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Financial Intermediation and Economic Growth: The Banking Function Perspective in Nigeria

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Abstract
The study examine the effect of financial intermediation on the growth of Nigerian economy from 1990 – 2023. The main objective is to investigate the relationship between financial intermediation and Nigerian economy growth while the specific objectives are to examine the effect of commercial banks credit, deposit, investment and credit to Small and Medium Scale Enterprises. Time series data were sourced from Central Bank of Nigeria Statistical Bulletin. The study model Real Gross Domestic Product as the function of Total Commercial Bank Credit, Total Commercial Bank Deposit, Total Commercial Bank investment and Total credit to Small and medium Scale Enterprises. Multiple regressions with econometrics view statistical package were used as data analysis techniques. β-coefficient, R-square, F-statistics and Augmented Dickey fuller Unit Root Test were used to examine the relationship between the variables. Findings revealed that the independent variables in the model have positive effect on the dependent variable. The study concludes that there is positive and significant relationship between financial intermediation and the growth of Nigerian economy. It therefore recommends that policies should be devise and the existing ones reformed to enhance the operational efficiency of the commercial banks for effective intermediation that will facilitate the realization of monetary and macroeconomic goals of economic growth in Nigeria.

Keywords: Financial Intermediation, Economic Growth, Banking Function Perspective, Nigeria

INTRODUCTION

The roles of financial intermediaries in achieving the monetary and macroeconomic goals remain very important. The institutions such as the banking institutions intermediate between the deficit and the surplus economic units and bridge the financial disequilibrium that exists among them. The economic agents are able to interact for co-benefits by means of financial intermediation. Financial intermediation is a monetary function that involves the mobilization of savings and allocation of financial resources by the relevant financial institutions such as the deposit money banks. The financial sector as the "life blood" of every nation's economy performs the intermediary function between the economic agents by capital accumulation, deposit mobilization/saving mobilization and resource allocation which is important for the achievement

of the macro economic objectives and the transmission of monetary policy to achieve growth in output, balance of payment equilibrium and full employment (Aranjo & Minetti, 2007; Lucky, 2018). Economic growth theories such as the Neo-classical the new growth theory laid more emphases on the availability of capital in achieving desired macroeconomic goals. The importance of the financial sector to the economic growth is compared to the importance of engine oil to the engine. It lubricates the economy by making funds available for financial and real sector investment. The role of financial intermediation has been exemplified in numerous literature of finance. Besides the performance of specialized task, it also performs such function as mitigating the cost associated with information acquisition and the conduct of financial transactions (Benston & Smith, 2009). In addition to the above, Gromb and Vayanos (2010) noted that financial intermediation makes provision for insurance and risk sharing, stimulate the funding of liquidity needs through the credit lines and aid the creation of specialized product for better economic performance.

The banking sector occupies a central position in the function of financial intermediation through the savings deposit mobilization and allocates same through investment. This function necessitated the various reforms in the banking sector for effective and efficient intermediation function, for instance, the deregulation of the financial sector in the last quarter of 1986 which gave birth to 120 commercia1 and merchant banks, some of the bank's collapse after few years of existence (Toby, 2006; Lucky & Achebelema, 2018). The introduction of Prudential Guideline for Licensed Banks and the Basel Capital Standard in 1991 was aimed at repositioning the financial intermediation functions. The adoption of universal banking in 2001 and the banking sector consolidation by recapitalization through merger and acquisition in 2005, aimed at effective intermediation function for better economic performance. The relationship between financial intermediation and economic growth in the developing countries like Nigeria has been the subject of growing literature. While some researchers agreed that financial intermediation drives economic growth (Niel et al 2009, Osman, 2011), others argued that economic growth drives financial intermediation (Odhiambo, 2011). This controversy has long been a point of departure among researchers. However, Nigerian government believes that financial intermediation drives economic growth. This belief led to establishment of various financial intermediation institutions. There have been various institutional and policy re-structuring and reforms, for effective financial intermediation over the years. For instance, the banking sector consolidation and recapitalization with the objective of repositioning the banking system for effective intermediation function, the reform in the community to microfinance bank, the reform in other capital market institutions such as the Nigerian Stock Exchange, the deregulation of the economy and the stock price, the internationalization of the capital market. Despite these reforms, availability of capital remains a challenging factor to investors this has affected negatively the economic growth of the country. Nigeria is rated among the poorest countries in the world. Over 60% of the labor force is unemployed. In the light of the above, the study examined the impact of financial intermediation functions of deposit money banks on Nigerian economic growth.

LITERATURE REVIEW

Perfect Theory of Financial Intermediary

Three pillars are at the basis of the modern theory of finance: optimality, arbitrage, and equilibrium. Optimality refers to the notion that rational investors aim at optimal returns. Arbitrage implies that the same asset has the same price in each single period in the absence of restrictions. Equilibrium means that markets are cleared by price adjustment through arbitrage at each moment in time. Levine et al (2000). In the neoclassical model of a perfect market, e.g. the perfect market for capital, or the Arrow-Debreu world, the following criteria usually must be met:

i. No individual party on the market can influence prices;
ii. Conditions for borrowing/lending are equal for all parties under equal circumstances;
iii. There are no discriminatory taxes;
iv. Absence of scale and scope economies;
v. All financial titles are homogeneous, divisible and tradable;
vi. There are no information costs, no transaction costs and no insolvency costs;
vii. All market parties have ex ante and ex post immediate and full information on all factors and events relevant for the (future) value of the traded financial instruments.

