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EFFECT OF MERCHANT BANK OPERATION ON ECONOMIC DEVELOPMENT IN NIGERIA

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ABSTRACT: *This study investigates the operation of merchant bank on economic development in Nigeria. The data used in this study were collected from the period of 2010 to 2015. Augmented Dickey Fuller (ADF) and Philip Perron unit root test, ordinary least square and granger causality test have been used. Unit root test confirms the stationary of all variables at first difference. Regression results indicate that deposits, investments, advances, profitability and interest earnings have significant positive impact on economic development in Nigeria. The Granger-Causality test confirms the bidirectional causal relationship of deposits, advances and profitability with economic growth. On the other side we found unidirectional causal relationship of investments and interest earnings with economic growth runs from investments and interest earnings to economic growth. It is recommended that the policy makers should make policies to enhance the banking sector in Nigeria because banking sector is significantly contributing to the economic development in Nigeria.*

KEYWORDS: Merchant Bank, Operation, Economic Development, Investment, Nigeria.

INTRODUCTION

Before the 2005 banking consolidations in Nigeria, there were more than a hundred banking institutions. These banks offered or claimed to offer different services to different client bases. Some were basically merchants making profits from supporting enterprises. Others were deposit holding institutions, while a few 'less fashionable' ones were community banks. There were agricultural banks too. But in reality, many of these banks were distinctions without any difference to the the banking public (Adekunle, Salami & Adedipe, 2013). After the 2005 banking consolidations, which resulted in the merger of many of these banks, they simply became 'jacks of all trade', managing to master all. There were mega banks into mega businesses. The slogan seemed to be 'anything the customer wanted'. The merchant banks were gone. To some, this was a most pragmatic approach, but not to the regulator. This didn't go down well with the Central Bank of Nigeria ("CBN"), as it felt this had led to banking (or better put, financial services) conglomerates who simply didn't have the capacity to effectively govern such huge structures (Aderibigbe, 2014).

Then came the sweeping reforms in 2008, piloted by then CBN Governor Sanusi Lamido Sanusi. The CBN introduced several measures to halt the near failing (if not, failure) of several banks. One of such measures was abolishing universal banking in Nigeria. Banks could no longer (at least in theory) are 'masters of all'. The 24 banks that existed at this time were essentially deposit money banks. Their territorial reach was also streamlined in accordance with their capital base.

However, it was recently announced that Kakawa Discount House had applied for a merchant banking license in 2014 and its application was granted in principle sometime in December 2014. This was not the first of such moves. In fact, in 2012 and 2013, Rand Merchant Bank and FSDH (now FSDH Merchant Bank) had obtained licenses from the CBN to transform their existing businesses into merchant banks (Ajayi, 2015).

These moves have now brought back the once non-existent merchant banks into the financial services space in Nigeria. No doubt, merchant banks play a vital role in the financial services sector of many economies the world over. Apart from their broad range of advisory and investment-related services, merchant banks provide much needed corporate finance majorly in form of equity stakes and subordinated facilities for companies and trade finance. They are private equity investors. According to Valentine Craig of the United States Federal Deposit Insurance Corporation "merchant banking is generally understood to mean negotiated private equity investment by financial institutions in the unregistered securities of either privately or publicly held companies (Adewunmi, 2016).

Merchant banks first arose in the Italian states in the middle Ages, when Italian merchant houses (generally small, family-owned, import-export, and commodity-trading businesses) began to use their excess capital to finance foreign trade in return for a share of the profits. This trade generally consisted of lengthy sea voyages. Thus, the investments were very high risk: war, bad weather, and piracy were constant threats, and by their nature the voyages were long-term and illiquid (Benhabib & Spiegel, 2007).

However, these days' merchant banks tend to focus more on corporate investments, corporate loans, portfolio management, credit syndication, bond financing, and merger and acquisitions advisory to even real estate investment as well as trade finance. The 'second coming', as it were, of merchant banks will no doubt open opportunities for increased investments and trade facilitation- roles that have been hitherto left to only commercial banks (Uche, 2012).

