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Capital Investment is Financed by Financial Institution in Nigeria Economy

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ABSTRACT

This study aimed at examining the role of financial institution in financing capital investment in Nigeria economy. The study lays much emphasis on whether capital investment is really financed by financial institution thereby contributing immensely to the development of the economy. It is also looks at the contribution of financial institution in promoting the development of the stock market thereby mobilizing fund that will enhance manufacturing of goods. Data were collected from the CBN statistical bulleting spanning a period of 16 years (1992-2007). The data collected was analyzed with regression using SPSS version 16 and also the hypothesis formulated were also tested. The computation of the method of regression is fairly simple compared with other economic techniques; the ordinary least square regression method has been in a wide range of economic relation yielding satisfactory result. On analysis of the data, it was discovered that financial institution have not contributed much in financing capital investment but they have however contributed towards stock market development. We recommended that financial institutions should be encouraged to mobilize more deposit for lending that will aid capital investment. While the Central Bank on the other hand should reduce its minimum rediscounting rate.

Key words: Capital investment, financial institution, Nigeria economy, central bank

INTRODUCTION

A financial institution can be defined as any institution whose portfolio of assets consists largely at claim. In other words, financial institution serves as intermediaries in the financial market.

It is noted that the mobilization of financial resources has led to capital formation, since capital formation requires the release of domestic goods and services which promote the real investment. Then any economy that wants to increase its real capital formation must be able to provide a climate receptive to the impact of resources from overseas and the encouragement of domestic savings. This requires an institution arrangement that encourages the mobilized savings and productive investment.

Therefore, in order to sustain the rate of economic development programmed, government has made a conscious effort to make available funds adequate enough since the primary function of financial institutions is the extension of credit to borrowers who are worthy.

The main actors in the economic context that make economic growth exist are the supplier of the invisible funds for productive purpose. In this regard, the users are the business entrepreneurs and investor who passes brilliant ideas on how to create additional wealth in the economy but lack necessary capital. This group of people approach financial institutions for necessary capital with which to execute their plans.

The objectives of the study are stated as follows:

- To investigate if financial institutions have contributed in financing capital investment in Nigeria economy
- To investigate the relationship between Stock Market Development and Bank Credit

LITERATURE REVIEW

Ajayi and Ojo (1981) viewed commercial banks as financial institutions which hold themselves out to the public individual firms, organizations and governments by accepting deposit and giving out advance as well performing other services to their customers.

Adebayo (1996) viewed banks as specializing in keeping money and valuables safely and granting short-term loans advances and overdrafts to individuals and corporate.

According to Perry (1996) commercial banks are the major financial intermediaries through which the monitory authorities act on behalf of the government to ensure effective distribution of money, as well as exert control over Money supply. He also defined it as profit making enterprises whose primary function is to facilitate the flow of savings from those of the economy with surplus funds to other sectors with insufficient funds.

FUNCTIONS OF THE COMMERCIAL BANKS

Heffernan (2005) viewed the functions of commercial banks as follows:

Provision of international trade services: Offering various services to their customers who are exporters or importers. For instance, a Nigeria exporter can receive payment from abroad through his commercial bank by drawing a bill of exchange on the importer.

Commercial banks also discount bill of exchange that is buy the bills of exchange at a price less, by the amount of discount, than the face value of the bill. This will enable the exporter to collect payments on the goods exported before the importer makes payment.

Provision of brokerage services: Commercial banks in Nigeria act as share distribution agents engaging in buying and selling of securities in buying and selling of securities for their customers. That is why they act as intermediaries between their client and stock brokers (or merchant banks) to acquire or sell stock in the capital market (Securities and Exchange commission and the Nigeria stock Exchange).

Provision of foreign exchange services: Commercial banks act as intermediaries between the Central Bank of Nigeria or authorized foreign exchange dealers (Bureau de change) and their clients-mostly manufacturing companies, in processing applications for foreign exchange allocation. They also provide travelers with traveler's cheques and foreign currency notes to enable them carry out minor transactions on getting to their countries.

