EFFECECTS OF CAPITAL ADEQUACY ON PERFORMANCE OF THE BANKING SECTOR IN NIGERIA (2001-2014)

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Abstract

The research work examined the effect of capital adequacy on performance of Nigerian banking sector from 2001-2014. This study was inspired by two leading controversial issues regarding how capital adequacy impact on the bank performance. Nigeria is a developing economy with a dicey banking system provides an opportunity to empirically examine the effect of capital adequacy on performance of banks. The study specifically examined the following objectives amongst others; to evaluate the effect of capital adequacy on return on asset. In an attempt to give the work sound theoretical background, relevant literatures were viewed. The study utilized secondary data from CBN and NDIC publications for various years. The data collected were analyzed using Ordinary Least Square (OLS) regression techniques. The study found out among other things that capital adequacy has negatively, but insignificant relationship with ROA and ROE, while it has positive but significant relationship with yield on earning asset. Recommendations were made thereof based on these findings.

Introduction

The aims of bank capitalization are to resolve the problem of unsound banking, enhance efficient management in the banking system. Aderinokun (2004) maintain that increasing the capital base of banks in Nigeria would strengthen them and, in the process, deepen activities within the industry, provides better funding for bank’s lending activities and increase profitability. Improved capital will help to reduce risk, to ensure quality asset management and to put banks in a strong liquid position. Central Bank of Nigeria from time to introduces reforms which include requirement for increasing banks capital base. Banking in Nigeria embraced the “Lazier faire” principle in which there are virtually no rules guiding the establishment of banks. This philosophy persisted from the early part of 20th century up to the great depression of the 1930s. It was after that great depression that people started insisting that certain guidelines be put in place. As for Nigeria, we were still a colonial territory of the Britain, and it was not until 1951 through the instrumentality of the Britain Government that the banking ordinance of 1952 came into effect (Isu, 2009).

The trust of the banking Ordinance was to introduce regulations that governed capitalization in Commercial Banks in Nigeria. Isu, (2009), maintain that most of the banking sector reforms, from inception, were always aimed at addressing peculiar problems in the sector. From Banking Ordinance 1951 to the recapitalization reform of 2005, the reform were designed to ensure a diversified, strong and reliable banking sector which will ensure the safety of deposits money, play
vital development role in Nigeria economy and be competitive players in the global banking space. These problems were identified by Nyong (2001), as follows: first (Independence) reform (1969-69); second, the era of indigenization 1970-1976; third, (Okigbo Committee) reforms (1977-85), fourth, Structural Adjustment Programme (1986), fifth, Banking recapitalization and consolidation (2000-2011). The aim of these reforms was to improve the effective performance for the banking sector. One of the marks of good performance of every business organization is to improve profitability-in fact sustained profitability.

Soludo (2004) as cited in Bakere (2011) identified the problems of the banks, especially those seen as feeble, as persistent illiquidity, unprofitable operations and poor asset base. Also, Ikpefan (2012) opines that the evolving competition in the banking industry as a result of globalization has made it difficult for Nigerian banks to play their major role of financing economic activities arising from inadequate capital which has led to a crisis of confidence in the banks and losses suffered by banks led to bank failure especially in the areas of lending. Therefore, the soundness, safety and profitability of a bank affect the quality of its loan portfolio. To ensure that the banking system is efficient and operationally effective, the government of every country does exert some regulatory controls. One of such control is the regulation of bank capital base through capital requirements policy.

This is because, according to (Oyedokun, 2013), the solid financial base will assist the bank to withstand fluctuations in the liability portfolio and be able to absorb some unexpected losses due to asymmetric information on their customers. Ajayi (2005) maintains that capital in an important tool in the Nigeria banking industry, because a bank with strong capital base has the ability to absorb losses arising from increasing nonperforming loans. In 2004, the Governor of Central Bank of Nigeria, Prof Charles Soludo, announced a 13-point reform programme for the Nigerian Banks which include increasing the capital requirements of banks to N25b. The capital position of most commercial banks in Nigeria have marked increased ever since the change came into effect in 2005. The primary objective of a sound capital base is to guarantee an efficient banking system. Lemo (2005) said that solid capital base would enable the banking system to develop the required flexibility to support the economic development of the nation, by efficient performing its functions as the pivot of the process of financial intermediation.