The Arrow-Debreu world is based on the paradigm of complete markets. In the case of complete markets, present value prices of investment projects are well defined. Savers and investors find each other because they have perfect information on each other preferences at no cost in order to exchange savings against readily available financial instruments. These instruments are constructed and traded Costless and they fully and simultaneously meet the needs of both savers and investors. Thus, each possible future state of the world is fully covered by a so-called Arrow-Debreu security (state contingent claim). Also important is that the supply of capital instruments is sufficiently diversified as to provide the possibility of full risk diversification and, thanks to complete information, market parties have homogenous expectations and act rationally. In so far as this does not occur naturally, intermediaries are useful to bring savers and investors together and to create instruments that meet their needs. They do so with reimbursement of costs, but costs are by definition an element – or, rather, characteristic – of market imperfection. Therefore, intermediaries are at best tolerated and would be eliminated in a move towards market perfection, with all intermediaries becoming redundant: the perfect state of disintermediation. This model is the starting point in the present theory of financial intermediation. All deviations from this model which exist in the real world and which cause intermediation by the specialized financial intermediaries are seen as market imperfections. This wording suggests that intermediation is something which exploits a situation which is not perfect, therefore is undesirable and should or will be temporary. The perfect market is like heaven, it is a teleological perspective, an ideal standard according to which reality is judged.

There are different views on how the financial intermediation affects economic growth exactly Levine (2000).

i. The bank-based view holds that bank-based systems – particularly at early stages of economic development – foster economic growth to a greater degree than market-based systems.

ii. The market-based view emphasizes that markets provide key financial services that stimulate innovation and long-run growth.
iii. The financial services view stresses the role of banks and markets in researching firms, exerting corporate control, creating risk management devices, and mobilizing society's savings for the most productive endeavors in tandem. As such, it does regard banks and markets as complements rather than substitutes as it focuses on the quality of the financial services produced by the entire financial system.
iv. The legal-based view rejects the analytical validity of the financial structure debate. It argues that the legal system shapes the quality of financial services La Porta et al., (1998).

The legal-based view stresses that the component of financial development explained by the legal system critically influences long-run growth. Political factors have been introduced too, in order to explain the relationship between financial and economic development (Zingales, 2000).

Modern Theories of Financial Intermediation

In order to give firm ground to our argument and to illustrate the paradox, we will first review the doctrines of the theory of financial intermediation. These are specifications, relevant to the financial services industry, of the agency theory, and the theory of imperfect or asymmetric information. Basically, we may distinguish between three lines of reasoning that aim at explaining the raison d'être of financial intermediaries: information problems, transaction costs and regulatory factors. First, and that used in most studies on financial intermediation, is the informational asymmetries argument. These asymmetries can be of an ex ante nature, generating adverse selection, they can be interim, generating moral hazard, and they can be of an ex post nature, resulting in auditing or costly state verification and enforcement. The informational asymmetries generate market imperfections, i.e. deviations from the neoclassical framework. Many of these imperfections lead to specific forms of transaction costs. Financial intermediaries appear to overcome these costs, at least partially. For example, Diamond and Dybvig (1983) consider banks as coalitions of depositors that provide households with insurance against idiosyncratic shocks that adversely affect their liquidity position. Another approach is based on Leland and Pyle (1977). They interpret financial intermediaries as information sharing coalitions. Diamond (1984) shows that these intermediary coalitions can achieve economies of scale. Diamond (1984) is also of the view that financial intermediaries act as delegated monitors on behalf of ultimate savers. Monitoring will involve increasing returns to scale, which implies that specializing may be attractive. Individual households will delegate the monitoring activity to such a specialist, i.e. to the financial intermediary. The households will put their deposits with the intermediary. They may withdraw the deposits in order to discipline the intermediary in his monitoring function. Furthermore, they will positively value the intermediary's involvement in the ultimate investment (Hart, 1995).

There can be assigned a positive incentive effect of short-term debt, and in particular deposits, on bankers (Hart and Moore, 1995). For example, Qi (1998) and Diamond and Rajan (2001) show that deposit finance can create the right incentives for a bank's management. Illiquid assets of the bank result in a fragile financial structure that is essential for disciplining the bank manager. Note that in the case households that do not turn to intermediated finance but prefer direct finance, there

is still a "brokerage" role for financial intermediaries, such as investment banks (see Baron, 1979 and 1982). Here, the reputation effect is also at stake. In financing, both the reputation of the borrower and that of the financier are relevant (Hart and Moore, 1998). Dinç (2001) studies the effects of financial market competition on a bank reputation mechanism, and argues that the incentive for the bank to keep its commitment is derived from its reputation, the number of competing banks and their reputation, and the competition from bond markets. These four aspects clearly interact (see also Boot, Greenbaum and Thakor, 1993).

An Alternative Approach of Financial Intermediation

When information asymmetries are not the driving force behind intermediation activity and their elimination is not the commercial motive for financial intermediaries, the question arises which paradigm, as an alternative, could better express the essence of the intermediation process. In our opinion, the concept of value creation in the context of the value chain might serve that purpose. And, in our opinion, it is risk and risk management that drives this value creation. The concept of value creation, introduced by Michael Porter (1985), can be seen as a dynamic extension of the theory of industrial organization, in the tradition of Joseph Schumpeter. It represents the other side of the coin, which glitters in the theory of the firm: transaction costs are incurred to create value. It is amazing that the value added approach, now widely recognized and applied in the literature on business organization, management and finance (e.g. EVA, Economic Value Added; see Damodaran, 1996; Grinblatt and Titman, 1998), has not yet been widely used to explicitly explain the operations of the financial industry. There are a few noticeable exceptions: Jordi Canals (1993) describes the value creation process in banking in his book "Competitive Strategies in European Banking", making reference to Porter. However, he does not elaborate on this concept to create an alternative to the existing paradigm of financial intermediation. Nor does he go into depth to explain the basic process of value creation by financial intermediaries. David Llewellyn's concept of contract banking is also based on the value chain idea (Llewellyn, 1999). But here too, there emerges no alternative for the mainstream view on financial intermediation.

Building Blocks for an Amended Theory

The keystones for a complete new understanding of the financial intermediation process and for a future direction of the theory of financial intermediation, it compares these with the key concepts of current financial intermediation theory. The building blocks of the amended theory fundamentally differ from those of the existing theory. As has been said in the beginning of this essay, there is a difference in paradigm; a completely different perspective that is taken to look at the same phenomenon. Fortunately, it should be noted that in almost all of the new building blocks, extensive research based on the concepts we indicate is well underway, as we will conclude in the next section on the research agenda, but gaps are still there. The research we refer to does hardly, or only very indirectly, point to the essence of the intermediation process, deriving its dynamics from specific basic views and problems (Zingales, 2000).