Safekeeping of valuable assets: The commercials banks have strong rooms where valuables can be kept. Customers usually keep their government stocks, share certificates of occupancy, wills and jewelry's with banks for safety.

Debt factorizing: Debt factorizing is a debt recovery strategy in which a commercial bank acting as the third party or a factor buys a debt at a discount and gets the fact value of the debt at maturity.

Accepting deposits of money: Commercial banks are deposit taking financial intermediaries. They accept deposits act as financial intermediaries. They accept deposits from households, firms and governments (State and Local government) in the form of demand deposits.

Granting of loan and advances: This is the profitable function of the commercial banks. They make profit by lending to creditworthy customers that is, that's having collateral securities, at a higher rate of interest then the rate they pay on deposits. In order to protect depositors, commercial banks provide mostly short-term loans that is, loans repayable within a period of one year.

Acting as agents for transfer of funds: Commercial banks act as agents of payments of transfer funds on behalf of their customers through collection of cheques, standing orders, direct debiting and so on. For instance, a customer's cheque on his current account. The bank is expected to honour the cheques as long as the customer has sufficient are regular and the cheque is presented within 6 months of issue.

Creating demand-deposit money: Commercial banks create demand-deposit money by lending out the money that they received from some other customers.

SERVICE RENDERED BY THE COMMERCIAL BANKS

The financial products and services of the banks include:

Current account: (Alade *et al.*, 2003):

- Personal Accounts: Those that are salary fed or serviced through lodgments of dividends, rents and other benefits accruing to account holders
- Personal business account: These includes also proprietorships, partners professional, associations, charity organization
- Corporate accounts: This includes accounts of private limited and public liability limited companies or government agencies

SAVINGS ACCOUNT

- Time deposit scheme
- Cashing credit facility
- Foreign currency domiciliary accounts: According to Asiedu (2006), foreign currency accounts may be opened by the following people
- Citizens of Nigeria

- Aliens resident in Nigeria
- Corporate bodies
- Foreign diplomats, diplomatic and consular missions and international organizations.
- Such other persons as the government may form time designate
- Agricultural lending scheme
- Bankers acceptance
- Correspondent banks to community banks: Areas covered by the correspondent relationship includes.
- Opening and operation of current accounts with union bank plc.
- Investments
- correspondent to Foreign Bank: Union banks of Nigeria act as a correspondent bank to foreign banks such as:
- Bankers trust company, New York

In addition, there are computerized service delivery packages available in the bank. They include:

- Customer Self- Service Window (CSW): This enable customers of same branches to obtain details of their account directly from the computer system
- Electronic Funds Transfer (EFT): Links up major commercial branches in a network that make it possible for customers to transect their business from locations other than the where they maintain account
- Corporate Treasuries Window (CTW): It enables customers to maintain constant link with the bank by obtaining information readily from terminates located in their offices
- Automated Teller Machine (ATM): Available at present in limited number of branches as signature verifies
- Signature Verification Software: Available at present in limited number of branches as signature verifier

Also, at the international level, the bank has commercial operation as an appointed agent of the society for worldwide inter-bank financial telecommunication (SWIFT) to speed-up international financial transaction.

INVESTMENT FINANCE BY FINANCIAL INSTITUTIONS

Isimoya (1994) investment financed by commercial bank is made through the provision of credit facilities to the potential investor for the production of capital goods. Capital goods are one aspect of what are called investment goods. Ezeoha (2007) investments as goods including stock of finished and semi-finished goods. The role of credit is very crucial in the economic development especially at a certain stage in economic development especially at a certain stage in economic development; investment finance clearly becomes a strong face for further improvement. The word' credit' is a wide term used in connection with operation or state involving lending, generally at short term. To give credit is to finance directly or indirectly the expenditure of the other against future repayment.

