International Journal of Managerial Studies and Research (IJMSR)
Volume 9, Issue 11, November 2021, PP 24-31
ISSN 2349-0330 (Print) & ISSN 2349-0349 (Online)
https://doi.org/10.20431/2349-0349.0911004
www.arcjournals.org

An Evaluation of the Barriers to Capital Adequacy in the Deposit Money Banks in Nigeria

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Abstract: *The study examined the barriers to capital adequacy of Deposit Money Banks (DMBs)and the role of Regulatory authority in Nigeria. The population for the study is the entire DMBs in Nigeria. Purposive sampling was used to select the 15listed banks on the Nigerian stock exchange while the Staff of the banks randomly selected. The number of banks covered was occasioned by the availability of data for the period under study and Three hundred copies of a questionnaire were administered randomly on the selected staff of the 15 deposit money banks sampled out of which two hundred and fifty were returned and used for the study. Frequency count and percentage were used to analyse the data collected for the study. Findings revealed that risk of finance management is the most pressing barrier to adequacy of capital of DMBs followed by growth barriers, adverse operating results, and large portfolio of non-performing loans, regulatory constraints, additional capital, and poor management team. Thus, it was recommended that Monetary Authorities should be given continued autonomy so that the full effect of the reform strategic policy will manifest for the benefit of better banking performance in the banking sub-sector.*

Keywords: *Capital Adequacy, Deposit Money Banks, Barriers, Regulatory authorities; Nigeria*

1. Introduction

Capital base of banks which is normally dictated by the government in Nigeria ensures that banks maintain adequate capital to boost efficiency in the system by adhering strictly to the prescription. Reserve Bank of New Zealand (2004) sees capital adequacy ratio (CAR) as a measure of the bank's capital expressed as a percentage of its total risk weighted assets. This ratio was set by the appropriate authority, usually the apex bank of any country, to guarantee that banks can withstand losses before becoming troubled. This protects banks' depositors from the possibilities of bankruptcy, which is the latter effect of insolvency. Bank insolvency usually sends a bad signal to the financial market and this may lead to loss of confidence in the financial system. Therefore banks must have adequate capital to be stable and contribute positively to the nation's economic growth. According to Chinonye, Kelikume and Umoren (2007), capital is crucial issue in the context of financial strength of banks as such that the definitive strength of a bank lies in its capital funds, given its importance as a tool for meeting liabilities in a financial crisis.

Abba,Okwa, Soje and Aikpitanyi (2018) conclude that capital adequacy ratio (CAR) is largely determined by banks risk-portfolio, deposit level, profitability and asset quality and that CAR of Nigerian banks is well above the regulatory minimum. Whereas Williams, (2011) submitted that economic indicators such as rate of inflation, real exchange rate, demand deposits, money supply, political instability, return on investment are most robust predictors of the determinants of capital adequacy in Nigeria. This calls for further empirical study to evaluate the determinant factors for adequacy of capital in deposits money banks. For a bank to operate profitably and gain the confidence and assurance of stakeholders, it must have a strong capital base as evidence of its stability in the business and a tool for functioning profitably so that shareholders' funds can increase over the years (Diamond and Raghuram, 2000). In essence, banks by the nature of their operations may make substantial profit from loans and advances but without commensurate level of capital to cushion unanticipated losses may failas observed by Onaolapo and Olufemi (2012). According to Soludo (2004), the issue of adequate capital has been how to improve management efficiency, resolve the problem of weak liquidity base, reduce non-yielding loans and advances, increase cost-effectiveness, reduce risk and to ensure proper asset management so as to put banks in a better position to meet customers obligations as and when due. Further, Asikhia and Sokefun (2013) opine that for sound and safe banking, it is vital for banks to meet up the required capital.

Over the years, Nigerian banks have found it difficult to fulfill their duties in financing major economic activities that will cause economic development because of ever-increasing competition arising from inadequate capital base. Evidence from the literature indicate that weak capital base has led to a crisis of confidence in the banks to the extent that the main bank roles that are to foster the bank's business, to meet a reasonable credit need and to absorb losses that may arise have been eroded. Losses suffered in the past years led to bank failure especially in the areas of loan and advances. Basel Accord cited in Lenee and Sulaiman (2016) as international standard of capital adequacy recognizes the ratio of capital funds to deposit and posit that a bank should have capital funds equal to at least 10% of its deposits liabilities.

