Financial Structure and Economic Performance in Nigeria: Evidence from Bank View Approach

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ABSTRACT

The study examines the effect of financial structure on economic performance in Nigeria with an emphasis from bank based theories. The study used time series data for the period of 38 years spanning from 1981-2018 which were collected from Central Bank Statistical Bulletin. The financial structure was proxy with bank activities, bank size and bank efficiencies while the economic performance was measure through output per head. VAR Toda- Yamamoto granger causality was used as the estimation technique. The study found that financial structure cannot explain the economic performance and neither does economic performance predict the future behaviour of financial structure. The study concluded that the provision of financial services is important and in sync with economic performance because it encompasses creation of functioning banks and efficient markets. In view of this, the regulatory authority should formulate a policy and create an enabling environment where financial services are soundly and efficiently provided.

Keywords: Financial structure, economic performance, VAR Toda-Yamamoto, bank-based theory.

1. INTRODUCTION

The nexus between finance and economic growth and development has long been documented decades ago by Schumpeter in 1934 who contends that the services provided by financial intermediaries are important for stimulating technological innovation and economic development. He emphasised that well-developed financial systems can channel financial resources to their most productive use, leading to the expansion of the economy. This corroborate with the assertion of Dada (2015) that finance serves as leveraging mechanism that facilitates the enhanced flow of credit and other financial services to the needy sectors of the economy and segments of the population to improve livelihood and contribute to national development.The economic strength of a nation and the ability of such a nation to gain the most from its accumulated human and material resources require a well-developed financial market to power the industrial sector in particular and the economy as a whole (Chernykh and Theodossiou, 2011).

Ojo (2010) asserts that sustainable industrial development cannot be achieved without efficient and well-functioning financial institutions to channel funds to the industrial sector for productive uses. In the same direction, Abosede (2004) and Somoye (2011) opine that financial intermediation is perhaps the most important function of the banks, especially in developing countries like Nigeria, where available resources are generally inadequate or insufficient to meet the developmental needs of the economy.

The efficient and effective performance of this function over time guarantees financial stability and industrial growth of a nation. In view of this, the link between financial development and economic growth has been tested in various dimension, most studies concentrate on the role of financial development on economic growth but surprisingly, immense attention among researchers and policy makers from both the developed and developing countries has been drawn. This study concentrates on other financial sector development which is financial structure and in relation with economic performance. However, the link between financial structure and economic growth have been categorised on basis of financial structure theories which are; the bank-based view, the market-based view, the financial services view and the legal based view (Levine, 2002; Beck and Levine, 2002).

The bank-based theory lays emphasis on the positive role of banks in development and growth, and also, stresses the shortcomings of market-based financial systems. It argues that banks can finance development more effectively than markets in developing economies, and, in the case of state-owned banks, market failures can be overcome and allocation of savings can be undertaken strategically (Gerschenkron, 1962). According to the bank-based view, bank-based financial systems, especially in countries at an early stage of economic development, are more effective at fostering growth than market-based financial systems.Indeed, bank-based financial systems are in a much better position than market-based systems to address agency problems and short-termism (Stiglitz, 1985).

Banks have been considered to be more effective in financing industrial expansion than any other form of financing in developing economies, especially in Nigeria where banks constitute the largest financial intermediaries (Gershenknon, 1962). In the same vain, Ojo (2010) asserts that the experience and expertise of banks in savings mobilization and financial resource allocation make them an important phenomenon in economic growth and development of emerging economies. The funds mobilized from numerous customers are aggregated and disbursed as credit facilities to the deficit sector usually the investors. These facilities in form of loans and advances facilitate the exploration and expansion of productive investment by small, medium and large scale industries.

Based on this, the main thrust of this research is to examine the relationship between the bank-based view financial structure and their effect on economic performance. The fundamental question in this study is: Does relationship exist between bank-based view financial structure and economic performance? To answer this question, the remaining part is structured as follow: section two reviews literature and theory that underpin the study, section three outlines the methodology and model specification adopted for the study. Data analysis and discussion were presented in section four while section five concludes the paper and proffer recommendations.

