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## AN EVALUATION OF THE IMPACT OF UNIVERSAL BANKING ON THE NIGERIAN ECONOMY

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### Abstract

*The search for a sound financial system led to trials of different designs by many countries. One of such designs in Nigeria is the adoption of universal banking in 2001. The adoption was borne out of the many benefits which have been ascribed to the system. However, the reversal of the model in year 2011 pointed to the Nigeria's inability to avail herself of those potentials or perhaps such benefits were marred by attendant costs of adopting the model. Thus, this paper evaluates the impact of universal banking on the Nigerian economy. Mann-Whitney U was employed as the statistical tool for testing the null hypothesis at 5% level of significance. The result of the test shows that there is no significant difference in the contribution of the universal banking model to GDP during the periods. The study concludes that the shift to the former commercial banking system was appropriate.*

**Keywords:** Universal, Banking, Synergy, GDP, financial sector, Nigeria,

### 1.0 INTRODUCTION

Designing a sound financial system remains a major issue in most countries' economic reforms, particularly the developing nations like Nigeria. Economic reforms are carried out to see that all sectors of the economy are functioning efficiently to achieve the macroeconomic goals of the country (Sanusi, 2012). The question of which financial system is the best for the long term performance of national economies also remains a point of discourse (Saunders and Walter, 1996).

Universal Banking is a global phenomenon, as a number of countries have adopted the system though on different versions owing to several debates which have been held on the extent to which banks should be allowed to undertake a universal set of financial services (Saunders and Walter, 1996).

Having recognized the potential benefits associated with universal banking model, the apex regulatory authority for the banking industry in Nigeria acknowledged the need for it and granted approval for universal banking adoption in 2001.

Although so many benefits have been ascribed to the universal banking model, the reform on its abolition by the CBN is a pointer to Nigeria's inability to avail herself of these potentials or perhaps such benefits were marred by attendant costs of adopting the model. This made the regulatory authority reverse to the old specialized banking system though with modifications.

In a specialized banking system, banks operate with separate licences depending on the type of banking business in which they engaged. To this end, this study seeks to evaluate the impact of universal banking model on the Nigeria economic development.

## **2.0 LITERATURE REVIEW**

### **2.1 Theoretical Framework**

The theoretical underpinning of this study is embedded in the theory of synergy. "Synergy is a concept that describes the systemic processes whereby business units of diverse, complex organizations will generate greater value through working as one system than working as separate entities" (Benecke, Schurink & Roodt, 2007). According to Gupta and Roos (2001), synergy is "the interaction of two or more intellectual capital resources from previously sovereign organizations, which enhances the combined effect of value creation and competitive performance, which effect is greater than the sum of the individual effects". Thus synergy involves the coming together of separate entities that are often diverse whose joint actions create an integrated solution that yields results that are greater than the sum of the individual parts' results working independently (Harris, 2004). In this context, the coming together of related and unrelated entities to form a universal bank is conceptualized as synergistic. Thus it is expected that their coming together should create a better performance of the financial sector of Nigeria.

### **2.2 Conceptual Issue: Universal Banking**

#### **2.2.1 Universal Banking: Meaning, Types, Benefits and Costs**

The economic rationale for merger and acquisitions of financial services may be said to have stemmed out of the desire to improve the financial performance of financial institutions and their consequential positive contribution to the larger economy.

According to Figueiria, Nellis and Schoenberg (2007), one of the strategies for achieving the synergistic objectives of merger and acquisition is the creation of universal banking system. This implies that with universal banking in place, financial institutions will be able to perform better than they would have done under the commercial banking system. Several authors have defined the concept of universal banking though with variations, they all seem to point to the same fact. Unugbro (2009) defines universal banking as a system of banking which involves carrying on a range of financial services such as deposit taking, credit lending, equity issues, and insurance services, among others. Saunders and Walter (1994) see universal banking as the conduct of a range of financial instruments and foreign exchanges, underwriting of new debt and equity issues, brokerage, investment management and insurance. Also, Krishna (2005) views universal banking as the system in which banks undertake a range of financial activities under one roof thereby creating a financial supermarket. Summarily, universal banks are financial institutions which may offer a wide range of financial services in addition to the banking business, such as insurance business, underwriting of securities, owning of equity interests in financial and non financial firms (Benston, 1994).

### **Types of Universal Banks**

While explaining the types of universal banks, Krishna (2005) classified universal banking as an In-house system, capitalized subsidiaries, and a holding company structure universal banking. In the In-house system, universal banks perform other financial services like insurance broking, equity issues, etc. all taking place in a department within the bank. The system characterized the Swiss and German banking systems (Saunders and Walter, 1996).

In the second division are banks that engage in financial services other than the core banking services through a separate subsidiary of the bank itself. Examples of these could be found in Canada and England (Krishna, 2005).