The popular view in the accounting and finance literature is that a bank statutory capital is considered satisfactory if it covers customers' withdrawal needs and safeguard depositors against total or partial loss of deposits in the event of liquidation or losses sustained by the bank. For instance, Onuh (2002) posits that often times a bank statutory capital is adequate if it covers the bank expenses protect depositors against total or partial loss of deposits and satisfy customer's withdrawal needs. Earlier studies on capital adequacy as a determinant of profitability of banks reveal that a high capital adequacy ratio should signify a bank that is operating over-cautiously and ignoring potentially profitable trading opportunities (Goddard, Molyneux, and Wilson 2004), which implies a negative relationship between equity to asset ratio and bank performance. At the same time, banks with higher equity to asset ratio will normally have lower needs of external funding and therefore higher profitability (Pasiouras and Kosmidou, 2007).

A lot of interest is attached to capital adequacy of banks being the nucleus of country economic activities. Adequate capital in banking is regarded a confidence booster as it provides the customer, the public and the regulatory authority with confidence in the continued financial viability of the bank. It provides confidence to the depositor that his money is safe; to the public that the bank will stable, or is in a position to give genuine consideration to their credit and other banking needs in good as in bad times and to the regulatory authority that the bank is, or will remain, in continuous existence. Due to capital inadequacy of many banks in the country, they were faced with high cost of financial distress and this certainly affected profitability. Asedionlen (2004) opines that recapitalization may raise liquidity in short term but will not guarantee conducive macroeconomic environments required to ensure high asset quality and good profitability.

Literature describe financial performance as an assessment of the financial condition or profitability of a bank in order to gain valuable insight into the health of the bank using an index that relates two pieces of financial data by dividing one quantity by the other (Asikhia and Sokefun, 2013; Bobakova, 2003). Previous studies produced mixed results on capital adequacy measures. This is because some authors submitted that capital adequacy indeed influence the financial performance indices of businesses in general and banks in particular (Onaolapo and Olufemi, 2012; Ezike and Oke, 2013; Ikpefan, 2013; Ejoh and Iwara (2014). While authors seem to agree on the significant global effect of adequate capital on business performance, there appear to be disagreements in respect of the relative effects of capital adequacy barrierson the performance of banks in Nigeria. For instance, Oladejo and Oladipupo 2011 argued that regulations of capital of banks should be approached with caution. Further, Ini and Eze, (2018) believed capital regulation is good if the regulatory framework could be enhanced in such a way that will impact positively on bank management and enhance financial performance of commercial banks in Nigeria. This suggests that much need be investigated on the barriers to capital adequacy of banks in the Nigerian context. In the light of the above, this study attempts to assess effect of barriers to capital adequacy on performance of deposit money banks in Nigeria and is expected to provide answers to the following questions

i. What are the determinants of capital base of deposit money banks in Nigeria;

ii. To what extent did the barriers to capital adequacy affect performance ofsampled deposit money banks in Nigeria?

Research Hypothesis:

Ho: There is no significant impact of capital adequacy barriers to performance of sampled Deposit Money Banks in Nigeria.

2. Literature Review

2.1. Capital adequacy issues in Deposit Money Banks in Nigeria

The central bank of Nigeria (CBN 1995) report claims that banks are expected to maintain adequate capital to meet their financial obligations, operate profitably and contribute to promoting a sound financial system. It is for these reasons that the CBN prescribes minimum capital requirements. This minimum ratio of capital adequacy has been increased from 6 percent in 1992 to 8 per cent in 1996. It is further stipulated that at least 50 per cent of the component of a banks' capital shall comprise paid-up capital and reserves, while every bank shall maintain a ratio of not less than one to ten (1:10) between its adjusted capital funds and its total credit. When a bank's capital falls below the prescribed ratio, it is an indication that the bank may be heading for distress. Bank examination reports showed that a good number of banks operating in Nigeria were grossly undercapitalized. Ogubunka (2003) and Imala (2004) confirmed that this situation has been attributed to the low level of initial capital, the effect of inflation, the adverse operating results mainly due to their inability to make appreciable recoveries from their non-performing assets and the large portfolio of non-performing loans maintained by some banks. These factors among others have combined to erode the capital base of many banks as evidenced from extant literature.