In 2010, in exercising its statutory mandates under the *Central Bank of Nigeria Act of 2007(3)* and the Bank and Other Financial Institution Act (4) the CBN issued the *Scope, Conditions & Minimum Standards for Merchant Banks Regulations 2010* (the Regulation) to regulate merchant banks and provide for the terms and conditions under which merchant-banking licenses will be issued. Under this Regulation, merchant banks are required to have a minimum paid-up share capital (minimum capital base) of N15 billion and not allowed to accept cash deposits except they are beyond N100 million. They are allowed to engage in foreign exchange services, act as issuing houses, act as underwriters, and provide financial advisory services, asset management services, custodial services and debt factoring services (Uche, 2012)

No doubt the lure of this specialized kind of banking will be attractive to many of the existing issues and discount houses and even commercial banks to vie into or establish new entities to engage in merchant banking. This apparently has the potential of opening new opportunities for them and exposing them to new customers. Of course, on the regulatory side of things, it calls for more attention from the CBN to ensure merchant banks operate within their licences and stay within the required cash reserve and liquidity ratios that would ensure a sustainable and sound merchant banking system. Hence, the main thrust of the study is to investigate the effect of merchant bank operation on economic development.

Functions of the Merchant Banking Services

These banks have a number of functions and some of the most important among them include:

Raise funds: one of the main functions of this banker includes helping the clients' company to raise funds from the markets. The banks help to manage equity offerings and debt. This function further includes underwriting support, pricing and marketing of the issue, stock exchange listing, allotment and refund, offer document registration and so forth.

Offer advisory services: these banks also offer advisory services to its clients for a proposed fee.

Security distribution: the functions of these banking services also include distribution of different types of securities like fixed deposits, equity shares, mutual fund products, commercial paper and debt instruments.

Aid in projects: these banks also provide aid in the projects undertaken by the clients by helping them to visualize the concept of the project. The feasibility of the project is also analyzed by these banks. The clients are also given support to prepare project reports.

Overall financial reconstruction: the merchant banking services provide better financial options and solutions to the clients. They help the clients to raise funds through cheaper resources. With the aid of other financial institutions, these banks also help to revive the sick units of the clients' companies.

Offer advice on management of risks: another important function performed by these banks includes providing timely advice on risk management. The merchant banker provides advice on different strategies adopted by the clients.

Today the merchant banking services provide a number of other services like loan syndication, credit acceptance, counseling of mergers and acquisitions, management of portfolio and so forth. They also assist companies with short term liquidity funds. In a nutshell, these banking services are indispensable as they support individuals and corporate to expand their business ventures

LITERATURE REVIEW

Fadare (2004) empirically identifies the effect of banking sector reforms on economic growth in Nigeria by using the data 1999 -2009. Variables used for the study are interest rate margins, parallel market premiums, total banking sector credit to the private sector, inflation rate, inflation rate lagged by one year, size of banking sector capital and cash reserve ratios. Results indicate that the relationship between economic growth and other exogenous variables of interest rate margins, parallel market premiums, total banking sector credit to the private sector, inflation rate and cash reserve ratio show the negative and insignificant. Hence it is suggested that criteria which encourage banking sectors to give more capital or start huge amount of lending to the individuals by minimize cash reserve ratios which is not supposed to be motivated factors for economic growth if the borrowing capacity that due to these criteria it will not surpass to the growth of private sector in the form of longer-term finances. To find

out the solution of this problem, the financial policies should consider to reform and enforce the borrowing in small industries with proper regulatory policies and against secure type of collaterals and confirmation of guaranteed repayment of finances given to them.

Al-Laham (2009) studied the Development of Electronic Money and Its Impact on the Central Bank Role and Monetary Policy. This paper depends on analytical method at determining the impact of the development of electronic money in the different areas. Data variables such as monetary supply, exchange rates, the money multiplier and velocity of money are considered. Results shows that e-money, as a network good, could become an important form of currency in the future. Such a development would influence the effectiveness and implementation of monetary policy. If an increased use of e-money substantially limits demand for central bank reserves, it would require changes in the operational target of the central bank and a closer coordination of monetary and fiscal policies.