According to Adegbaju and Olokoyo (2008), the primary objective of bank capital was the maintenance of public confidence because confidence was the only collateral any bank would offer to depositors of funds. Capital is a very vital tool for the efficient and effective performance of any business enterprise especially banks because of the nature of their operations. Capital is being referred to in this study as equity share and reserves. This study wishes to determine the relationship between shareholder’s fund (capital) and profitability.

Statement of the Problem

Without profit, no firm can survive and attract outside capital to meet its investment target in a competitive environment. Thus, profitability plays a key role in persuading depositors to supply fund in terms of bank deposits on advantageous terms. But in Nigeria, low capitalization of banks made them less able to finance the economy and more prone to unethical and unprofessional practices. Soludo (2005) observed that many banks appear to have abandoned essential intermediation role of mobilizing savings and inculcating banking habits at the household and micro enterprise level due to capital inadequacy of many banks in the country. They were faced with high cost of financial distress and this certainly affected profitability.

In view of this, one will have to wonder, does increase in capital actually guarantee soundness and improved performance?, how far did the recapitalization exercise of 2004 go in achieving its objective to warrant further upward review of the bank capital base?, what are the other aspects of CBN policy that should also be reviewed alongside the recapitalization policy to ensure that the banks starts and continues performing to their bank?, do banking sector of other countries that are performing better in the international scenario constantly engage in upward review of the capital base or what are the other strategies they have employed to ensure improved banking performance?. Answers to these questions and inconclusive researches on the effect of bank capital on banking performance in Nigeria therefore necessitated the need of the present research.
Objectives of the Study

The broad objective of this research is to ascertain how capital impact on the performance of the Nigerian banking sector. However, the specific objectives of this research will be to:

1. Ascertain the effect of capital adequacy on the return on asset of the Nigerian banking system.
2. To determine the effect of capital on the return on asset in the Nigerian banking system.

Research questions

The research will tend to provide answers to the following questions:

1. To what extent does the capital adequacy affect the return on asset of Nigerian banking system?
2. To what degree does capital adequacy affect the return on asset in the Nigerian banking system?

Hypotheses

The research hypotheses will be stated in their null form as follows:

$H_0 \ 1$: capital adequacy does not have any significant effect on the return on assets of the Nigerian banking system.

$H_0 \ 2$: capital adequacy does not have any significant effect on the return on assets of the Nigerian banking system.

Review of Related Literature

Meaning of Bank Capital

The difference between the value of bank’s assets and its liabilities. The bank capital represents the net worth of the bank or its value investors. The asset portion of bank’s capital includes cash; government securities and interest-earning loans like mortgages, letters of credit and inter banks loans. The liabilities section of a bank’s capital includes loan-loss reserves and any debt it owes. A bank’s capital can be thought of as the margin to which creditors are covered if a bank liquidates its assets. Loan-loss reserves or loan-loss provisions are amount set aside by banks to allow for any loss in the value of the loans they have offered (Ayodele, 2013).

Bank capital is the value of the bank’s assets minus its liability, or debts. Assets include cash, loans and securities, while liabilities cover customer’s deposits, and money owed to other banks and bondholders. If all the assets were sold and all the debts repaid, the value which would be left over is equal to the bank’s equity. A bank’s capital is made up of certain loss-absorbing bonds, as well as its equity. These bonds include additional tier 1 bonds and tier 2 bonds. These bonds have equity-like features, which is why regulators allow them to count towards a bank’s capital. The more capital there is, this means the bank can absorb more losses on its assets before it becomes insolvent (Fadi, 2008).

Importance of Capital Adequacy to Various Bank Units

The Capital Adequacy Ratio (CAR) measures the amount of capital a bank retains compared to its risk. National regulators must attract the CAR of banks to determine how effectively it can sustain a reasonable amount of loss. National regulators must also determine if a bank’s current CAR is compliant with statutory capital regulations (Lemo, 2005). The CAR is important to shareholders because it is an important measure of the financial soundness of a bank. Two types of capital are measured with the CAR. The first, tier 1 capital, can absorb a reasonable amount of loss without forcing the bank to cease its trading. The second tier type, tier 2 capital, can sustain loss in the event of liquidation. Tier 2 capital provides less protection to its depositors. In relation to the amount of funds borrowed and deposits made, the amount of shareholders’ equity within a bank is comparatively small. Because of this, banks are typically highly leveraged which requires banks to operate on a higher plane of borrowing than would be seen in most other businesses.