The third division of universal banking is that which allows banks to carry on other financial sector activities through a holding company structure. A holding company that controls separate subsidiaries is set up to provide banking, investment services and other financial service (Walter, 2003).

Saunders and Walter (1994) states that a Universal Bank may be a fully integrated bank providing all services within a single firm or a partially integrated bank that undertakes commercial and investment banking under the same roof but that provides other services through specialized subsidiaries. The table below summarizes the Walter's (1996) classification of universal banking system.

Table 1: Types of universal banking system

|         |                                                                                                                                                                                                                                                                                                                             |
|---------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Type A: | A fully integrated service institution that provides a broad range of financial services (banking, securities, insurance, etc.);                                                                                                                                                                                            |
| Type B  | A partially integrated universal bank that conducts both commercial and investment banking within the same entity, but undertake insurance underwriting and distribution, mortgage banking, asset management, lease-financing, debt factoring, management consulting and so on through separately capitalized subsidiaries. |
| Type C  | A commercial bank whose core banking function is taking deposit and making commercial loans, is the parent of subsidiaries carrying on a variety of other financial services ranging from investment banking to insurance.                                                                                                  |
| Type D  | A holding company structure which controls affiliates engaged in commercial banking, investment banking, insurance, and possibly other types of financial and non-financial businesses.                                                                                                                                     |

Source: Adapted from Walter (1996)

A number of literatures have appeared with convincing evidence that universal banking system accelerates growth and brings about great benefits to the banks, business firms and the economy and on the other hand a number of literature also attest to the attendant cost that accompany these benefits. These are discussed below.

### Benefits and Costs of Universal Banking

While reviewing the economies of scale and scope as advantage of universal banking, Rajan (1996) holds that allowing commercial banks to conduct security businesses can have two opposing effects on firm performance. On one hand, Rajan (1996) stated that economies of scope and scale in universal banking can facilitate firms' access to credit and promote economic growth. Economies of scale deals measure the cost advantage from the increased output of a product which can arise in several areas within a large enterprise. While the scope economy implies an economic theory that the average total cost decreases as a result of increase in the number of product.

On the other hand, he argued that combining commercial banking and security business may also introduce possibility of conflicts of interest (Allen, Jagtiani, and Saunders, 2004).

Oni (2001) notes that universal banking enhances competition from sources hitherto considered unusual, including insurance, financial intermediation services and, eventually, foreign participation in the industry. Also, Kannan (2002) posits that Indian banks opt out for diversification so as to maximize scale and scope economies. This is because, synergies in joint production of financial and non-financial services increase economic efficiency, reduce cost and increase earnings (Bhole, 2004). Despite all these benefits, universal banking model has its attendant problems. Conflict of interest arises from universal banking model (Kang and Liu, 2007; Wilmarth, 2009).

The universal banking model causes reduction in universal banks' diversification ability arising from increased systematic risk (Allen and Jagtiani, 2000). Also, the model leads to increase in moral hazards arising from the increased incentives for banks (under the universal banking model) to take equity position in firms (Boyd, Chang and Smith, 1998). Finally, regulatory issues or problems also accompany the universal banking model (Benston, 1994).

### **2.3 Universal Banking and Nigerian Economy**

Reforms according to Kolawole (2006) are those improvements made on the prevailing state of affairs, usually embarked upon to eliminate waste and attain efficiency. The adoption of universal banking model was one of the major policy reforms in the Nigerian banking sector in recent years. The adoption removed the dichotomy between commercial and merchant banking in Nigeria (CBN, 2000). The ultimate objective of any economic reform is to achieve economic growth and development. This was evidenced in the dramatic growth of the Nigerian banking sector during the universal banking era; unfortunately, neither the industry nor the regulators were sufficiently prepared to sustain the sector's explosive growth (Sanusi, 2010).

Given the growth of the banking sector, one would have expected a consequential growth in the larger economy. This is because of such benefits as economy of scale and scope of banks operations as well as economic growth, accrued with universal banking model (Rajan, 1996.) These were the experiences in some other countries like Germany and Japan which had the most successful universal banking practices. Banks in these countries had made significant contributions towards industrialization and economic growth (Al-Jarhi, 2005).

In Nigeria however, the growth of the banking sector fueled by the adoption of universal banking, had no corresponding growth in the economy. Okpara (2009) identified poor infrastructural facilities such as intermittent power supply, poor internet services; inadequate disclosure and lack of transparency about the financial positions of banks; ineffectiveness of regulators and poor risk management as the major impediments to the success of universal banking in Nigeria.

Following the lapses noticed in the universal banking model, the CBN scrapped it in 2010 and ordered the return to the specialized banking model with some modifications. The reversal according to the apex bank had the objectives of protecting the depositors, ensuring effective regulation of the entire business of banks and facilitating the enhancement of risk management among others (CBN, 2010).