Encyclopedia-poritanica credit facilities is defined as the facilities through which an investor borrow and repay at a later date in order to facilitate the acquisition of capital assets for production, processing and marketing of their product. It is the lack of credit as some of the factors that make it difficult for investors might which obviously, is the innovation which investor might wish to carry out may not be possible if assets to financial resources is restricted or not in existence for the

necessary transformation to take place in the economic activities. Financial resources through credit among other factors must be adequate. The ineffectiveness of most form of credit has chronic must be adequate. The ineffectiveness of most form of credit has chronic elsewhere, rather than improve with time as a means of investment finance, they have become restricted and if small scale investor is to grow to become a medium and eventually use to a large.

Scale production, he must have among other things as assure supply or credit for short, medium and long term.

The inherent problems of investment finance which tend to inhibit the smooth flow of credit into productive activities some of the effective planning, economies.

Environment factor the ineffectiveness of supporting, institutional and infrastructure inadequacies.

The major problem facing both the lender and borrowers to investible fund is that of feasibility study which was more of assistance to the investor rather banker itself, since the banker world be better advised to conduct visit to the proposed site. The bank ought to assess the viability of the project but it may be difficult because of the problem of inadequate infrastructural and capital acquisition, complex application form, lack of collateral securities, the elerk surrounding the preparation of feasibility reports, inadequate supply of loan able fund under capitalization of firm enterprises and high lending rate.

In order to solve this problem, there should be improvement in investment data collection that will elicit facts about financial needs of Nigeria investor, greater incentives to credit instructors and the strengthening of rural bank branches to promote all round development.

HOW COMMERCIAL BANKS INFLUENCE CAPITAL INVESTMENT

By deciding to whom and for what purpose to lend funds, commercial banks influence the pattern of investment of capital. Once a firm makes an initial investment, buying land, building, machinery or equipment, it typically must borrow additional funds to keep its project going. Laws regulating the establishment of banks not infrequently restrict them primarily to granting short-term credit or very secure longer- term loans to ensure that the commercial banks can pay cash on demand to their depositors.

Soyibo and Adekanye (1991) commercial bank credit finances the working capital needs of businesses in the private sector: loans to enable firms to finance wage payments, the purchase of raw materials and spare parts for machinery and equipment, or the storage or stocks or goods until they are sold. Once the firm has sold the goods it produced with credit, it can repay the bank, often within the year.

Infrequently however, funds borrowed for longer periods commercial banks typically may make loans secured by mortgages on real property: homes, office buildings, machinery and equipment. They may provide a firm a line of credit and agree to the funding to a specified amount. In return, the firm retains an agreed portion of the line of credit (usually 10 to 15%) on deposit in the bank. The bank may also provide the firm with a revolving credit, a commitment to level up to a certain amount but a fee normally 0.5% on the unused portion.

Uremadu (2000) the firms may use borrowed funds to produce additional profit which, if the interest rate charged by the bank is low enough, will enable it to increase the dividends of its shareholders. The bank managers seeking to maximize their profits, i.e., the banks' returns in the form of interest decides to whom and for what purposes they will lend funds. Their decisions in editable influence the decisions of individual or firms as to whether and now much to invest, for,

without access to essential working capital or needed longer term credit, without access to essential working capital or needed longer term credit, many capital investments in plant and equipment become unavailable.

Commercial banks may also indirectly influence the pattern of investments in a national economy through the activities of their affiliates. They often establish trust departments to which individuals, business and pension funds entrust large sums of money for investment purposes. The trust department may buy and sell share of ownership in firms on behalf of the trustees, in reality, in so doing, it decides in what sectors and in what firms to invest the funds it holds in trust. Commercial banks may also establish affiliated merchant banks which the law usually permits to make longer term investment in industrial, commercial and real-estate properties. Firms seeking new funds for investment may be influenced by the criteria which these bank affiliates establish for SOUND investment.