The static concept of a perfect, fully transparent market where homogenous products are traded between numerous parties who have no individual influence on equilibrium prices has a limited significance as a benchmark for the financial intermediation process. This is the case even after, and paradoxically, to a considerable extent due to, the information and communication revolution.

The public financial markets which are growing in importance – seem to approach the characteristics of a perfect market but they remain in a continuous process of development and change, both with regard to the traded instruments and to the institutions that service the trading on the public markets. This process is conditioned by the expertise of investment banks and the underwriting risk taking of banks, as well as by the asset management expertise of banks, insurers and investment funds. Without these intermediaries the public markets could not exist. Traditional corporate banking is under pressure from this move towards public markets, but evolves toward specific solutions for corporate finance (cash flow based project finance, leasing, etc). Retail banking innovates by blending private savings, insurance, finance and investment products and marketing these through a diversity of distribution channels on a mass scale. Financial intermediaries "de-homogenize" the markets by carving out niches for specific product market combinations and in specific geographical areas where their position is strong. By doing so they differentiate the market and create market imperfections in so far as new products or databases for marketing contain unique, captive information. This process of building up market imperfections in niche markets goes hand in hand with the leveling off of market imperfections in the public markets trading. It is the process of creative destruction, as described by Schumpeter (1912).

Commercial Banks and Intermediation Functions

Accepting Deposits

The most important function of commercial banks is to accept deposits from the public. Various sections of society, according to their needs and economic condition, deposit their savings with the banks Romeo-Avila (2007). For example, fixed and low income group people deposit their savings in small amounts from the points of view of security, income and saving promotion. On the other hand, traders and businessmen deposit their savings in the banks for the convenience of payment. Therefore, keeping the needs and interests of various sections of society, banks formulate various deposit schemes. Generally, there ire three types of deposits which are as follows:

Current Deposits

The depositors of such deposits can withdraw and deposit money whenever they desire. Since banks have to keep the deposited amount of such accounts in cash always, they carry either no interest or very low rate of interest Deidda (2006; Akani, Lucky & Uzah, 2016;).). These deposits are called as Demand Deposits because these can be demanded or withdrawn by the depositors at any time they want. Such deposit accounts are highly useful for traders and big business firms because they have to make payments and accept payments many times in a day.

Fixed Deposits

These are the deposits which are deposited for a definite period of time. This period is generally not less than one year and, therefore, these are called as long term deposits Allen and Gale (2004). These deposits cannot be withdrawn before the expiry of the stipulated time and, therefore, these are also called as time deposits. These deposits generally carry a higher rate of interest because banks can use these deposits for a definite time without having the fear of being withdrawn.

Saving Deposits

In such deposits, money up to a certain limit can be deposited and withdrawn once or twice in a week. On such deposits, the rate of interest is very less Gromb and Vayanos (2010). As is evident from the name of such deposits their main objective is to mobilize small savings in the form of deposits. These deposits are generally done by salaried people and the people who have fixed and less income.

Giving Loans

The second important function of commercial banks is to advance loans to its customers. Banks charge interest from the borrowers and this is the main source of their income. Banks advance loans not only on the basis of the deposits of the public rather they also advance loans on the basis of depositing the money in the accounts of borrowers Aranjo and Minetti (2007). In other words, they create loans out of deposits and deposits out of loans. This is called as credit creation by commercial banks. Modern banks give mostly secured loans for productive purposes. In other words, at the time of advancing loans, they demand proper security or collateral. Generally, the value of security or collateral is equal to the amount of loan. This is done mainly with a view to recover the loan money by selling the security in the event of non-refund of the loan. At limes, banks give loan on the basis of personal security also. Therefore, such loans are called as unsecured loan. Banks generally give following types of loans and advances:

Cash Credit

In this type of credit scheme, banks advance loans to its customers on the basis of bonds, inventories and other approved securities. Under this scheme, banks enter into an agreement with its customers to which money can be withdrawn many times during a year. Under this set up banks open accounts of their customers and deposit the loan money Wachtel (2001). With this type of loan, credit is created.

Demand Loans

These are such loans that can be recalled on demand by the banks. The entire loan amount is paid in lump sum by crediting it to the loan account of the borrower, and thus entire loan becomes chargeable to interest with immediate effect.

Short-Term Loan

These loans may be given as personal loans, loans to finance working capital or as priority sector advances. These are made against some security and entire loan amount is transferred to the loan account of the borrower.

Over-Draft

Banks advance loans to its customer’s up to a certain amount through over-drafts, if there are no deposits in the current account. For this banks demand a security from the customers and charge very high rate of interest.

Discounting of Bills of Exchange

This is the most prevalent and important method of advancing loans to the traders for short-term purposes. Under this system, banks advance loans to the traders and business firms by discounting their bills. Onoh (2002) in this way, businessmen get loans on the basis of their bills of exchange before the time of their maturity.

Investment of Funds

The banks invest their surplus funds in three types of securities Government securities, other approved securities and other securities. Government securities include both, central and state governments, such as treasury bills, national savings certificate etc. Other securities include securities of state associated bodies like electricity boards, housing boards, debentures of Land Development Banks units of UTI, shares of Regional Rural banks etc Levine et al (2000).

Agency Functions

Banks function in the form of agents and representatives of their customers. Customers give their consent for performing such functions. The important functions of these types are as follows:

(i) Banks collect cheques, drafts, bills of exchange and dividends of the shares for their customers.

(ii) Banks make payment for their clients and at times accept the bills of exchange: of their customers for which payment is made at the fixed time.

(iii) Banks pay insurance premium of their customers. Besides this, they also deposit loan installments, income-tax, interest etc. as per directions.