## 2.4 Empirical Framework

Several studies confirm empirically the potential benefits and costs of universal banking system as well as its impact on economic growth and development. Rime and Stroh (2003) examine the scale and scope economies of 289 Swiss universal banks for periods between 1996 and 1999. The study finds evidence of economy of scale advantage in small and medium sized banks. Clark (1996) in his earlier study finds the scale economies in terms of both production and economic efficiency. Also studies of European universal banks indicate some economies of scale and scope as benefits of universal banking system. For example, Vennet (1998) analyses 2,375 banks covering the period between 1995 and 1996 from 17 countries in the European Union where financial conglomerate is legally practiced. He finds evidence that the universal banking system is more cost efficient than its commercial counterpart. Risk reduction also constitutes an advantage of universal system and research studies have confirmed this.

Chen, Li, Moshrian and Tan (2006) analyses 213 bancassurance mergers in Europe from 1986 to 2004 and conclude that the systematic risk of acquirers falls while the short term abnormal return is negative for bidders. Fields, Frager and Kilari (2007) assess 129 bancassurance mergers among U.S and non-U.S companies from 1997 to 2002 and find similar result with that of Chen *et al* (2006). Also, Chen, Li, Liao, Moshrian and Szablocs (2008) provide a comprehensive study of 71 institutions in 28 developed and developing countries for the period between 1999 and 2003. Their finding confirms the risk reduction through diversification and cost savings in large operations. In his own study, Okeahlan (2008) finds that retail merged institutions products are six percent cheaper than the sum of stand-alone products in South Africa indicating the cost saving through economies of scale and scope that is possible with universal banking. This finding support that of Allen and Jagtiani (2000) which submits that combining banking with security and insurance activities reduces the overall risk.

Nurullah and Staikoura (2008) study empirically the impact of European banks' diversification into life, non-life insurance underwriting and insurance broking on risk and profitability. They conclude that the return of entering into life underwriting and insurance broking increases significantly.

One of the major costs of universal banking system is the conflicts of interest that may result in banking going into other businesses. It has been found that conflict of interest can arise when banks have the access to and use information to remove loans with lower quality from their balance sheet by converting the loans into public securities. However, Krishnan (2007) examines the behaviour of U.S banks between 1990 and 2003 after firms' debt issuance, and finds that banks do not punish debtors that have less credit and higher spread if they fail to give underwriting mandate to the bank as supposed.

Instead, banks use information gathered in underwriting process to avoid loan approval to clients with lower quality. Thus, access to both lending and underwriting leads to lower financing costs and better loan allocation. Therefore, argument of conflict of interest is contradictory in this instance.

In Nigeria, Onu (2013) assesses the impact of universal banking on banks' performance in Nigeria and concludes that universal banking enhances real sector funding, reduces bank failure and enhances the performance of Nigerian banks.

Unfortunately, as many literatures exist with regards to universal banking system, empirical investigations that compare the performance of universal banking system and former commercial banking model in Nigeria is still scanty. Hence this paper seeks to cover this gap.

### 3.0 METHODOLOGY

The study adopts two non-parametric methods in analyzing the data sort. These methods were adopted upon testing for the normality of the data (see table 2 and 3 below). The data were sourced from the statistical bulletin of the Central bank of Nigeria. The categories of the data collected were the GDP and the financial sector contribution to the GDP. The ratio of the former to the latter was found and the results were compared over twenty years (1991-2010).

Years 1991 to 2000 represented the financial sector contribution to GDP prior to the adoption of the universal banking system in Nigeria while years 2001 to 2010 represented the period of universal banking system adoption. The two periods were compared using Mann-Whitney U and Wilcoxon test. The results of the two tests are presented in tables 3 and 4 below.

### 4.0 DISCUSSION OF FINDINGS

Table 2 depicts the result of Levene's test. "Levene's test examines the null hypothesis that the variances in different groups are equal" (Field, 2009). A significant value of the test ( $p \leq .05$ ) indicates that there is a significant difference in the variance of the groups, thus the normality assumption is violated. In this context, there is a significant difference between the variance of the financial sector contribution to the GDP in the pre and post adoption of the universal banking system as the p-value based on the mean (.017) is less than .05. Hence the data are not normally distributed.