Koivu (2002) investigated the relationship between financial sector and economic growth by using empirical methods, data variables INT = Difference between lending and deposit interest rates as percentage points. CREDIT = Ratio of bank credit to private sector to GDP. RI = Reform index. INF= Annual consumer price index as percentages. GDP growth = Real GDP growth rate. Fixed-effects panel model techniques have been used. Khatib (2007) examined the relationship between commercial banking performance and economic growth in Qatar. By using the variables of bank profit, GDP, foreign interest rates, government revenues, government expenditures and banks equity by using the regression analysis model and (OLS) techniques have been used. By using Data for the period from 1996 to 1997. Further more stability tests for structural stability and granger causality experiments in which granger causality tests also use to analysis on all variables and other variables are suppose insignificant at acceptable. Hence the results find out that predictions through variables and model are highly effective and responsible for economic growth. The study suggests that the commercial banks are playing a large role in economic growth because of the profit-making organizations. In addition, among all the variables on GDP and banks equities were significant and with the positive signs, in the model equation found to be stable. Thus, the financial advisors should be analysis through associations according to monetary policies and the financial factors and economic variables, the author further suggest that the model also support to check the relation through financial factors and other countries economic growth of that country.

Yazdani (2011) studied the role and performance of private banks on the economic growth of Iran by using the variables economic growth, profitability, cash, and investment the analysis has been proposed through various questions by conducting two main hypotheses and five minor hypotheses for his study the part of financial sectors with relation to private banks and what is the impact occurs on economic growth of the Islamic republic of Iran. Further the study is conducted for test and find out the significance of hypotheses, by using the statistical secondary data was selected from among private banks which include Eghtesad Novin, Parsian, Karafarin, Saman, Pasargad, and Sarmayeh. In the theoretical background the study defines the bank system performance and also financial development competiveness' indices have been used. For analysis of the secondary data statistical software SPSS has been used. The method used for analysis the data is inferential statistics indices also including Spearman correlation test, Pierson correlation test, David Watson test, independent t test, variance analysis F and linear regression chart. Hence the find and results obtained through analysis

shows that all variables check in the research hypotheses are exist with the definite impact on the economic growth of Iran.

Samolyk (1992) empirically investigated the relation in the bank performance and economic growth at the state level. In their study they develop a review for regional credit that explain, one of the reasons which is data cost effects the banking sectors and can also influences economic performance by development ability to funds local investments. Further the model supports that government banking sectors facing problems of economic criteria where by not well financially sound, and same that no evidence needs to link in the sector which is financial established. The data has been used to find relation of this credit analysis model for the period of 1983 to 1990 the data consists of regional level and find the output of such channels which particularly, local focus on government banking sectors, further the results explain the real individual income growth in the country in consideration with NPL's which is out of the average share.

METHODOLOGY

To find the long run relationship between the variables we have used multiple regression analysis. In this research, the study focused on secondary type of data, all data is collected from the different official publications of respected banks. In this study we have used six variables namely, gross domestic product, deposits, investments, advances, profitability and interest earning. In this study we have used the data of two banks from the period of 2010 to 2015. After selection of the above variables we can describe the economic growth function of Nigeria in the following way:

GDP = f (DEP, INV, ADV, PRF, INE)

Where GDP is the gross domestic product, f represents the function of and DEP, INV, ADV, PRF, INE represent respectively, deposits, investments, advances, profitability and interest earning. After specifying the trade balance function in linear form with an addition of error term, we can write in following way:

$$GDP = \alpha DEP + + \beta 1 \beta 2 INV + \beta 3 ADV + \beta 4 PRF + \beta 4 INE + Ut$$

RESULT ANALYSIS

Table 1: Descriptive Statistics

	GDP	DEP	INV	ADV	PRF	INE
Mean	3182.309	283.548	137.872	312.871	59.309	38.059
Maximum	6004.405	1325.790	746.330	1987.002	338.354	83.802
Minimum	1346.376	27.529	20.948	13.341	0.347	9.900
Std. Dev.	1347.689	439.590	180.724	338.235	99.797	21.846
Observations	12	12	12	12	12	12

Source: Author Computation, 2018.