(iv) Banks purchase and sell securities, shares and debentures on behalf of their customers.

(v) Banks arrange to send money from one place to another for the convenience of their customers.

Miscellaneous Functions

Besides the functions mentioned above, banks perform many other functions of general utility which are as follows:

(i) Banks make arrangement of lockers for the safe custody of valuable assets of their customers such as gold, silver, legal documents etc.
(ii) Banks give reference for their customers.
(iii) Banks collect necessary and useful statistics relating to trade and industry.
(iv) For facilitating foreign trade, banks undertake to sell and purchase foreign exchange.
(v) Banks advise their clients relating to investment decisions as specialist
(vi) Bank does the under-writing of shares and debentures also.
(vii) Banks issue letters of credit.

(viii) During natural calamities, banks are highly useful in mobilizing funds and donations.
(ix) Banks provide loans for consumer durables like Car, Air-conditioner, and Fridge etc.

Savings as Financial Intermediation

Savings, which we define as the part of incomes not immediately, consumed, but reserved for future consumption, investment or for unforeseen contingencies is considered as an indispensable weapon for economic growth and development. Its role is reflected in capital formation through increased capital stock and the impact it makes on the capacity for an economy to generate more and higher incomes.

Abu- Bader and Abu- Qarn (2008) noted that the importance of savings beyond capital formation. To her, savings are a catalyst for capital formation but equally, a major determinant of the cost of credits based on the law of scarcity, which holds that 'when the former is low and scarce, it becomes more costly to obtain'. The classics 5 as well as modern growth models hold that savings constitute the principal parameter, and determinant of economic growth. This idea is upheld by which showed that on the average, third world countries with higher growth rates incidentally are those with higher saving rates. Capital mobilized from domestic sources is very fundamental for a country's development not only because it has a low cost, but also due to the fact that it is durable and permanent. Adam (1985) considered that most of this domestic savings will come from the rural areas especially in countries with a dominant rural because there is a greater saving capacity and growth potentials. Thillairajah (1994) and Padmanabhan (1988) sharing the same opinion, explain the high marginal propensity to save by the unstable economic conditions that generally prevails in these areas (unstable incomes, fluctuations in harvest).

But unfortunately, in spite of these advantages, most of the saving potentials of rural communities in developing economies remain not mobilised especially in respect to the formal financial system on which an economy depends for growth. To permit an efficient and sustainable mobilization of savings in general and rural savings in particular, a number of factors must be fulfilled. These, according to are classified into the capacity to save and the willingness to save. Whereas the capacity to save is influenced by the level of per capita income, growth of these incomes, population age structure and income distribution; the willingness to save on the other hand depends more on the country's financial system through variables such as the level of financial deepening, and inflation.

They however concludes that the number, proximity and diversity of financial institutions (willingness to save factor) serving the various needs of savers play a dominant influence over the primeval factor of the capacity to save. But there appear to be a strong link between the rates of growth of financial circuits and how develop and efficient a country's financial system can sustainably mobilize domestic savings. Bomda (1998) stressed on the influence of certain factors on the supply of savings and empirically showed the existence of a negative correlation between the rate of savings and the costs/risks incurred by customers. These include transportation cost and risk involve in moving with large sums of money through long distances. Whatever motive an individual may have for savings, the rate of savings in any given community according to Schmidt & Kropp, 1988, depends on the available savings institutions which themselves must fulfill conditions like an efficient number, diversity, accessibility, attractive terms of operations, perfect knowledge on their existence and the usefulness and trust people have on them. Thus, an efficient and sustainable savings mobilization will certainly depend on the availability and or number of

financial variables, their accessibility and nature of and the way such services are rendered to customers. Unfortunately, Cameroon's formal financial system seems poorly developed, poorly diversified and inefficient. It is also fragmented and records a low financial deepening ratio (M2/GDP) which witnessed a decline from 22 percent in 1989 down to 17 percent in 1995 according to (Heidhue and Weinschenck, 1989; Kammogne, 1988). Due to this low financial deepening ratio, Cameroon was ranked behind countries like Gambia, Ghana, Nigeria, Senegal and South Africa whose respective per capita incomes were far lower than hers during the same period. But to ensure that the banking industry is efficiently spread equally requires financial soundness of these institutions.

Commercial Banks and Financial Intermediary

The savings/investment process in capitalist economies is organized around financial intermediation, making them a central institution of economic growth. Financial intermediaries are firms that borrow from consumer/savers and lend to companies that need recourses for investment. For instance if you wanted to lend your money to MTN or Globalcom, you would not go directly to the CEO of the company and offer a loan. Instead you would lend your money to such company's indirectly through financial intermediaries, institutions such as commercial banks, saving and loan associations mutual saving banks, credit unions, insurance companies, pension funds, and finance companies, that borrow funds from savers. Banks are the financial intermediary that the average person interacts with most frequently. A person who needs a loan to buy a house or car usually obtains it from a local bank. Most people keep a large proportion of their financial wealth in banks in form of checking accounts, savings account or other various specialized financial product. Financial intermediation is an important activity in the economy because it allows funds to be channelled from people who might otherwise not put them to productive use to people who will.

In this way financial intermediation helps promoted a more efficient and dynamic economy. According to Onyolo (2006) banks more effectively finance industrial expansion than any other form of financing in developing economies. Banks are the largest financial intermediates in the Nigerian economy.

They act as intermediaries between, ultimate save-lenders and ultimate borrower-spenders. According to Vane and Thompson, J.L. (1982), financial intermediaries help to bridge the gap between borrowers and lenders by creating a market in two type of security, one for the lender and the other for the borrower. In this study, we will examine the impact of loan able funds on the Nigerian economy by applying the Keynesian principle of economic growth, specifically Harrod-Domar principle. Keynesians postulate that the impact of money in an economy depend the ability of money to influence interest rate, rate of interest to influence demand for investment fund and for investment fund to influence national income.