2. LITERATURE REVIEW

According to Stulz (2001), financial structure entails the institutions, financial technology, and rules that guide financial activity at a point in time. In the same token, Merton (1995) asserts that it is a payment system, that is, a mechanism for pooling funds, ways of transmitting resources across space and time, ways to manage uncertainty and control risk, price information to allow the economy to implement a decentralized allocation, and ways to deal with the asymmetric information problems that arise when one party to a financial transaction has information that the others do not have. The performance of an economy is usually assessed in terms of the achievement of economic objectives. These objectives can be long term, such as sustainable growth and development, or short term, such as the stabilisation of the economy in response to sudden and unpredictable events, called economic shocks. Thus, there are several indicators of measuring economic performance, which include but not limited to income and savings adjusted for population, gross domestic product (GDP), consumption, investment, and international trade adjusted for population, among others.

Ujunwa, Salami, Nwakobyand Umar (2012) documented the impact of competing financial structure theories on economic growth in Nigeria. The study used time series data for a 17 year and the Ordinary Least Square regression approach to estimate the formulated models. The study found that the coefficients of bank-based theory and legal-based theory were positive in promoting economic growth, while the regression coefficients of market-based theory and the financial service theory were negative in promoting economic growth.The study concluded that the impact of financial structure on economic growth showed mixed effect. Adusei (2013) employed cointegration, Fully-Modified Ordinary Least Squares (FMOLS), Error Correction and the Generalized Method of Moments (GMM) techniques to investigate the relationship between economic growth and financial development using annual time series data (1971-2010) from Ghana. It was found that financial development undermines economic growth in Ghana.

The study concluded that financial development has negative effect on economic growth in Ghana.Maduka, and Onwuka,(2013) investigated both the long run and short run relationships between financial structure and economic growth using time series data. The study adopted Augmented Dickey – Fuller and Philips – Perron test, Johansen and Juselius maximum likelihood procedure and vector error correction model. The main results revealed that financial market structure has a negative and significant effect on economic growth based on Nigeria data. The study concluded that there exists a low level of development of the country's financial sector. Onwumere, Onudugo and Imo (2013) investigated whether financial structure has positive and significant impact on economic growth and development in Nigeria. The study used ordinary least square estimation method and it was revealed that total financial structure has positive and significant impact on economic growth. However, while some sectors exert more influence (banking and market), other sectors (such as insurance) were found to have non-significant impact on economic growth. The study concluded that different part of the financial structure exert mixed result on the economic growth in Nigeria.

Aigbovo and Uwubamwen (2014) studied the short-run and long-run relationships between financial system development and economic growth in Nigeria. The findings of the study revealed that financial development (measured by banking system and stock market development) positively determine economic growth in Nigeria while also showing causality from finance to growth in the finance-growth nexus. The study concluded that financial development can predict economic growth in the future.

Rateiwa, and Aziakpono (2016) investigated the long-debated question of whether or not a country's financial structure matters for economic performance. The study used the Johansen co-integration and vector error correction modelling framework within a country-specific setting to examine the existence of a long-run equilibrium relationship between the financial structure of a country and per capita GDP and the causality thereof within the period of 1971-2013. It was documented that that there exists a strong relationship between the financial structure of Egypt and South Africa, and per capita GDP in these countries.It was concluded that the nature of the relationship between the financial structure of Egypt and South Africa and per capita GDP is positive,albeit based on different measures of financial structure. Guei, (2018) examined the effect of financial structure on economic performance in South Africa. The study utilizes the autoregressive distributed lag model for econometric estimation on the data set for the period 1975-2016. It was revealed that financial structure does not matter for economic growth in South Africa. The study concluded that government should place an emphasis on improving the quality of the financial system as opposed to developing a particular financial system.

Qamruzzaman, and Wei (2018) explored the relationship between economic growth, financial innovation,and stock market development of Bangladesh for the period 1980–2016. The study used the autoregressive distributed lag (ARDL) bounds testing approach and the Granger-causality test is used to identify directional causality between research variables under the error correction term. It was revealed that there is an existence of a long-run association between financial innovation, stock market development, and economic growth. The study concluded that there is bidirectional causality between financial innovation, economic growth and stock market development, and economic growth both in the long run and short run. Liu and Zhang (2018) used the two-stage least square and generalized method of moments to explore the endogenous mechanism between financial structure and economic growth in China's provinces over the period from 1996 to 2013. The study found that the financial market has positive and significant impact on economic growth. The study concluded that the effect on economic growth varies across regions and presents an inverse U-shape.

Nkoro and Uko, (2019) investigated the role of financial structure in explaining economic growth dynamics in Nigeria using annual time series from 1981-2017. The study employed the vector error correction model (VECM) in the analysis of the data. The result showed that stock market and bank-based have a significant effect on growth. The study concluded that financial structure is the most useful way to assess the financial systems since both bank and stock market system matter in explaining economic growth as against bank-based versus market-based debate. Chu, (2020) assessed the long-debated relationship between the financial structure and economic growth. The study employed the generalized method of moments estimation to a panel of 99 countries over the period of 1971 to 2015.