In general, a business borrows funds that are approximately equal to its net worth. A bank, by contrast, has liabilities that are typically in excess of 10 times its equity capital. The greatest part of those liabilities are representative of smaller sums of money that depositor have entrusted to the bank. Because of the nature of risk under which banks operates, capital
regulations require banks to maintain a minimum level of equity per loans and other assets. This required minimum that is designed of protection, allowing banks to sustain unanticipated losses. The minimum is also designed to offer depositors confidence in the security of their deposits given the asymmetric information.

An individual depositor cannot know if a bank has taken risks beyond what it can absorb. Thus, depositors receive a level of assurance from shareholders’ equity, along with regulations, audits and credit ratings. The amount of equity a bank receives from shareholders sets the limit on the value of deposits it can attract. This also limits the extent to which the bank can lend money. If a bank sustains large losses through credit or trading, eroding the bank’s net worth, this causes a decreased fund base through which a bank can offer loans. The CAR provides shareholders with a better understanding of the risks a bank is taking with the equity they provide. A bank that continually takes more risks than it can reasonably sustain leaves potential shareholders with a sense that their equity investments are more at risk. A bank must maintain a professional level of risk management and sound lending practice to attract the capital that acts as its first line of defense against loss, both expected and unforeseen.

**Concept of Bank Profitability and Factors Affecting Bank Profitability**

Profitability is the state or condition of yielding a financial profit or gain. It is often measured by the price-to-earnings ratio. Profit is a financial benefit that realized when the amount of revenue gained from a business activity exceeds the expenses, cost and taxes needed to sustain the activity. Any profit that is gained goes to the business’s owners, who may or may not decide to spend it on the business (Brash, 2001).

The following are some factors affecting the profitability of the commercial banks:

**Amount of working funds**: funds deployed by a bank in profitable assets are the working funds of the bank. Profitability of a business is directly proportionate to the amount of working funds deployed by the bank.

**Cost of funds**: Cost of funds are the expenses incurred on obtaining funds from various sources in the form of share capital, reserves, deposits and borrowings. Thus, it generally refers to interest expenses. Lower the cost of funds, higher the profitability.

**Yield on funds**: The funds raised by the bank through various sources are deployed in various assets. These assets yield income in the form of interest. So, higher the interest, greater the profitability.

**Spread**: Spread is defined as the difference between the interest received (interest income) and the interest paid (interest expense). Higher spread indicates more efficient financial intermediate and higher net income. Thus, higher spread leads to higher profitability.

**Operating Costs**: Operating costs are the expenses incurred in the functioning of the bank excluding cost of funds all other expenses are operating costs. Lower operating cost gives rise to greater profitability.

**Capital Adequacy and Bank Performance**

Capital accounts form a small percentage of the financial resources of the banking institutions and it plays a crucial role in their long-term financing and solvency position (Barrios and Blanco, 2000). As bank’s capital are subjected to the regulation of the apex bank which centers on increasing bank’s capital base from N2 billion to N25 billion in 2005, the Nigerian banks faced high degree of competition within the banking sector in their attempts to meet up with the requirements Furlong and Keeley (1991) listed the factors that may affect bank’s capital; these include competition, more depositors, less fund costs, risk in portfolio interest, high return on equity, less distress incidences, profit maximization, avoidance of bankrupt and their negative externalities on the financial system and incentive to increase risky assets. The effect of capital adequacy on bank’s performance depends highly on these factors and the regulatory body prevailing in the country. Since bank’s capital accounts for over 30% and 44% of the bank's total assets and deposits respectively, determining capital adequacy of banks in isolation (without considering its performance), might be misleading.