HOW THE COMMERCIAL BANKS PROVIDE BUSINESS FINANCE

According to Jones (1993) commercial banks provides:

- Short term business finance by loan to the discount market who in turn discounts bills of exchange, loan and overdraft facilities direct to business, discounting bills of exchange Accepting bills of exchange loan to and shareholdings in factoring companies
- Medium term business finance by loans direct to business, loan to shareholdings in finance companies which in turn provide business with hire purchase and equipment leasing facilities
- Long term business finance by shareholding in industrial and commercial finance corporation and its corporation and its subsidiary company technical development capital, loan to finance cooperation for industry loan to estate duties investment trust. Shareholding in agricultural mortgage corporation

PROBLEMS OF COMMERCIAL BANKS IN NIGERIA

According to Akinsulire (1989), Nigeria commercial banks are faced with varieties of problems daily. Some of these problems are as follows:

Lack of adequate trained personnel and managerial experts to carry out their duties: The problem of finding staff who is disciplined in banking aspect is rare. Thus, the banks keep on employing staff who studies other courses in its establishment. Due to this, they end up not measuring up to the standard and thus deficiency in the banks.

Problems of communication: Communication is the energizer and appetizer in banking and is of paramount importance within a bank, between banks and with their customers. Without effective communication being the harmonious and timely combination or elements and action to achieve a desired result.

Poor bank management: The problem of bank management is one of the difficulties encountered by the manager. This is as a result of influence firm relations or instructions from the lead office. Thus, a bank manager in a branch may reject an unviable loan application to receive instruction the following day from the head office to grant the loan. He may even return from office to meet his mother or any other relation awaiting his arrival only to persuade him to grant the facility.

Problems of recruiting and training the right caliber of staff: The commercial banks are sometimes faced with the problem of who to recruit into its services and which staffs is to go on a specific training. This problem arises due to the selfish attitude of some officers that only believe in favoring themselves or relations of theirs.

Poor quality of banking services: The commercial banks are faced with the problem of improving on their banking services daily. This is due to the fact that most banks keep on reciting staffs who are not disciplined in banking sector. Their ability to discharge their duties is usually affected by their lack of knowledge in the area that they are employed. Thus, you delays to customers by clerks in the banks.

High degree of staff irregularities ranging from cash shortage to large and complicated funds: Some of these are often reported in the dailies. This affects the cash, flow system of the banks, thus making it difficult for the banks to discharge its duties effectively.

Research methodology: The focuses on the construction of the model to carry out an investigation of financial institutions (banks) have contributed on financing capital investment in Nigeria economy.

Research design: According to Asika (2008), research design means the structuring of investigation aimed at identifying variable and their relationships to one another. This is used for the purpose of containing data to enable the researcher test hypotheses or answer researcher through the various stages of the research.

Sampling is regarded as a process of selecting a sample from a large population sampling. In this research work, gout a sampling technique was used to select the sample size for the study. But every element in the population has equal change like any other if being included in the sample. Apart from being convenient and economically, it enable the researcher to specify the size of the size of the sample that can be continently handled. The sample consist of data of private credit from first bank Nigeria, Guaranty Trust Bank and Union Bank Nigeria Plc.

Sources of data: The date analyzed in this study are secondary in nature i.e., data that are ready made. This data was sourced from the CBN statistical bulletin 2008 edition. The time series data that will be analyzed in this study spanned 1992 to 2007. The test of the hypotheses earlier stated would be done at 5% level of significance and as such, the generalization of the study findings would be limited to this extent.

Data analysis technique: The estimation technique we are going to use is the single equation of Ordinary Least = Square (OLS) method by extending non-linear relationship to linear regression model. It is widely used for the fact that one parameter estimate obtained by ordinary least square has some optional properties such as being fairly simple and data requirement are not excessive. In running the regression, the statistical package for social sciences (SPSS) version 16 was used.