The table 1 represents the descriptive statistics of the model. In the above table GDP is a dependent variable and DEP, INV, ADV, PRF and INE are independent variables. The sample size comprises of 12 observations from the period of 2010 to 2015 of two banks. The minimum and maximum value of GDP (1346.376) & (6004.405) respectively, whereas the mean value is (3182.309) and standard deviation is (1347.689). The minimum and maximum value of DEP (27.259) & (1325.790) respectively, whereas the mean value is (283.548) and standard deviation is (439.590). DEP having minimum value (9.90), maximum value (83.80), mean value (38.059) and standard deviation (21.846). INV having minimum value (20.948), maximum value (746.330), mean value (137.872) and standard deviation (180.724). ADV having minimum value (13.341), maximum value (1987.002), mean value (312.871) and standard deviation (338.235). PRF having minimum value (20.948), maximum value (746.330), mean value (137.872) and standard deviation (180.724). INE having minimum value (9.90), maximum value (83.80), mean value (38.059) and standard deviation (21.846).

Study in the mentioned subject of econometrics indicates that various macroeconomics variables data are found non-stationary. The finding was drawn from regression (integrated in different order) proceeds non-sense or spurious regression. Thus, it is essential to analysis the stationary of the data before drawn the long run association among the variables.

Table: 2 Stationary Test Results

Variables	Augmented Dickey Fuller test				Philip Perron test			
	Level		First Difference Level				First Difference	
	Inter.	Trend & Inter.	Inter.	Trend & Inter.	Inter.	Trend & Inter.	Inter.	Trend & Inter.
GDP (Gross Domestic Production)	1.48	-1.36	-4.00	-4.36	1.98	0.32	-4.97	-5.11
DEP (Deposit)	0.96	-1.83	3.37	-3.39	2.46	-1.34	-6.19	-8.12
INV (Investment)	-2.55	-2.40	-3.95	-4.34	-2.34	-2.38	-3.92	-4.34
ADV (Advances)	2.43	-0.03	-3.95	-5.21	-1.35	-0.27	-3.95	-5.21
PRF (Profitability)	0.16	-0.46	-4.13	-4.46	-0.07	-0.61	-4.13	-4.39
INE (Interest Earning)	-0.73	-2.88	-4.44	-4.35	-0.90	-2.60	-4.48	-4.33

Source: Author Computation, 2018.

Table 2 highlighted the finding of Augmented Dickey Fuller (ADF) test and Philip Perron unit root test. The result show that the non-stationary in all variables at level. Here equation is used to check stationary in the data first with intercept and then with trend and intercept. Here null hypothesis means non-stationary in the data and alternative hypothesis means stationary in the data. All the given variables are non-stationary at level. Analyzing the stationary in the data at level consequently checking stationary at first difference the result indicates that all the variables are stationary at first difference. All the variables are checked at the lag length of one. All the given variables are integrated at order one.

Table 3: Results of OLS

Variables	**Coefficient**	**t-Statistic**	**Probability**	**VIF**
C	0.775	9.815	0.000	
DEP	0.410	1.991	0.049	6.798
INV	0.536	3.007	0.003	4.615
ADV	1.067	4.955	0.000	7.451
PRF	-0.099	-0.923	0.036	1.844
INE	0.018	0.226	0.002	1.061
R-squared	0.887			
Durbin Watson	1.906			
F Statistic. (Probability)	72.742 (0.000)			

Source: Author Computation, 2018.

In the above table GDP is a dependent variable and DEP, INV, ADV, PRF and INE are independent variables. Table 4.2 gives us the value of R square, which represents the correlation between the observed values and predicted values of the dependent variable. R-Square is called the coefficient of determination and it gives the adequacy of the model. Here the value of R-Square is 0.887 that means the independent variable in the model can predict 89% of the variance in dependent variable. The p-value is given by 0.000 which is less that 0.05, which shows the significance of our model. The values of Durbin-Watson statistics for dependent variables in our case is very near to 2.00, this indicates that there is no autocorrelation exists in our study and the regression models assume that the error deviations are uncorrelated. The Beta value shows the relationship between the variables in the model, if the value of coefficient is positive it means that independent variables have positive relation with dependent variable i.e. increase in dependent variable is caused by

increase in independent variable and if the value of coefficient is negative than independent variables are having negative relation with the dependent variable i.e. decrease in dependent variable is caused by increase in dependent variable. The values of coefficients beta and constant are used to construct the regression model, the model is shown below:

GDP = 0.775+ 0.410 (DEP) + 0.536 (INV) + 1.067 (ADV) –0.099 (PRF) + 0.018 (INE)

Beta coefficient shows the tendency of an independent variable to respond against dependent Variables. Therefore, greater value of beta indicates the larger impact on dependent variable and vice versa. Deposits (0.410), Investments (0.536), advances (1.067) profitability (0.099) and interest earnings (0.018) all are having positive and significant impact on the economic growth because the p-value is less than 0. if DEP, INV, ADV, PRF and INE are increase then the GDP will also increase.

In table 3 column label P-value shows that all variables P-values are <0.05; i.e., deposits (DEP) has (0.049), investments (INV) has (0.003), advances (ADV) has (0.000), profitability (PRF) has (0.036) and interest earnings (INE) has (0.002) therefore all variables are significant. VIF is the test of multicollinearity among the variables (Excessively high correlation among the independent variables). The rule of thumb describe that VIF>10.0 indicates multicollinearity problem among the variables, since the table 4.3 shows that no variable have VIF value >10.0 so therefore multicollinearity does not exist in this model. Durbin-Watson test is use to test autocorrelation among the data (error term). In Durbin-Watson test, null hypothesis indicate that autocorrelation does not exist in error term and alternative hypothesis depicts that autocorrelation exist in error term. Since regression model has assumption of uncorrelated error term therefore it must be fulfilled to run regression analysis. In Table 4.3 indicate value of Durbin Watson as 1.906 which shows that autocorrelation does not exist in error term. Regression model Overall significance has identified by F-value. It is actually the explained variance divided by unexplained variance (mean error). In table 4.3 F-stat shows the value (72.742) and it's (0. Probability 000).

Table 4: Results for Causality

Null Hypothesis:	F-Statistic	Probability
DEP does not Granger Cause GDP	4.563	0.010
GDP does not Granger Cause DEP	2.389	0.089
INV does not Granger Cause GDP	5.245	0.030
GDP does not Granger Cause INV	0.234	0.633
ADV does not Granger Cause GDP	2.987	0.069
GDP does not Granger Cause ADV	7.524	0.003
PRF does not Granger Cause GDP	6.600	0.016

GDP does not Granger Cause PRF	7.360	0.003
INE does not Granger Cause GDP	6.177	0.007
GDP does not Granger Cause INE	0.158	0.855

Source: Author Computation, 2018.

The Granger Causality approach to the problem of whether 'x' causes 'y' is to see how much of the current 'y' can be explained by past values of 'y' and then to see whether adding lagged values of 'x' can improve the explanation. 'Y' is said to Granger-Caused by 'x' if 'x' helps in the prediction of 'y' or equivalently, if the coefficients on the lagged x's are statistically significant. After applying the causality test, the study found the bidirectional causal relationship of deposits, advances and profitability with economic growth. On the other side, the study found unidirectional causal relationship of investments and interest earnings with economic growth runs from investments and interest earnings to economic growth. The study found unidirectional causal relationship of investments and interest earnings with economic growth runs from investments and interest earnings to economic growth.

CONCLUSION AND RECOMMENDATIONS

This study investigates the contributions of merchant bank operation on economic development in Nigeria. The data used in this study were collected from the period of 2010 to 2015 of 2 banks. Augmented Dickey Fuller (ADF) and Philip Perron unit root test, ordinary least square and granger causality test have been used. Unit root test confirms the stationary of all variables at first difference. Regression results indicate that deposits, investments, advances, profitability and interest earnings have significant positive impact on economic growth of Nigeria. The Granger-Causality test confirms the bidirectional causal relationship of deposits, advances and profitability with economic growth. On the other side, the study found unidirectional causal relationship of investments and interest earnings with economic growth runs from investments and interest earnings to economic growth. It is recommended that the policy makers should make policies to enhance the banking sector in Nigeria because banking sector is significantly contributing in the economic growth of Nigeria.

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