In an attempt by regulatory authority to ensure stable banking operations the inability to meet stipulated higher minimum capital requirements was one of the criteria used for either classifying banks into "healthy" or "unhealthy" thus barring the latter category from the foreign exchange market. Available statistics on banks capitalization reveal that as at the end of 1992, 120 operating banks in the country required the aggregate additional capital to the tune of N5.6 billion to meet the statutory minimum capital funds set by bank regulators for 1992. Ogubunka (2003) contends that when a bank is undercapitalized, it ought not to continue with its magnitude of operations prior to the depletion of capital. If it does without the introduction of increased capital, distress could ensue. Further, Akinleye and Fajuyagbe (2015) concluded that adequate and good management of capital would stimulate and improve the financial performance of deposit money banks in Nigeria. Also, Ejoh and Iwara (2014) argued that the positive and significant relationship between capital adequacy and banks' profitability suggest that banks with more equity capital are perceived to have more safety and such advantage can be translated into higher profitability.

2.2. Liquidity Risk Theory

Halling & Hayden (2006) explains that a bank should define and identify the liquidity risk to which it is exposed for all legal entities, branches and subsidiaries in the jurisdictions in which it is active. A bank's liquidity needs and the sources of liquidity available to meet those needs depend significantly on the bank's business and product mix, balance sheet structure and cash flow profiles of its on- and off-balance sheet obligations. As a result, a bank should evaluate each major on and off balance sheet position, including the effect of embedded options and other contingent exposures that may affect the bank's sources and uses of funds, and determine how it can affect liquidity risk. A bank should consider the interactions between exposures to funding liquidity risk and market liquidity risk (Jeanne & Svensson, 2007). A bank that obtains liquidity from capital markets should recognize that these sources might be more volatile than traditional retail deposits. For example, under conditions of stress, investors in money market instruments may demand higher compensation for risk, require roll over at considerably shorter maturities, or refuse to extend financing at all. Moreover, reliance on the full functioning and liquidity of financial markets may not be realistic as asset and funding markets may dry up in times of stress (Perera et al., 2006). Market illiquidity may make it difficult for a bank to raise funds by selling assets and thus increase the need for funding liquidity.

2.3. Empirical Review

Ikwuagwu, Ihemeje and Ifionu (2015) investigate the impact of the capital restructuring on the performance of Deposit Money banks in Nigeria. The researchers used secondary data sourced from the published financial statements of Deposit Money banks in Nigeria from 1994-2013, and central bank of Nigeria (CBN) statistical bulletin publication and NDIC annual report and the simple regression analysis was employed to test the hypotheses formulated for the study. The findings from the result revealed that capital restructuring has no statistical significance on deposit money banks performance.

Babalola (2011) undertook a study on Bank failure in Nigeria: a consequence of capital inadequacy, lack of transparency and non-performing loans? The researcher identified capital inadequacy, lack of transparency and huge non-performing loans as major causes of bank failure in Nigeria. These factors were examined and the extents to which they have been accountable for bank failure in Nigeria were determined. Aside these factors, the author did not pay attention to other factors that may be responsible for bank failure which include ownership structure, weak/ineffective internal control system, and poor management among others. Simple percentages were used to describe the data presented and the conclusion drawn was that these three factors have been the main reasons of the incessant bank failure. The paper recommends full disclosure of all financial transactions and the separation of the post of the chairman from that of the managing director for all the banks.

Jegede and Mokuolu (2004) examined the effect of financial sector reforms as a panacea to capital market growth in Nigeria. Two approaches were employed in their study, the first approach involves the comparison of the capital market variables before and after the adoption of financial sector reform and the second approach is a regression analysis. Overall, the main findings indicated that the financial sector reform in Nigeria has led to a significant improvement and growth of the capital market. Chinonye, Kelikume and Umoren (2007) examined the effect of capital adequacy on banks' performance. The researchers were more concerned on the determination of how banks' recapitalization for capital adequacy can advance bank performance. It was a time series study and secondary data was used for the research. Data collected were analyzed with regression analysis and it was gathered that the problem with banks is not actually having or not having capital inadequacy, but the realization of the gaps in their internal measurement and management process. Also, the result revealed that it is not enough for banks to hold adequate capital, banks must be ready to identify and assume risky activities commensurate with such capital, and this will help to enhance their performance.