In line with this, Barrios & Blanco, (2000) opined that determining bank’s performance in relation with its capital adequacy, some variables must be considered. These variables include bank’s managerial quality and productive efficiency which depends so much on the degree of competition in the industry. The ability of the bank management to ensure that bank’s capital is effectively managed, determines how adequate the capital is. Having capital adequacy ratios above the
minimum levels recommended by the Basle Capital Accord does not guarantee “safety” of a bank, as capital adequacy ratio is concerned primarily with credit risks. As Brash, (2001) rightly observed that “there are also other types of risks which are not recognized by capital adequacy ratios e.g. inadequate internal control system could lead to large losses by fraud, or losses could be made on the trading of foreign exchange and other types of financial instruments”. Other risks involved in financial transitions ratios are only as good as the information on which they are based, and should not be interpreted as the only indicators necessary to judge a bank’s financial soundness (Brash, 2001).

Methodology

Research design

The study covered the period of 2001-2014. This was to enable the researcher measure quantitatively, the effect of capital adequacy on the performance of banks in Nigeria, to cover the pre capitalization era, the bank post consolidation era in the Nigerian banking industry.

Model Specification

A model is simply an abstraction of reality. The study adopted three major variables in order to capture performance variability. These variables include: yield on earning asset, return on asset, and return on equity. The choice of the three profitability variables is grounded in the overall goal of the researcher. The study investigated the effect of capital adequacy on the performance of banks in Nigeria using simple regression analysis. The researcher however adopted a model by Olaitan (2009), which was modified by the researcher to suit the present research. The model is as specified below;

Model 1
\[
\text{YEA} = f(TQ, TIER, \text{CAP})
\]

Model 2
\[
\text{ROA} = f(TQ, TIER, \text{CAP})
\]

Model 3
\[
\text{ROE} = f(TQ, TIER, \text{CAP})
\]

Model 1
\[
\text{LogYEA} = a_0 + a_1 \text{LogTQ} + a_2 \text{LogTIER} + a_3 \text{LogCAP} + u_t
\]

Model 2
\[
\text{LogROA} = a_0 + a_1 \text{LogTQ} + a_2 \text{LogTIER} + a_3 \text{LogCAP} + u_t
\]

Model 3
\[
\text{LogROE} = a_0 + a_1 \text{LogTQ} + a_2 \text{LogTIER} + a_3 \text{LogCAP} + u_t
\]

Where:
- \(a_0\) = slope of the regression equation
- \(a_1\) to \(a_3\) = parameter estimates
- \(ut\) = white noise, capturing other variables not covered in the model
- ROE = Return on Equity
- ROA = Return on Asset
- YEA = Yield on Earning Asset
- TQ = Total Qualifying Capital
- TIER = Tier 1 capital (adjusted shareholder’s fund)
- CAP = Capital to total risk weighted asset ratio

Apriori expectation: \(a_1<0, a_2<0, a_3<0\)

Techniques for Data Analysis

The study adopted analytical method of data analysis. The analytical tool consisted of Ordinary Least Square (OLS) regression. Five separate regressions were estimated for 2001-2014. The essence was to enable researcher reveal the effect of capital adequacy on the performance of banks in Nigeria. The usual tests of significance and goodness-of-fit were employed to decide whether or not capital adequacy has any significant impact on performance of banks in Nigeria. These include the t-values, the coefficient of determination (R²) and adjust R², and the F test.
Evaluation of Estimate

The evaluation of estimates deals with how the study interprets results of the analysis in the study. Basically, the coefficient of correlation ($r^2$) is gotten from the relation below;

Where:
- $r$ = coefficient of correlation
- $n$ = number of time periods
- $x$ = value of the independent variable
- $y$ = value of the capital adequacy
- $\sum$ = summation sign.

The ‘$r$’ shows the pattern of the relationship between capital adequacy and each of the major performance variables. A positive ‘$r^2$’ shows a positive and direct relationship while a negative ‘$-r^2$’ shows a negative or an inverse relationship between capital adequacy and any of the performance variables.

A relationship (F significance) below 0.05 shows significance, while above 0.05 shows insignificance.

The coefficient of determination, ‘$R$’ is defined as ‘$r$’ multiplied by 100. This reveals the percentage change in one variable as a result of a percentage change in another variable. Therefore, the coefficient of determination indicates the extent of the instability in each of the major performance variables that is due to the variability of level of capital.