Economic Growth

Economic growth Economic growth refers to an increase in the country's production in terms of gross domestic production, over a period of time. The economic growth theory focuses on improvement in the quality life of people with an increase in productive capacity (Adamopoulos,

2010). Endogenous growth theory shows that economic growth is primarily the result of endogenous and not external forces. The theory holds that economic growth is possible if investment in human capital, innovation, and knowledge are made. The theory also primarily holds that the long run growth rate of an economy depends on policy measures. Under endogenous growth model, the development of financial development can affect economic growth by increasing the productivity of investments, reducing the transaction cost thus increasing the share of savings which channelled into productive investments and improving the liquidity of investments (Pagano, 1993). Economic growth is the positive trend in the nation's total real output or GDP over the long-term. It is the term used to mean per capita increase in productive ability. This is the kind of growth, which can provide an increasing standard of living for the people. Economic growth refers to increase in real output or real per capita output of an economy. The definition correctly recognized that the standard of living of the people in any economy is best measured in terms of real output per person (Olugbenga, 2012). Stock Market Development Market Capitaliation (MCAP) Volume of Capital Value of Stock Traded (VST) Value of Capital Economic Growth All Share Index (ASI) Volume of Capital Economic Grwoth 18 Soyode and Kajola, (2016) defined economic growth as a stable progress by which the productive capacity of the economy is increased over a period resulting to rising rate of national output and income Finally, economic growth can be evaluated by in relations to the Gross Domestic Products of a nation and Human Development Index (HDI); an indicator used for the measurement of national growth in relation to life expectancy at birth, education attainment, literacy and adjusted real per capita income (Frey, 2013).

Gross Domestic Product

Gross domestic product (GDP) is the total social output under the system of national accounts (SNA). It refers to the sum of the market value of all final products produced by the economic society (a country or region) using factors of production in a certain period of time. GDP is an important indicator to measure the economic situation and national development level, the core indicator of national accounts, and an important indicator of concern to the world economy. Many countries use GDP to measure the potential and competitiveness of economic development and have an impact on the formulation of economic policies and the regulation of social resource allocation. At this stage, GDP has a deeper connotation and extension. Green GDP is to deduct the cost of economic losses caused by environmental pollution, degradation of natural resources, poor education, out-of-control population and mismanagement from the current GDP, so as to obtain the real total amount of national wealth. Green GDP reflects humanity's new attitude toward the relationship between humans and nature. Analyzing the influencing factors of economic growth has always been the focus of academic research on economic growth theory.

Keynes used the expenditure method to calculate GDP of national income as: total income = total expenditure = consumption (C) + investment(I) + government purchases(G) + net export (NX), in which C, I, and NX are called "troika" that drive the economy . Modern economic growth theory emphasizes the important role of capital accumulation and technological progress in economic growth. The GDP of any country is influenced by different macroeconomic variables, and modern scholars have also conducted extensive research on this. General macroeconomic variables include interest rates, savings, unemployment, and international direct investment. Mehmood investigated the impact of independent variables on the GDP of Pakistan and Bangladesh.

Empirical Review

Nwabeke, Nwezeaku, Nzotta, Chris-Ejiogu, and Ogoke(2022) examined the effect of financial sector development on capital formation of Nigeria and South Africa using time series data from 1987-2019.Time series data was used percentage of capital formation to gross domestic products was used as the function of credit to private sector, broad money supply, interest rate spread and market capitalization ratio. Ordinary least square methods of cointegration, granger causality test, unit root test and Vector error correction model. The study found that the financial sector development explained 64.1 percent variation in Nigeria capital formation as against 46.4 percent variation from South Africa; this implies that the variables have more explanatory powers in Nigeria than South Africa.

Lyndon's (2019) study explored the relationship between Nigeria's insurance industry and economic growth from 2001 to 2017. This study used descriptive stats and multiple regression for analysis. Insurance investment, premium, and claims positively impacted GDP. The insurance sector has greatly aided Nigeria's economic advancement. Mandatory insurance policies recommended for individuals and businesses. Encourages investment, protects investors, promotes steady growth. Regulators should enforce transparent fund management by insurers. Insurers should diversify investments to boost returns and pay claims.

Nwanli and Omankhanlen (2019) analyzed insurance receivables' impact on Nigerian economic growth from 2008-2017. This study used panel data analysis to investigate the correlation between insurance industry indicators (life premium, non-life premium, and insurance investment) and economic growth. The study showed that life premium and economic growth related positively yet insignificantly, and non-life premium related negatively but insignificantly with economic growth. Insurance investment had no effect on economic growth. Nigerian insurance industry has little impact on economy. Policy makers should tackle insurance industry challenges from government and public. With policies and awareness, the industry can achieve its potential. Chizoba et al. (2018) studied the effect of inflation on insurance penetration in Nigeria from 1985 to 2016. Study used regression analysis and found inflation has a small positive impact on insurance penetration in Nigeria. The study recommends measures to reduce inflation in Nigeria, which will increase insurance penetration in the industry. Adedokun, Nwude, and Sergius (2018) linked insurance and economic growth in Nigeria from 1996 to 2015. This study used OLS estimation. Insurance in Nigeria boosts economic growth. Gov't should boost insurance industry with economic policies. Enforce insurances; enhance industry reputation with education campaigns.

Osakwe, Ogbonna and Obi-Nwosu (2020) examined a comparative study of the stock market capitalization on economic growth in Nigeria and South Africa for the period 2000-2018. The impressive growth recorded by Nigeria and South Africa Capital markets performance indicators are expected to transform their economies to the desired level. The study relies on time series OLS regression to analyze the data. The study found that the relationship between market capitalization ratio to GDP and economic growth is positive for South Africa but insignificant for Nigeria. Thus, the economic growth is positively correlated with the size of both countries' capital markets, though the size of South Africa capital market has better contribution to economic growth compared to Nigeria.