It was documented that financial market has positive and significant effect on economic growth. It was concluded that the positive effect of the securities market development relative to the banking system weakens significantly if the financial structure is unbalanced. Yua, Adoms, Okaro, and Ogbonna (2020) examined financial structure and economic growth of contemporary African economies; evidence from Nigeria. The study used secondary data obtained from World Bank Data Atlas and subjected them to Granger Causality technique to test the interaction between independent variables and the dependent variable at the 5% level of significance. The findings show that financial structure in bank credit to the private sector ratio, market capitalization ratio , liquid liability ratio, turnover ratio and value of traded share had no significant effect on GDP in the contemporary African economies. Thus, the study concludes that financial structure does not have significant effect on economic growth in the contemporary African economies.

From the study reviewed, it was found that there are scanty of literature on the effect of financial structure on economic growth and this justifies the importance of conducting this research. Apart from this, most of the studies concentrate on the economic growth but this current study focus on the economic performance. More so, most of these studies reviewed used ordinary least square, vector error correction mechanism among others but this study employed the Toda Yamomoto vector autoregressive approach to differentiate this study from previous study. The study is anchored on bank view theory.

3. METHODOLOGY

Ex post-factor is employed in the study and time series data were collected over a successive period of time of thirty-eight years which spans from 1981 to 2018 from Central Bank of Nigeria statistical bulletin and World Bank data indicators. Financial structure was captured using bank activities, bank size and bank efficiency while the economic performance was measure through output per head.The study also includes the control variable which includes the inflation, foreign direct investment and trade openness. The study employed ARDL which takes its source from the linear specifications of Walsh and Yu (2010) but this specification is replicated using different variables as stated in my baseline equations as follow.

$$eco_t = b_0 + \sum_{i=1}^{q^1} b_i eco_{t-i} + \sum_{i=1}^{q^2} h_i bac_{t-i} + \sum_{i=1}^{q^3} g_i beff_{t-i} + \sum_{i=1}^{q^4} f_i bsz_t + \sum_{i=1}^{q^5} k_i \inf_t + \sum_{i=1}^{q^6} l_i fdi_t + \sum_{i=1}^{q^7} m_i to_t + w_t ....3.1$$

Where: $q^1 = q^2 = q^3$, i= 1, 2, 3, eco represent economic performance, bac represents bank activities, beff represents bank efficiency, bsz represents bank size, inf represents inflation, fdi represents foreign direct investment, to represents trade openness an q is the lag length. The study adopted Toda and Yamamoto VAR in order to avoid integration complexity among variables that is, it can be used at any order of integration, level, first difference or second difference and improve the power of granger-causality test. It has the advantage of making parameter estimation valid even when the VAR system is not co-integrated. However, before estimating the model there is need to conduct pre-estimation test such as lag selection criterion to determine the optimum lag based on the information criterion, unit root tests correlation matrix among others, then the estimation of the Toda and Yamamoto VAR. The table below show the variable measurement

3.1 Variables Measurement

S/N	Variables	Types	Measurements	Source
1	Economic performance	Dependent	Output per head	Oyedeko and Adeyeye (2019)
2	Financial Structure: Bank activities Bank size Bank efficiency	Independents	*Bank Credit to the Private Sector/GDP M2/GDP Net Interest Margin/Total Assets*	Ujunwa, etal. (2012)
3	Trade openness	Control	Export plus import divided by GDP	Rateiwa, and Aziakpono (2016)
4	Foreign direct investment	Control	WDI Index	Rateiwa, and Aziakpono (2016)
5	Inflation	Control	WDI Index	Rateiwa, and Aziakpono (2016)

Source: Authors' Computation, (2020).

4. RESULTS

This section presents the analysis of the data and the discussion of the findings. The analysis is carried out on the basis of pre-estimation and estimation Toda Yamamoto VAR. The result started with descriptive statistics which include mean, maximum, minimum, standard deviation, skewness, kurtosis, and Jarque-Bera statistics. Table 4.1 gives the results of the statistical method.