Data Presentation and Analysis

This chapter tests and analyzes the data generated for this work. As a descriptive analysis, the regression result which was conducted for this work was presented here. With the help of E-view econometric software version 3.0, the regression model was analyzed and relevant tests were also conducted. The result of the analysis is shown on subsequent pages.

Table 1: Total qualifying asset, adjusted shareholder’s fund, capital to total risk weighed asset ratio, return on asset, return on equity, and yield on earning asset.

<table>
<thead>
<tr>
<th>Year</th>
<th>TQ</th>
<th>TIER 1</th>
<th>CAP</th>
<th>YEA</th>
<th>ROA</th>
<th>ROE</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>173.00</td>
<td>1,065.00</td>
<td>16.20</td>
<td>9.10</td>
<td>4.73</td>
<td>55.81</td>
</tr>
<tr>
<td>2002</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>6.42</td>
<td>3.47</td>
<td>36.00</td>
</tr>
<tr>
<td>2003</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>4.47</td>
<td>2.67</td>
<td>25.52</td>
</tr>
<tr>
<td>2005</td>
<td>543.00</td>
<td>3,050.00</td>
<td>17.83</td>
<td>9.85</td>
<td>1.85</td>
<td>12.97</td>
</tr>
<tr>
<td>2006</td>
<td>1,000.00</td>
<td>4,600.00</td>
<td>22.60</td>
<td>8.35</td>
<td>1.60</td>
<td>10.40</td>
</tr>
<tr>
<td>2007</td>
<td>1,700.00</td>
<td>8,200.00</td>
<td>20.90</td>
<td>18.27</td>
<td>1.80</td>
<td>13.80</td>
</tr>
<tr>
<td>2008</td>
<td>2,802.00</td>
<td>127.89</td>
<td>21.91</td>
<td>18.27</td>
<td>4.29</td>
<td>24.11</td>
</tr>
<tr>
<td>2009</td>
<td>2,201.84</td>
<td>448.99</td>
<td>10.24</td>
<td>22.87</td>
<td>9.28</td>
<td>-64.72</td>
</tr>
<tr>
<td>2010</td>
<td>429.60</td>
<td>312.36</td>
<td>4.32</td>
<td>11.24</td>
<td>3.91</td>
<td>162.9</td>
</tr>
<tr>
<td>2011</td>
<td>1,900.31</td>
<td>1,934.93</td>
<td>17.71</td>
<td>13.78</td>
<td>-0.04</td>
<td>-0.28</td>
</tr>
<tr>
<td>2012</td>
<td>2,183.13</td>
<td>2,150.3</td>
<td>18.07</td>
<td>11.92</td>
<td>6.62</td>
<td>22.20</td>
</tr>
<tr>
<td>2013</td>
<td>2,415.40</td>
<td>2,418.75</td>
<td>17.18</td>
<td>12.13</td>
<td>2.15</td>
<td>19.14</td>
</tr>
<tr>
<td>2014</td>
<td>2,880.40</td>
<td>2,440.20</td>
<td>15.92</td>
<td>11.71</td>
<td>2.33</td>
<td>20.34</td>
</tr>
</tbody>
</table>

Source: NDIC AND CBN PUBLICATIONS FOR VARIOUS YEARS

From the table presented above, the banks witnessed loss in the year 2009 and 2011 on return on asset and return on equity, even when the amount of capital was high. It is also evident that the banks witnessed the highest on return on equity and return on asset in 2011 when the capital was very low. This supports the view that capital adequacy has negative effect on the performance of the deposit money banks. Some may have argued that the negative return witnessed in 2009 was as a result of the effect of the world economic meltdown which seriously affected the Nigerian economy, and hence the banks were still recovering from the shock. But the loss witnessed again in 2011 which is years after the meltdown and comes after 2010 where the banks have made positive returns on assets and equity confirms the fact that adequacy capital is not necessarily a yardstick to improvement of bank performance.
Testing of hypotheses

Step 1: Restate the hypotheses

H₀: capital adequacy does not have significant effect on the return on assets of the Nigerian banking system.

H₁: capital adequacy has significant effect on the return on asset of the Nigerian banks.