In running the regression the following test will be observed:

R^2 (co-efficient of determination): The square is used in measuring the overall goodness of fit for a model. The larger the R^2, the higher the magnitude of the dependent variable being explained

by the explanatory variables or vice-versa. The statistical criteria aim at ascertaining the statistical reliability of the estimates of the parameter of the model.

R^2 adjusted: This allows the degree of freedom. It is used to compare equations with different explanatory variable as to whether the model result is high or low.

T-test: This test is obtained by the ratio of the estimated parameter to the standard error of the parameters. The test determines whether or not a given independent variable belongs to an equation.

Standard error: This is used in measuring the accuracy of the model.

F-test: The test is an improved version of the t-test. It is a test of significant linear relationship between independent variables put together on the dependent variable.

Durbin Watson: The Durbin Watson is used for serial and auto correlation in the data used to run the regression.

PRESENTATION AND ANALYSIS OF RESULT

As stated in the previous study, the following variables are used to compute the model and these include; BCE which represent the aggregate credit of financial institutions available for capital investment as the dependent variable; while GCF represents the additions to capital investments in the economy; SMD issued in this sense to represent stock market development and it is a measure of investment in the capital market inflation (INF) and Index Industrial Production (IIP) were used as the independent variables.

The data used in the regression is presented in Table 1.

The data was analyzed with regression using SPSS version 16.The result is presented below:

- BCE = 6.033-43.510GCFt+121.268SMDt-3772658.244IIPt-110679.822INFt+et (5.155) (23.950) (7.767) (408260.807) (85967.039)
- T-Ratio (1.170) (-1.817) (15.613) (-0.925) (-1.287)
- $R^2 = 0.971$
- R^2 adjusted = 0.960
- F-stat = 90.472
- D.W. stat = 1.414

From the results so far, it is observed that BCE will assume a value of 6.033 when all the relevant explanatory variables in the model assume zero value. Gross Capital Formation has a negative co-efficient of 43.510. Stock Market Development (SMD) had positive coefficient of 121.268 and is significant at 1 and 5% levels of significance respectively. Index of Industrial production has a negative coefficient of 3.772658.244 while inflation has a negative co-efficient of 110679.822.

From the T-ratio, we find that only the stock market development variable is significant. This is due to the fact that its t-value is above the rule of thumb of 2. The other variables have t-values that are either negative or below the rule of thumb of 2.

Table 1: Yearly data on different parameters used in regression analysis

YEAR	BCE	GCF	IIP	SMD	INF
1992	171071.0	58640.3	136.2	491.71	44.5
1993	280697.6	80948.1	131.7	804.40	57.2
1994	439113.8	85021.9	129.2	985.90	57.0
1995	474361.4	114476.3	128.8	1838.80	72.8
1996	371079.0	172105.7	132.5	6979.60	29.3
1997	365870.6	2005553.2	140.6	10330.50	8.5
1998	519510.6	192984.4	133.9	13571.10	10.0
1999	632010.1	175735.8	129.1	14072.00	6.6
2000	472011.7	268894.5	138.9	28153.10	6.9
2001	848992.8	371897.9	144.1	57683.80	18.9
2002	1311910.4	438114.9	145.2	59406.70	12.9
2003	1833694.8	429230.0	147.0	120402.60	14.0
2004	1993610.7	456970.0	151.2	225820.00	15.0
2005	2256411.7	561931.4	158.8	262935.80	17.9
2006	24739480.5	595821.6	151.5	470253.40	8.2
2007	10757571.7	6346556.6	158.9	1076020.40	5.4

Source: CBN Statistical Bulletin, 2008

Both the R^2 and adjusted R^2 are robust, explaining the fact that variations in the BCE are caused by the regressors up to 97 and 96%, respectively. The F-statistic 90.472 is also highly significant. This shows the goodness of fit of the model and also explains the dependent variable in relation to the independent variable in 97 ways. The 3% left is known as the error term. This indicates that this model can be felled on in 97 ways.