De Haan, Pleninger, and Sturm (2022) estimated an unbalanced fixed-effect panel model on the role of financial development of 84 countries in the poverty gap from 1975 to 2014; and found no direct effects. Ahmed, Kousar, Pervaiz, and Shabbir (2022) used World Bank data to explain the role of financial development and institutional quality in green-growth in South Asian economies from 2000 to 2018. The study also employs fully modified ordinary least squares (FMOLS) and dynamic ordinary least squares (DOLS) and show that institutional quality and financial development are long-term drivers of green economic growth.

Zuojun, Khan, and Khan (2022) employed the dynamic OLS and panel regression on 189 nations. The study found that better institutions are imperative for financial development. Specifically political stability, corruption control, and regulatory quality positively alter financial development. Over the period from 1985-2019, Khan, Gu, Khan, and Meyer (2022) investigated the effects of national culture on financial sector development in emerging and developing economies. The findings show that cross-country differences in financial sector development are significantly explained by national culture.

Shahbaz, Nasir, and Lahiani (2022) explored on the impact of financial development on countries' levels of financialization. The findings revealed the existence of variable threshold asymmetric co-integration between 1986 and 2020. Baloch, Ozturk, Bekun, and Khan (2021) investigate the relationship between financial development, economic growth, energy innovation, and environmental pollution for a panel of OECD countries from 1990 to 2017. The study employs the Pooled Mean Group Autoregressive Distributed Lag (PMG/ARDL) and finds that financial development promotes energy innovation and improves environmental quality.

Gong, Song, and Chang (2021) examined the long-run relationship between corruption, economic growth, and financial development in 142 countries using panel cointegration and panel error correction models from 2002 to 2016. The findings confirm the existence of long-term cointegrating relationship among the variables. The results show that economic growth has a positive effect on financial development, whereas corruption has a negative effect. Nwinee and Olulu-Briggs (2016) explored the import of financial development when the Nigerian economy is open, and found a significant link between the growth rate of the economy and private sector credit. the study advocates for more flexibility in both loans and interest rate so that industrialists can be encouraged to stimulate businesses in Nigeria.

Yirdaw (2019) analyzed the effect of banking and insurance sector on economic growth in Ethiopia from 1980 to 2018 using VECM technique and found that banking and insurance sector positively influence growth in Ethiopia both in the long run and the short-run. However, the study concluded that the financial sector is still poorly developed. Bist (2018) analyzed the long-run effect of financial development on economic growth on 16 low-income countries from 1995 to 2014. Using fully modified OLS and a Pedroni panel cointegration analyses, the result showed that financial development has a positive effect on economic growth.

Ibrahim and Alagidede (2018) examined the growth effect that will result if a country experiences growth in its financial and real sector using data of 29 sub-Saharan African countries, and the system generalized methods of moments (GMM). From the analysis, financial development support growth but this depends on the real-time growth from both the real and financial sectors.

Fagbemi and Ajibike (2018) analyzed the short and long-run effect of institutional quality on financial development in Nigeria from 1984 to 2015 using the ARDL approach. The result showed that institutional quality does not affect financial development both in the short and long run.
Yousuo and Ekiou (2020) investigated the impact of financial deepening on economic growth in Nigeria for a period of thirty-eight years from 1981 to 2018, with four specific objectives; examining the effects of the monetized, credit, savings and stock markets criteria on the economic growth taking cognizance of the impact of administrative regimes. Time series data were employed sourced from the Central Bank of Nigeria statistical bulletin of 2018 edition, the classical least square of multiple regressions with the application of dummy variable to capture the effects of the various Regimes was adopted in analyzing the data. The results show that financial deepening has both short and long-term effects on economic growth, the estimated regression line is significance as confirm by the f-statistics. The stock market, credit criteria have positive and significant effect on economic growth, savings criteria has negative and significant effects on economic growth, while the monetized criteria have positive and insignificant effects on growth in the short run. The unit root test shows that all the variable data have unit root, the selected processes of financial deepening are the true determinant of economic growth in Nigeria with high degree of effectiveness in the civilian regime.

Aaqib Sarwar, Muhammad Asif Khan, Zahid Sarwar and Wajid Khan (2020) financial development, human capital and its impact on economic growth of emerging countries. This paper aims to investigate the critical aspect of financial development, human capital and their interactive term on economic growth from the perspective of emerging economies. Data set ranged from 2002 to 2017 of 83 emerging countries used in this research and collected from world development indicators of the World Bank. The two-step system generalized method of moments is used to conduct this research within the endogenous growth model while controlling time and country-specific effects. The findings of the study indicate that financial development has a positive and significant effect on economic growth. In emerging countries, human capital also has a positive impact on economic growth. Financial development and human capital interactively affect economic growth for emerging economies positively and significantly. The data set is limited to 83 emerging countries of the world. The time period for the study is 2002 to 2017.

Joshua Dzanka Zoaka and Hasan Gungor (2023) examined effects of financial development and capital accumulation on labor productivity in sub-Saharan Africa: new insight from cross sectional autoregressive lag approach. This study aims to shed light on the effects of financial development and accumulation of capital on the productivity of labor in the sub-Sahara African region within the period of 1990–2018, in this work, used the (dynamic) common correlated effects estimator-mean group and additional techniques such as cross-section autoregressive distributed lag to calibrate the sample into the African subregion to ensure robustness. The findings reveal that financial progress in the region over time leads to an increase in productivity of labor and also the accumulation of capital. Furthermore, financial markets have a progressive impact on the productivity of labor within sub-Saharan African regions. We extend the very limited literature on the nexus between financial development and labor productivity by incorporating capital accumulation into our model which has not been previously studied.

Okoro (2021) attempted to give a better understanding of the type of relationship by analysing post-SAP (Structural Adjustment Programme) time-series data since the notable financial reforms began with SAP in Nigeria. The study employed the Johannsen Cointegration, error correction and granger causality as estimation techniques to determine the nexus between financial deepening and economic growth. The variables contained in the model include the ratio of credit to the private sector to gross domestic product (CPS) which proxy bank-based financial deepening, the proportion of market capitalization to gross domestic product (MCAP) which proxy for stock market development. The result of the analysis revealed that the Nigerian economic growth is influenced by financial deepening positively and significantly, especially the bank-based financial depth.