Table 4.1-Statistical Description of Data

	INF	BAC	BEFF	BSZ	ECO	FDI	TO
Mean	19.35040	0.110526	0.518422	0.142025	166.3399	1.571674	0.033347
Median	12.71577	0.082093	0.511819	0.126931	51.83440	1.266578	0.003798
Maximum	72.83550	0.207733	0.703690	0.213073	618.0170	5.790847	0.295383
Minimum	5.388008	0.059173	0.303374	0.091517	1.845600	0.257422	0.000842
Std. Dev.	17.24364	0.053777	0.103610	0.039317	204.2691	1.243177	0.063987
Skewness	1.741920	0.875430	-0.337954	0.598480	1.008058	1.704920	2.630729
Kurtosis	4.838732	1.962942	2.439872	1.828851	2.534880	5.937561	9.686897
Jarque-Bera	24.57028	6.556586	1.220111	4.440146	6.778342	32.07244	114.6294
Probability	0.000005	0.037693	0.543321	0.108601	0.033737	0.000000	0.000000

Source: Output from E-view, (2020).

The Table 4.1 shows the summarized descriptive statistics computed on the variable-series of inflation, bank activities, bank efficiency, bank size, economic performance, foreign direct investment and trade openness. It is remarkable that both the mean and median are positive for the variables and this implies that these variables displayed an increasing tendency through the period of investigation. Also, there is statistical evidence that throughout the period of 38 years economic performance has the largest range from 618.0170 to 1.845600 while the bank activities has the lowest range value from 0.207733 to 0.059173. These range values are associated with corresponding standard deviation values of 204.2691 and 0.059173 respectively. This implies that economic performance is the most volatile among the variables while bank activities is the lowest volatile variable.

The scale of skewness with respect to bank efficiency is -0.337954 and this implies that the variable is negatively skewed and as such, it exhibits large value over a long portion of the sampling period. On the contrary, inflation, bank activities, bank size, economic performance, foreign direct investment and trade openness are positively skewed and have large values over a short period. The values of kurtosis for inflation, foreign direct investment and trade openness exhibit values larger than 3 and this shows that they are leptokurtic, and therefore, they have tin tail in their distribution pattern, suggesting that there are presence of outliers or large values in the expected future date. On the other hand, bank activities, bank efficiency, bank size and economic performance have values less than 3 and this implies that they are platykurtic which suggest that there are absence of outliers or large values in the expected future date.

Finally, the probability values corresponding to Jarque-Bera statistics with respect to inflation, bank activities, economic performance, foreign direct investment and trade openness are less than 5 percent, meaning that the distribution pattern of these variables is not normal. However, the probability value in respect to bank efficiency and bank size is larger than 5 percent. This implies that the variables are normally distributed. Summarily, the statistical description of the data is not enough to conclude that the data is fit for analysis. Thus, to confirm the possibility of fitting the data into regression equations for estimation purpose the researcher conducts pre-estimation test such as optimum lag criterion, unit root test using Augmented Dickey-Fuller (ADF) method and correlation analysis for perfect collinearity test. In actual sense, test for lag selection precedes the unit root test. The maximum lag selection test based on all information criteria for the specified variables is conducted and the results are depicted in table 4.2 below.

Table 4.2 Optimum Lag Selection for the Specified Variables

Lag	LogL	LR	FPE	AIC	SC	HQ
0	-120.4845	NA	2.81e-06	7.082471	7.390378	7.189939
1	83.82927	317.8214*	5.30e-10*	-1.546071*	0.917181*	-0.686330*
2	124.0315	46.90265	1.20e-09	-1.057308	3.561289	0.554706

*Note that: * indicates lag order selected by the criterion, LR: sequential modified LR test statistic (each test at 5% level), FPE: Final prediction error, AIC: Akaike information criterion, SC: Schwarz information criterion and HQ: Hannan-Quinn information criterion.*
Source: Output from the E-view (2020)

The optimum lag is given by the smallest value of the information criteria. In the table above all the information criteria-LR, FPE, AIC, and HQ have the smaller value at lag 1; implying that 1 is the optimum lag selected by these information criteria. Thus, the AR framework that gives rise to unit root test and Toda and Yamamoto VAR approach are operationalized using lag 1 as the optimal lag. Table 4.3 provides the summarized results of the unit root test, while tables 4.4 display the correlation matrix for multicollinearity test.