Step 2: Analysis of the result

Table 2 result of the OLS ROA C TQ TIER CAR

<table>
<thead>
<tr>
<th>Variables</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>1.857500</td>
<td>2.239617</td>
<td>0.829383</td>
<td>0.4262</td>
</tr>
<tr>
<td>TQ</td>
<td>-0.000786</td>
<td>0.000997</td>
<td>-0.788554</td>
<td>0.4487</td>
</tr>
<tr>
<td>TIER</td>
<td>-0.000237</td>
<td>0.000615</td>
<td>-0.384942</td>
<td>0.7083</td>
</tr>
<tr>
<td>CAR</td>
<td>0.118115</td>
<td>0.209825</td>
<td>0.562921</td>
<td>0.5859</td>
</tr>
</tbody>
</table>

R-squared | 0.060186 | Mean dependent var | 1.801429 |
Adjusted R-squared | -0.221758 | S.D. dependent var | 3.417101 |
S.E. regression | 3.777030 | Akaike info criterion | 5.730710 |
Sum squared resid | 142.6596 | Schwarz criterion | 5.913297 |
Log likelihood | -36.11497 | Hannan-Quinn criter. | 5.713808 |
F-statistic | 0.213468 | Durbin-Watson stat | 2.556071 |
Prob.(F-statistic) | 0.884808 |

The result in the table above indicates that TQ and TIER have negative and insignificant relationship with ROA while CAR has a positive relationship with ROA. The coefficient of the constant 1.857500 means that if all the capital adequacy variables are kept constant ROA would increase by 1.857. The TQ coefficient of -0.000786 envisages that a percentage increase in TQ resulted in 0.0786 decline in ROA within the period of the study. This support the work of (you list other works that have found this negative result with ROA). On the other hand, it negates the work of (you list other works that have found positive relationship with ROA). The TIER coefficient of -0.000237 entails that a unit increase in TIER resulted in 0.0237 reductions in ROA within the period of the study. This support the work of (you list other works that have found this negative result with ROA). On other hand, it negates the work of (you list other works that have found positive relationship with ROA).

The CAR coefficient of 0.118115 reveals that a unit increase in CAR would increase ROA by a factor of 0.12. This support the work of (you list other works that have found this positive result with ROA). On the other hand, it negates the work of (you list other works that have found negative relationship with ROA). The coefficient of the Adjusted R-squared revealed that only -22.17% of variation in ROA were explained by TQ, TIER and CAR. This suggests that capital adequacy has not positively influenced bank performance measured on ROA. The F-statistic of 0.213468 and its p-value of 0.884808 suggest that the model is not statistically significant and has no goodness of fit. The Durbin Watson statistics of 2.5 is an indication that the variables in the models are free from problem of autocorrelation.

Testing of Hypothesis two

Step 1: Restate the Hypothesis

H₀: capital adequacy does not have any significant effect on the return on equity of the Nigerian banking system.

H₁: capital adequacy has significant effect on the return on equity of the Nigerian banks.

Step 2: Analysis of the result
Table 3 Result of the OLS ROA C TQ TIER CAR

<table>
<thead>
<tr>
<th>Variables</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>57.46490</td>
<td>29.48834</td>
<td>1.948733</td>
<td>0.0799</td>
</tr>
<tr>
<td>TQ</td>
<td>-0.010714</td>
<td>0.013129</td>
<td>-0.816076</td>
<td>0.4335</td>
</tr>
<tr>
<td>TIER</td>
<td>-0.002578</td>
<td>0.008093</td>
<td>-0.318516</td>
<td>0.7566</td>
</tr>
<tr>
<td>CAR</td>
<td>-0.652637</td>
<td>2.762705</td>
<td>-0.236231</td>
<td>0.8180</td>
</tr>
</tbody>
</table>

R-squared 0.156260 Mean dependent var 26.11000
Adjusted R-squared -0.096862 S.D. dependent var 47.48439
S.E. regression 49.73097 Akaike info criterion 10.88609
Sum squared resid 24731.69 Schwarz criterion 11.06868
Log likelihood -72.20262 Hannan-Quinn criter. 10.86919
F-statistic 0.617329 Durbin-Watson stat 3.155736
Prob.(F-statistic) 0.619407