Akujiobi and Ndugbu (2018) examined the relationship between public expenditure and capital formation in Nigeria, 1981-2018.Adopting the Ordinary Least Square Multiple Regression, the study revealed a significant relationship exists between public expenditure and capital formation in Nigeria. Also, the model indicated that three of the public expenditure components namely, total public expenditure on economic services (TES), total public expenditure on social and community services (TSC) and total public expenditure on transfers (TT) were statistically significant with all the explanatory variables meeting the a priori expectation with their positive coefficients. Based on the findings, the study concluded that public expenditure has positively contributed to the level of capital formation in Nigeria. Akani and Ruth (2020) examined the effect of financial intermediation on Nigeria gross fixed capital formation from 1985-2018 Nigeria gross fixed capital formation was proxy for dependent variables while banking sector credit, banking sector deposit, savings prime lending and maximum lending rates was proxy for independent variables. Ordinary least square methods of cointegration, granger causality test, unit root test and Vector error correction model. The study found that financial intermediation can explain 47.1 percent variation on Nigeria gross fixed capital formation.

Literature Gap

Despite the importance of financial intermediation and economic growth in Nigeria, there is a lack of comprehensive studies that examine the determinants of these processes and their impact on economic growth. This research work is poised to provide an answer in the area of financial intermediation and economic growth using perhaps not used before by previous researchers. By addressing these research gaps, policymakers and stakeholders can develop evidence-based policies and strategies that promote economic growth in Nigeria.

METHODOLOGY

This study used quasi experimental research design approach for the data analysis. This approach combines theoretical consideration (a prior criterion) with the empirical observation and extract maximum information from the available data. It enables us therefore to observe the effects of explanatory variables on the dependent variables. However, for the purpose of this study, the secondary data collection method was used, and the multiple regressions with the use of econometric view were used. The two-tailed test will be used in testing the hypotheses formulated. Secondary data were used in this study. The relevant data used were sourced from the publications of the Central Bank of Nigeria, Economic and Annual Report (various years).

Data Analysis Method

The method of data analysis to be used in this is the multiple linear regressions using ordinary least square method. This approach, which is a quantitative technique, includes table and the test for the hypotheses formulated by using ordinary least square with Econometric View regression analysis at 5% level of significance.

Moreover, in order to undertake a statistical evaluation of our analytical mode, so as to determine the reliability of the result obtained and the coefficient of correlation (r) of the regression, the coefficient of determination (r^2), the student T-test and F-test where employed.

(1) Coefficient of Determination (r^2) Test – this measures the explanatory power of the independent variables on the dependent variables. For example, to determine the proportion of economic growth into our model, we used the coefficient of determination. The coefficient of determination varies between 0.0 and 1.0. A coefficient of determination says 0.20 means that 20% of changes in the dependent variable is explained by the independent variable(s).

(ii) **F-Test:** This measures the overall significance. The extent to which the statistic of the coefficient of determination is statistically significant is measured by the F-test. The F-test can be done using the F-statistic or by the probability estimate. We use the F- statistic estimate for this analysis.

(iii) **Student T-test:** measures the individual statistical significance of the estimated independent variables. At 5% level of significance.

(v) **Regression coefficient:** This measures the extent in which the predictor variables affect the dependent variables in the study.

Model Specification for the Study

RGDP= F (CBC, CBD, TBI, CSCSME) ……(1)

$GDP_t = \beta_0 + \beta_1 CBC_t + \beta_2 CBD_t + \beta_3 TBI_t + \beta_4 CSCSME_t + Et$

Where

RGDP = Nigerian Real Gross Domestic Product proxy for dependent variable.

CBC = Commercial Banks Credit

CBD = Commercial Banks Deposit

TBI = Total Commercial Banks Investment

CSCSME = Credit to Small and Medium Scale Enterprises

Et = stochastic error term, is a surrogate or proxy for all. The Omitted or neglected variables that may affect the predictor variable but are not included in the regression model

β_0 = Represents constant that are estimated which are Not explained by the independent variable

Unit Root Test for Stationarity of Series

This involves testing whether a stochastic process is stationary or non-stationary and the order of integration of the individual series under consideration. Currently, the most accepted method for the testing for unit root is Augmented Dickey-Fuller (ADF) test due to Dickey and Fuller (1979, 1981), and the Phillip-Perron (PP) due to Phillips (1987) and Phillips and Perron (1988). One

advantage of ADF is that it corrects for higher order serial correlation by adding lagged difference term on the right hand side. It relies on rejecting a null hypothesis of unit root (the series are non-stationary) in favor of the alternative hypotheses of stationarity (Engel & Granger, 1987). The tests are to be conducted with and without a deterministic trend (t) for each of the series. For the purpose of this study, the ADF unit root will be adopted and the general form of ADF test to be estimated by the following regression:


.....3


.....4

Where Y is the time series, t is the linear time trend, □ is the first differential operator, α is the constant, n is the number of lags in the dependent variable and e is the random error term.

A-prior Expectation

The variables are expected to have a positive impact on Nigerian gross domestic product.Therefore it is mathematical stated as $\beta_1, \beta_2\ \beta_3\ \beta_4 > 0$.