Iyade, (2006) examined the impact of regulation and supervision on the activities of Nigerian banks with emphasis on the role of the Central Bank of Nigeria and The Nigerian Deposit Insurance Corporation. It evaluates the roles and contributions of CBN and NDIC to the Nigerian banking sector. A questionnaire and telephone based research was adopted for the study and the data collated was tested using the chi-square analysis and supported by fundamental evidence from the database of the regulatory authorities. Extensive field survey and library research was carried out and data collected were subjected to thorough analysis. The analysis shows that the supervisory and regulatory framework of the Central Bank of Nigeria and the Nigerian Deposit Insurance Corporation are not sufficient to guarantee effective banking practices in Nigeria.

Wanjohi (2013), assessed the current risk management practices of the deposit money banks and linked them with the banks' financial performance. Return on Assets (ROA) was averaged for five years (2008-2012) to proxy the banks' financial performance. To assess the financial risk management practices, a self-administered survey questionnaire was used across the banks. Multiple regression was used for the analysis. It was discovered that banks in Kenya were practicing good financial risk management and it has a positive correlation to the financial performance of deposit money Kenyan banks.

3. METHODOLOGY

The study adopts descriptive survey design and expo-facto research design. The population for the study is the entire deposit money banks in Nigeria. The study utilizes the financial statements of 15 out of the 22 deposit money banks for the period of this research covering from 2014-2018. The purposively selected banks are Union bank, Diamond Bank, UBA, GTB, Zenith Bank, Sterling Bank, Wema bank, First Bank, Access Bank, FCMB, Stanbic Bank, Eco Bank, Unity Bank, Fidelity Bank and Polaris Bank. The number of banks covered was occasioned by the availability of data for the period under study. In the same vein, 250 well-structured questionnaires were distributed across the selected banks in Lagos. Random sampling technique is considered appropriate and it was used to select the banks staffs. The questionnaire designed to elicit information from the respondent bankers on their perception of identified barriers effect on capital adequacy as well as regulatory challenges. The overall effect of both barriers and regulatory challenges were subjected to analysis to generate the results of the study using frequency count and percentages. Regression analysis was used to test the significance of the study variables.

4. Results and Discussion

4.1. Analysis of the Research Questions

The decision rules for the likert scale measurement is displayed in Table 1. It indicates the cut off point for acceptance or rejection of the stated null hypothesis. Any value above 2.50 is considered significant to accepting or rejecting the hypothesis of the study.

Table1. *Decision rule for strongly agree, agree, strongly disagree and disagree*

<table>
<tr><th>Response mode</th><th>Rating</th><th>Scale value</th><th>Cut off point</th><th>Decision</th></tr>
<tr><td>Strongly agree</td><td>4</td><td>3.50-4.49</td><td rowspan="4">2.50</td><td rowspan="2">Agree
2.50-4.49</td></tr>
<tr><td>Agree</td><td>3</td><td>2.50-3.49</td></tr>
<tr><td>Strongly disagree</td><td>2</td><td>1.50-2.49</td><td rowspan="2">Disagree
0.50-2.49</td></tr>
<tr><td>Disagree</td><td>1</td><td>0.50-1.49</td></tr>
</table>

Source: *Authors' compilation 2019*

4.2. Determinant Factors for Capital Adequacy of Deposit Money Banks in Nigeria

The analysis in table 2 indicated that tangibility of asset is the most determinant factor for capital base of DMBs, followed by liquidity level, business cycle, growth, profitability, bank size and government regulations with mean and standard deviation scores of 3.87 (0.346), 3.8 (0.484), 3.7 (0535), 3.46 (0.507), 3.4 (0.675), 3.36 (0.905) and 2.8 (1.064) respectively.