Table 2: Test of Homogeneity of Variance

|                 | Levene Statistic                      | df1 | df2   | Sig. |
|-----------------|---------------------------------------|-----|-------|------|
| pre and post ub | Based on Mean                         | 1   | 18    | .017 |
|                 | Based on Median                       | 1   | 18    | .224 |
|                 | Based on Median and with adjusted df. | 1   | 9.276 | .238 |
|                 | Based on trimmed mean                 | 1   | 18    | .037 |

Source: Authors' computation, 2014

Table 3 also tests of normality like the levene's test. The Kolmogorov-Smirnov and Shapiro-Wilk tests test whether the sample distribution is significantly different from a normal distribution. Thus, a significant p-value indicates a non-normal distribution of data. From table 3, it becomes apparent that the data are not normally distributed as the p-value of the Kolmogorov-Smirnov (.006) and Shapiro-Wilk (.007 and .04) are less than .05 for the two groups of data.

**Table 3: Kolmogorov-Smirnov and Shapiro-Wilk Tests of Normality**

| Period           |         | Kolmogorov-Smirnov <sup>a</sup> |    |      | Shapiro-Wilk |    |      |
|------------------|---------|---------------------------------|----|------|--------------|----|------|
|                  |         | Statistic                       | Df | Sig. | Statistic    | Df | Sig. |
| pre and post UBS | pre UBS | .313                            | 10 | .006 | .773         | 10 | .007 |
|                  | post BS | .232                            | 10 | .136 | .836         | 10 | .040 |

a. Lilliefors Significance

Source: Authors' computation, 2014.

Based on the tests' results in Table 3, indicating that the data are not normally distributed, Mann-Whitney U test, a nonparametric test was used in testing the hypothesis of this study. Table 4 describes the data for the two periods in the form of mean ranks. Higher mean ranks indicate higher values while lower mean ranks indicate lower values. Table 5 presents the result of the Mann-Whitney U test.

**Table 4: Mean Ranks of the two Periods**

| Period   | N  | Mean Rank | Sum of Ranks |
|----------|----|-----------|--------------|
| pre UBS  | 10 | 11.20     | 112.00       |
| post UBS | 10 | 9.80      | 98.00        |
| Total    | 20 |           |              |

Source: Authors' computation, 2014.

Table 4 depicts the mean rank of the financial sector contribution to GDP before (pre UBS) and after (post UBS) the adoption of universal banking system in Nigeria. The mean rank of the financial sector contribution to the GDP before the adoption of the universal banking system (11.20) is greater than the mean rank after the adoption of the universal banking system (9.80). This indicates that the financial sector contributed to the GDP more before the adoption of the universal banking system than after the adoption of the universal banking system.

Table 5: Test Statistics<sup>a</sup>

|                                | pre and post UBS  |
|--------------------------------|-------------------|
| Mann-Whitney U                 | 43.000            |
| Wilcoxon W                     | 98.000            |
| Z                              | -.533             |
| Asymp. Sig. (2-tailed)         | .594              |
| Exact Sig. [2*(1-tailed Sig.)] | .631 <sup>b</sup> |
| Exact Sig. (2-tailed)          | .613              |
| Exact Sig. (1-tailed)          | .306              |
| Point Probability              | .012              |

a. Grouping Variable: period

a. Not corrected for ties.

Source: Author's computation, 2014

Table 5 depicts the result of the Mann-Whitney test of the hypothesis of this study. The exact significance (2-tailed) is the actual result for this study. The null hypothesis is accepted at 5% level of significance as the p value (0.613) is greater than 0.05. Thus we conclude that there is no significant difference between the financial sector contribution to GDP before and after the adoption of the universal banking system.

## 5.0 CONCLUSION AND RECOMMENDATIONS

The search for a best financial architecture has led to trials of different financial system designs by many countries. Nigeria in the year 2000 decided to adopt the universal banking system. However, by the year 2011 this move was changed once more. The universal banking model was dropped by the directives of the Central Bank of Nigeria (CBN). The question that comes to the mind is "why the drop?" In an attempt to explain this, the study embarked on a comparative analysis of the financial sector contribution to macroeconomic development of Nigeria prior to and after the adoption of the universal banking. Our findings point to the fact that the financial sector contribution to the GDP was higher prior to the adoption of the universal banking system than when the universal banking model was adopted. Our findings further confirm that the synergy theory does not hold in all situations as the expectation is that the adoption of the universal banking system should lead to a better performance but our result confirms otherwise.

Conclusively, the success of a financial system design may be contingent on a number of factors which have led to different experiences across geographical boundaries. In Nigeria, the experience has not been that of a celebrated success hence leading to the demise of the universal banking system.

In order to prevent the case of repeated policy 'summersault', the study recommends that the regulators in the financial sector should at all times consider the economic environment of the country when formulating reform policies. This is because, one of the reasons for the adoption of universal banking in Nigeria was to move with the tide of globalization, with little or no regard for the country's economic environment.

Finally, this study has only made a comparison between the performances of the two systems; the factors leading to this outcome are however not examined as there are no relevant data to undertake such more robust study. Hence this study is limited by this. Nonetheless the study gives a reasonable insight into explaining the reason for the change of the financial system design by the CBN.

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