From the above, there is no conclusive evidence of serial or autocorrelation since the D.W. calculated of 1.414 fall in-between the upper and lower D.W. of 1.861 and 1,004, respectively.

TEST OF HYPTHESES

In the course of this research, hypotheses were developed and they are:

- Financial institutions have not contributed to the financing of capital investment in Nigeria
- There is no relationship between Stock Market Development and Bank credit

Decision rule: When the t-calculated is higher than the t-tabulated we accept the alternate hypotheses and reject the null hypotheses.

Decision: From the t-values, we discovered that the t-value for GCE is less than 2 i.e., t-cal < t-tabulated. We therefore accept the null hypotheses which states that: financial institutions have not contributed to the financing of capital investment in Nigeria.

To test for hypothesis two, we discover that the t-value for SMD is higher than the tabulated i.e., t-calculated > t-tabulated. We therefore reject the null hypothesis and accept the alternate hypothesis which state that: there is a positive relationship between bank credit and Stock Market Development.

However, certain macroeconomic effects that characterized the Nigerian economy can be used to justify the relationship found between capital market investment growth, stock market development and bank credit. Nigeria did not achieve stock market internationalization at the early

stage of her development. Considering this fact, it would have been difficult for the exchange to influence the inflow of foreign private capital in the country. This is also especially so, given that the banking industry equally suffered persistent distresses and failure, up until 2004 when an industry consolidation was forced by the Central Bank of Nigeria. Thus, consistent with the findings of Arestis *et al.* (2001), the banking industry could not play the necessary complementary role required to support the entire financial system and induce economic growth in the country. Under such condition, the stock market alone could not singularly spur capital investment growth. In line with the advice of Demirguc-Kunt and Levine (1996), stock market development and banking development should go hand-in-hand to be able to encourage long-run economic growth.

Implications of the result: The economic implications of this result are financial institutions credit does not contribute to growth of capital investment in Nigerian economy, at the long-run. The study shows that development in the Nigerian stock market over the years was able to spur growth in capital investment flows, but the country,s banking system rather had some weak effects on the flow of capital investments. The researcher attributed this to persistent cases of distress and failure in the banking system.

This study established the role of financial institutions in financing capital investment in the Nigerian context. The model adopted in this study capture some essential variables that influences growth in capital investments. Bank credit (measured in terms of the aggregate credit available to the economy) was used as the dependent variable.

From the analysis, it is observed that:

- Gross capital formation has a negative relationship with bank credit available in the economy
- Stock Market Development (SMD) had positive relationship with bank credit available to the economy. Moreover, this relationship is significant
- The index of industrial production has a negative and insignificant relationship with bank credit available to the economy
- Inflation also has a negative relationship with the bank credit available for the economy

CONCLUSION

The outcome of this empirical analysis clearly established some policy issues such as; the quantum of banking system,s credit allocated to the domestic economy growth does not have a positive and direct relationship with the growth of capital investment in Nigeria, although there is a positive relationship with this quantum of credit with the stock market development. This therefore implies that the availability of credit for financing capital investment in the economy is grossly inadequate and therefore posses a serious threat to infrastructural development. This is unacceptable because it will lead to infrastructural inadequacies in the economy and further hinder the pace of the development of the economy. It is therefore necessary that adequate measures be put in place by relevant agencies to correct this because capital investment has significant effect on economic growth. Commercial banks or rather the banking system should be encouraged to mobilize bigger demand deposit liabilities (ie., Bank debts) and they should be allowed to extend enough credit to the domestic economy from such loanable funds, by the monetary authorities via reduced Legal Reserve Requirements (LRR) provisions or concessions. The Central Bank of Nigeria should lower its Minimum Rediscount Rate (MRR) which serves as a benchmark from which

lending and borrowing rates take their cue. Finally, efforts should be geared towards reducing the banking system's over all investments in bank investment securities. This singular action will leave adequate loan able funds for direct loans to the domestic economy.

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