Table2. *Determinants of Capital Base of Deposit Money Banks (DMBs)*

S/N	Items	Mean	Std Deviation	Remarks
1	Government regulations	2.8	1.064	Agree
2	Business cycle	3.7	0.535	Agree
3	Profitability	3.4	0.675	Agree
4	Bank size	3.36	0.905	Agree
5	Growth	3.46	0.507	Agree
6	Tangibility of Assets	3.87	0.346	Agree
7	Liquidity level	3.8	0.484	Agree

Source: *Authors' compilation 2019*

4.3. Barriers to Adequacy of Capital of Deposit Money Banks in Nigeria

The analysis in table 3 showed that risk of finance management is the most pressing barrier to adequacy of capital of DMBs followed by growth barriers, adverse operating results, large portfolio of non-performing loans, regulatory constraints, large portfolio of non-performing loans, additional capital, regulatory constraint and poor management team with mean and standard deviation of 3.8 (0.407), 3.77 (0.430), 3.67 (0.479), 3.63 (0.718), 3.5 (0.572), 3.4 (0.563) and3.0 (1.114) respectively.

Table3. *Barriers to Adequacy of Capital of Deposit Money Banks in Nigeria*

S/N	Items	Mean	Std Deviation	Remarks
1	Regulatory constraints	3.4	0.563	Agree
2	Large portfolio of non-performing loans	3.63	0.718	Agree
3	Additional capital	3.5	0.572	Agree
4	Risk and Finance management	3.8	0.407	Agree
5	Growth barriers	3.77	0.430	Agree
6	Poor management team	3.0	1.114	Agree
7	Adverse operating results	3.67	0.479	Agree

Source: *Authors' compilation 2019*

5. Discussion of Findings

The Nigerian banking sectors over the years have been characterized by incessant systemic distress, instability and outright collapse and failures. This however has necessitated various reforms in the Nigerian banking industry, especially the persistent upward review of bank capital base. The adequacy of this capital for its absorption and to stimulate better financial performance of banks has been an issue of controversy. Therefore the researcher set out to examine the barriers to capital adequacy on banks financial performance in Nigeria. The study was designed to examine the determinants of capital base of deposit money banks in Nigeria and determine the barriers to capital inadequacy of deposit money banks in Nigeria. The study was predicted on liquidity risk theory. Empirically, several literatures were reviewed to help in justifying the discoveries of the study. It was discovered that government regulations, business cycle, profitability, bank size, growth, tangibility of asset and liquidity level were the determinants of capital base of deposit money banks in Nigeria. It was gathered that regulatory constraints, large portfolio of non-performing loans, additional capital, risk of finance management, growth barriers, poor management team, and adverse operating results were the barriers to capital inadequacy of deposit money banks in Nigeria.

Empirical results found that the influence of government regulations in respect of capital base, interest rate and inflation rate on profitability of banks were divergent. This is because there was a positive significant influence of capital base of deposit money banks on return on assets over the years under consideration, while there was a negative significant influence of interest rate on deposit money banks in Nigeria over the years under consideration. Further, inflation rate had no significant influence on the profitability of deposit money banks in Nigeria for the years under consideration. It was further discovered that, interest rate had less effect on profitability, while the impact of inflation on profitability of banks was positive but not significant. These findings are at variance with the conclusion of Ikwuagwu, Ihemeje and Ifionu (2015) that capital restructuring had no statistical significance on deposit money banks performance. However, these findings were in harmony with the findings of Ejokor, Konboye and Nteegah (2016) that capitalization had a significant impact on profitability of banks in Nigeria

6. Conclusion

This study concluded that tangibility of asset is the most determinant factor for capital base of DMBs, followed by liquidity level, business cycle, growth, profitability, bank size and government regulations. Further, risk of finance management is the most pressing barrier to adequacy of capital of DMBs followed by growth barriers, adverse operating results, large portfolio of non-performing loans, regulatory constraints, need for additional capital and poor management team.

Recommendations

Bankers should give adequate attention to risk of finance management so as to maintain adequate capital for enhanced profitability and business growth.

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Citation: *Oladejo, M.O et al. "An Evaluation of the Barriers to Capital Adequacy in the Deposit Money Banks in Nigeria" International Journal of Managerial Studies and Research (IJMSR), vol 9, no. 11, 2021, pp. 24-31. doi: https://doi.org/10.20431/2349-0349.0911004.*