Table 4.3-ADF Unit Root Test

Variables	ADF statistics	5%- CV	Prob	Order of Int.
Bac	-4.876972	-2.945842	0.0003	I(1)
Beff	-7.239283	-2.945842	0.0000	I(1)
Bsz	-5.643062	-2.945842	0.0000	I(1)
Eco	-9.729235	-2.948404	0.0000	I(2)
FDI	-3.895004	-2.943427	0.0049	I(0)
INF	-5.586929	-2.945842	0.0000	I(1)
TO	-9.021370	-2.957110	0.0000	I(0)

Source: Output from the E-view (2020)

The ADF unit root test is conducted to verify the order of integration of each variable. The outputs of the test are the ADF statistics, the 5 percent critical values and probability value, which are presented in table 4.3. The null hypothesis here is that the series is not stationary or the series has a unit root. The result shows that that all the variables were not stationary at level but also at first and secondary differences, indicating that these variables are multi-leveled integrated. However, in order to estimate the long-run relationship among the variables the Today-Yamamoto vector autoregressive will be used. Thus, the result of correlation is reported below.

Table 4.4-Correlation Test wrt BOP, EXC, INF, INT and MS

	INF	BAC	BEFF	BSZ	FDI	TO
INF	1	-0.2842	-0.5532	-0.2845	0.4466	-0.0259
BAC	-0.2842	1	0.5733	0.9552	0.0005	-0.3856
BEFF	-0.5532	0.5733	1	0.5334	-0.3366	0.1777
BSZ	-0.2845	0.6552	0.5334	1	0.0886	-0.4216
FDI	0.4466	0.0005	-0.3366	0.0886	1	-0.3461
TO	-0.0259	-0.3856	0.1777	-0.4216	-0.3461	1

Source: Output from the E-view (2020)

Table 4.4 reports the correlation coefficients used to study the extent of association among the variables for the period of thirty-one years. The interpretation of the Pearson correlation would follow Guilford rule of thumb which is < 0.2 is a negligible correlation, 0.2 to 0.4 is low correlation, 0.4 to 0.7 is a moderate correlation, 0.7 to 0.9 is a high correlation, > 0.9 is a very high correlation. The result shows that the correlation among the independent variables in the model is generally weak. The largest correlation coefficients exist between the bank activities and bank size (65.52%). Also, the correlation matrices does not reveal that two explanatory variable are perfectly correlated. This means there is absence of multicollinearity problem among the variables. Fulfilling this condition coupled with the fact that the variables are multileveled stationary. Other pre-requirements for the Toda and Yamamoto VAR are that the VAR process must be ergodic (stationary) and the error term must be IID compliant. The test for ergodicity and LM serial correlation are carried out and reported in table 4.5 below;
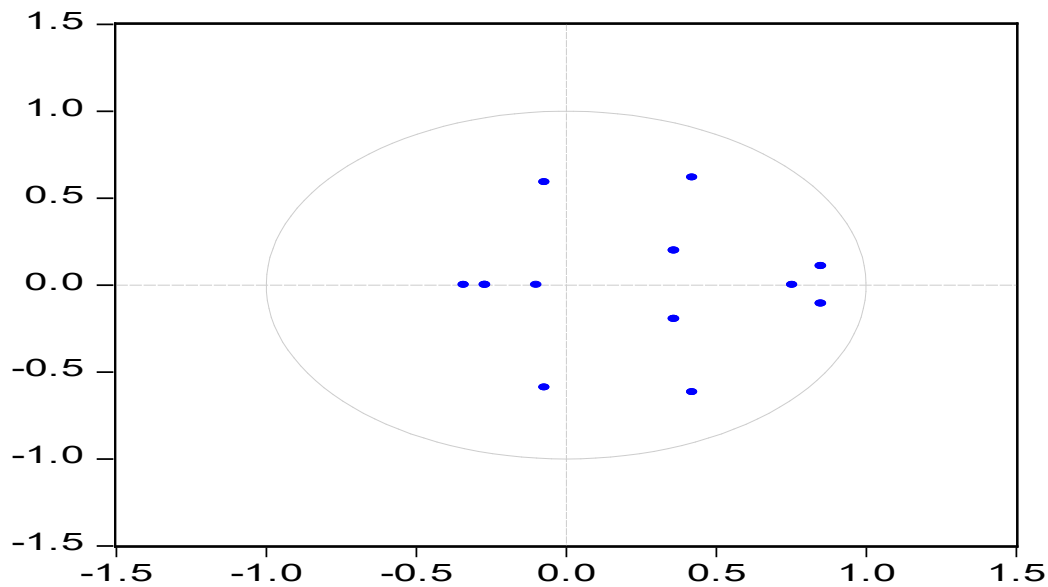
Table 4.5 Showing LM Serial Correlation Test

Lags	LM-Stat	Prob
1	70.81895	0.0524
2	58.48288	0.1664
3	33.14321	0.9597
4	55.22041	0.2513
5	51.07914	0.3919

Source: Output from the E-view (2020)

The study examined the LM statistics up to lag 5 and the statistics appear to be very small; while the corresponding p-values are respectively larger,5 percent. In view of this, the null hypothesis of no serial correlation cannot be rejected. The residuals are independently spread. The test for ergodicity is carried out by computing the root of the AR polynomial and it is shown in the figure below.