Source: regression result by the researchers

The result in the table above shows that all the capital adequacy indicators have negative and insignificant relationship with ROE. This is against the a priori expectation of a positive relationship between capital adequacy and performance of banks. The coefficient of the constant 57.46 suggests that if all the capital adequacy variables are kept constant ROE would be 57.46. The TQ coefficient of -0.010714 indicates that a percentage increase in TQ resulted in 1.0714 decline in ROE within the period of the study. This support the work of (you list other works that have found this negative result with ROE). On the other hand, it negates the work of (you list other works that have found positive relationship with ROE). The TIER coefficient of -0.002578 entails that a unit increase in TIER resulted in 0.2578 depreciation in ROE within the period of the study. This support the work of (you list other works that have found this negative result with ROE).

On the other hand, it negates the work of (you list other works that have found positive relationship with ROE). The CAR coefficient of -0.652637 reveals that a unit increase in CAR would reduce ROE by a factor of 0.65. This support the work of (you list other works that have found this negative result with ROE). On the other hand, it negates the work of (you list other works that have found positive relationship with ROE). The coefficient of the Adjusted R-square shows that -9.68 variations in ROE was accounted by capital adequacy. In other words, changes in capital adequacy have not contributed positively to improvement in ROE on banks in Nigeria within the study period. The F-statistic of 0.617329 and its p-value of 0.619407 unveils that the model is not statistically significant and has no goodness of fit. The Durbin Watson statics is above the benchmark of 2.0 suggesting that the variables in the models are free from problem of autocorrelation.

Findings

This study focused on the effect of capital adequacy on the performance of deposit money banks in Nigeria. From the analysis of the hypotheses formulated, using the relevant data, the following was revealed:

1. That total quality asset and TIER 1 capital have negative and insignificant relationship with Return on asset, while capital to total risk weighed asset ratio has a positive relationship with ROA. This result confirms our earlier postulations that increase in capital does not necessarily ensure improved performance of the banks in Nigeria.
2. Capital adequacy indicators have negative and insignificant relationship with ROE. This is in consonance with the a priori expectation of a negative relationship between capital adequacy and performance of bank in Nigeria, and thus reaffirms the findings of the work of Ikpefan (2013) which also detected a negative relationship between capital adequacy and return on asset.
3. Capital adequacy variables have positively but insignificant relationship with YEA. This is against the a priori expectation that improving the capital base of banks will negatively influence their performance. This finding counters
the finding of the work of Ayodele (2013), which suggests a negative relationship between capital adequacy and bank performance.

Conclusion

The essence of capital in the Nigerian banking industry cannot be overemphasized. Capital is a very dicey issue in the banking system which goes a long way to instigate public confidence in the system re-assuring the naive customers that the bank is able and capable of safeguarding their money without any fear of failure, and making them available as at when needed. It also to an extent determines the performance of a bank, as evidenced in the third finding of this research. It therefore pertinent to handle the issue of capital adequacy with due diligence, to ensure a sound banking system in the country.

Recommendations

The outcome of the study showed that two out of three variables of measuring bank performance has negative but insignificant effect with capital adequacy within the period under review, while one variable has a positive relationship with capital adequacy. Based on these findings, the researcher thereby recommends that: There should be a constant review of minimum capital requirement of deposit money banks in Nigeria to meet the prevailing economic situation in the country to ensure that too much cash is not left idle in the reserve when actually they would have been given out as loan which will yield better return for the banks. In as much as the findings of this research detects a negative relationship between capital adequacy and bank performance, the importance of capital adequacy in the Nigerian banking system should not be neglected, Nigerian banks should be well capitalized to enable them enjoy assess to cheaper sources of funds with subsequent improvements in profit levels. This would go a long way to help the public maintain confidence in the banks and also accommodate the credit needs of customers.

Bank capital regulation must be anchored on a sound monitoring system which regularly assess the economy, ascertains and establishes the level of capital commitment required by the banking sector. This is because enforcing capital adequacy or increasing bank capital without effective monitoring system will still leave loophole in the banking system, as it has been seen that capital adequacy is not a major determinant to bank performance.

References


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