data used and their analyses while section five concludes and makes recommendations.

2. REVIEW OF RELATED LITERATURE

Several reviews have been carried out as pertaining to many DMBs’ lending behaviour. Some of these studies dealt on the effect of credit extension on output and productivity. Most of these studies are in agreement that DMBs have some fundamental lending principles that act as guides in their lending activities. For Amano (2014), credit constitutes the largest single income-earning asset in the banks’ portfolio which explains why they spend huge resources to estimate, supervise and manage credit quality. Imeokpararia (2013) specified that banks should be watchful with their pricing decisions in lending as they cannot charge low interest rates on loans because interest income would be insufficient to cover general expenses, deposit costs, and the loss of income from some default debtors. Moreover, if the banks charge a high lending rate, it will result in price instability on the products and services of the banks as a result of information asymmetry along with moral hazard problems for the borrower. According to Olokoyo (2011), lending is unquestionably at the core of banking business and its administration requires substantial skill on the part of the bank management. Amano (2014) further emphasized that the main purpose of lending by DMBs is to obtain maximum profit. The modern bank lending and administration of credit strive to use modelling and operational research to aid their lending activities. Ojo (1999) discovers that commercial banks can lend on medium and short term basis without necessarily jeopardizing their liquidity but if they must contribute meaningfully to the economic development, the maturity pattern of their loans should be on a long-term nature rather than of short term period. Yet Oloyede (1999) declares that commercial banking by its nature is extremely prone to volatility and fragility - whether arising from exogenous shocks or endogenous policy measures, and therefore, amenable to regulations and supervision. The methods of regulation disagree, but generally, DMBs implement statutory regulations that may be imperiously imposed.
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