Figure4.1 Stability of Economic Performance-Financial Structure VAR Process

The result of the stability test reveals that the model is stable since none of the modulus value is greater than one. This implies that the Toda- Yamamoto can be estimated.

Table 4.6: Nature of the Long Run Relationship between ECO,BAC, BEFF, BSZ, INF, FDI and TO

Variables	Coefficients	Std.Error	T-statistics
BAC(-1)	1025.398	(1299.56)	[0.78903]
BEFF(-1)	826.9868	(305.893)	[2.70352]
BSZ(-1)	-6692.163	(2119.89)	[-3.15685]
INF(-1)	-10.26982	(2.17447)	[-4.72290]
FDI(-1)	337.5550	(40.4275)	[8.34963]
TO(-1)	-3496.956	(786.871)	[-4.44413]

Source: Output from the E-view (2020)

The long run coefficients with respect to bank activities, bank efficiency, bank size, inflation rate, foreign direct investment and trade openness are 1025.398, 826.9868, -6692.163, -10.26982, 337.5550 and -3496.956 respectively and their associated t- values are 0.78903, 2.70352, -3.15685, -4.72290, 8.34963 and -4.44413.This implies that in the long run, bank size, inflation rate, and trade openness has negative effect on economic performance while bank activities and bank efficiency have positive effect on economic performance.Also the table shows that all the variables are significant at 5% level of significance except the bank activities. This implies that the bank activities and the bank efficiency have significant effect on the economic performance in Nigeria. The study equally examines cause and effect; between each pair of the variables using the Granger causality technique. The results are shown in table 4.7 below;

Table 4.7: Granger Causality between Pair of ECO, INF, BAC, BEFF, BSZ, FDI and TO

Equation/Excluded	Chi2	Df	Prob.
ECO			
INF	2.171043	2	0.3377
BAC	0.396516	2	0.8202
BEFF	1.068039	2	0.5862
BSZ	0.581260	2	0.7478
FDI	0.921320	2	0.6309
TO	0.038403	2	0.9810
ALL	4.930127	12	0.9603

Source: Output from the E-view (2020)

For the purpose of the objective of this study, the result of the first compartment is reported above, all p-values are insignificant; this implies that the null hypothesis that the excluded variable does Granger cause equation variable cannot be rejected at 95 percent confidence. The explanation for this is that economic performance cannot be used to explain the future behaviour of financial structure based on bank view which includes the bank activities, bank efficiency and bank size. Also, financial structure based on bank view which includes the bank activities, bank efficiency and bank size cannot be used in predicting economic performance in Nigeria.

4.1 Discussion of Result
It was found that in the long run, bank size, inflation rate, and trade openness has negative effect on economic performance while bank activities and bank efficiency have positive effect on economic performance. Also, the study documented that economic performance can be used to explain the future behaviour of financial structure based on bank view which includes the bank activities, bank efficiency and bank size. Also, financial structure based on bank view which includes the bank activities, bank efficiency and bank size cannot be used in predicting economic performance in Nigeria. The implication of this is that, financial structure based on bank view has no effect on economic performance in Nigeria. This finding does not conform to the findings of Rateiwa and Aziakpono (2016). The explanation for this is that the effect of the financial structure from the banking perspective is not really felt in the economy in terms of their activities such as credit facility provision to private sector, bank efficiency and size of the banks operating in Nigeria.

5. CONCLUSION

The study examines the effect of bank-based view financial structure on economic performance. The study adopts Toda-yamamoto VAR as the estimation technique. The study found that financial structure cannot explain the economic performance and neither does economic performance predict the future behaviour of financial structure. The study concluded that the provision of financial services is important and in sync with economic performance because it encompasses creation of functioning banks and efficient markets. In view of this, the regulatory authority should formulate a policy and create an enabling environment where financial services are soundly and efficiently provided. Further researches are encouraged on the effect of financial structure in economic performance with an emphasis on some selected African countries.

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