ANALYSIS AND DISCUSSION

Table 1: Ordinary Least Square Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
TBC	5.938950	1.471785	4.035203	0.0008
TBD	4.260643	1.346335	3.164623	0.0054
TBI	3.846411	1.108546	3.469780	0.0027
CSCSME	3.253627	0.912659	3.564996	0.0022
C	-37142.58	15515.62	-2.393883	0.0278
R-squared	0.838914	Mean dependent var		886.0885
Adjusted R-squared	0.776269	S.D. dependent var		38974.73
S.E. of regression	18435.13	Akaike info criterion		22.72956
Sum squared resid	6.12E+09	Schwarz criterion		23.11667
Log likelihood	-287.4843	Hannan-Quinn criter.		22.84104
F-statistic	13.39161	Durbin-Watson stat		1.769220
Prob(F-statistic)	0.000006			

Source: Extract from E-View Window, 9.0, 2025

The result above shows the result of the estimated regression model in chapter three of this study. The coefficient of determination (R^2) and adjusted R^2 of 0.838 and 0.7762 prove that 83.8% and 77.62% variation in Real Gross Domestic Product can be explained by the independent variables in the model while the remaining 17.2 and 22.48 can be explained by variables not captured in the model. This signifies the important role of the commercial banks in facilitating the realization of economic goals. The F-statistics of 13.39 at the probability of 0.000006 signify the significant of the model in explaining change on the dependent variable. The Durbin Watson of 1.769 is greater

than 1.00 but less than 2.00 which means the presence of negative serial autocorrelation between the variables in the model.

However, the negative coefficient of the regression intercept of -37142.58 shows that without the independent variables, Nigerian economic growth proxied by Real Gross Domestic Product will fall by -37142.58. The β coefficient shows that all the independent variables have positive relationship with the dependent variable which means an increase in any of the independent variables will lead to increase on the dependent variable.

Table 2: Test for Stationarity (ADF) at level

Variables	*ADF Statistics At Level*	*Critical Value at 1%*	*5%*	*10%*	*Remark*
RGDP	*-3.721*	*-3.653*	*-2.957*	*-2.617*	*Non stationary*
TBC	*-2.0251*	*-3.653*	*-2.957*	*-2.617*	*Non stationary*
TBD	*-1.007*	*-3.653*	*-2.957*	*-2.617*	*Non stationary*
TBI	*-1.8005*	*-3.653*	*-2.957*	*-2.617*	*Non stationary*
CSCSME	*-2.589*	*-3.653*	*-2.957*	*-2.617*	*Non stationary*

Critical value: (ADF): 1% = -3.6576; 5% = -2.9591; 10% = -2.6181

Source: Extract from E-View Window, 9.0, 2025

The objective of Augmented Dickey Fuller Test is to examine the stationarity of the variable within the time series. From the result above, the ADF value is greater than the critical values at 1%, 5% and 10%. This means that the variables are non-stationary at level; this means the null hypotheses of stationarity is rejected.

Table 3: Test for Stationarity (ADF) at Difference

Variables	*ADF Statistics At Level*	*Critical Value at 1%*	*5%*	*10%*	*Remark*
RGDP	*-7.289*	*-3.653*	*-2.957*	*-2.617*	*Stationary*
TBC	*-5.228*	*-3.653*	*-2.957*	*-2.617*	*Stationary*
TBD	*-1.535*	*-3.653*	*-2.957*	*-2.617*	*Stationary*
TBI	*-7.329*	*-3.653*	*-2.957*	*-2.617*	*Stationary*
CSCSME	*-5.107*	*-3.653*	*-2.957*	*-2.617*	*Stationary*

Critical value: (ADF): 1% = -3.6576; 5% = -2.9591; 10% = -2.6181

Source: Extract from E-View Window, 9.0, 2025

The objective of Augmented Dickey Fuller Test is to examine the stationarity of the variable within the time series. From the result above, the ADF value is greater than the critical values at 1%, 5% and 10%. This means that the variables are Stationary at level; this means the null hypotheses of non-stationarity is rejected.

Discussion of Findings

Commercial banks plays critical role in the economy. It is the medium for the effective transmission of government monetary policy for the achievement required macroeconomic objective. The effect of banking system transaction on real gross domestic product was x-rayed in this study. It was found that bank investment has positive effect on the growth of Nigerian gross fixed real gross domestic product such that a unit increase in bank investment will increase

Nigerian gross domestic product by 1.4%. This finding is confirming the expectation of the result. Bank investment involves the allocation of financial resources by the banking sector, a prerequisite for effective mobilization of savings investment and economic growth. The insignificant relationship can be traced to ineffectiveness and inefficiencies in the banking sector transaction. It can also be traced to monetary, macroeconomic and fiscal policy shocks in the system. For instance, the global financial meltdown affected negatively the crude oil price in Nigeria, the major source of Nigerian foreign exchange earnings. This affected the entire economy including the banking sector. This finding confirms the statement of Toby (2004) that Nigerian banks are pocket sized banks. This finding is in line with the findings of Ajayi, (2009) who noted that banks are effective in efficient allocation financial resources to deficit economic unit. This finding confirms the various banking reforms which aimed at repositioning the Nigerian banking sector to be an effective player and not a spectator in the financial market (Toby, 2006). The finding also confirms principles, theories and empirical findings. For instance, it confirms the financial intermediation theory as posited by Wolde-Rufael (2009). This finding confirms the findings of Deidda (2006) who posited that effective banking system has positive effect in the growth of the economy through financial intermediation.

The positive coefficient of 0.064 as parameter for bank deposit mobilization implies that bank deposit mobilization is positive but not significant in inducing change in Real gross domestic product such that a unit increase will add only 0.6% to Nigerian real gross domestic product. The insignificant relationship might be as a result of harsh business environment and tight monetary policy that constrain bank investment. It can also be traced to ineffective and inefficient management of bank investment or macroeconomic policies.

The regression result showed that a positive coefficient of 8.070 as shown in the regression result as parameter for bank savings mobilization and 50.887 for bank credit means that there is positive and significant relationship between bank savings, bank credit and real gross domestic product. The coefficient indicates that with 1% increase in the variables, Real gross domestic product will increase by 8.0% and 50.8% as shown in the regression result. This finding confirms the a-priori expectation of the result. It also confirms the financial intermediation theory and economic principles. It is in line with the monetary functions of banking sector. It confirms the banking reforms objective such as the deregulation of interest rate in the last quarter of 1986 (Onoh, 2002, Onoh, 2007), the universal banking scheme in 2001 (Okereke, 2003) and the banking sector consolidation and recapitalization in 2004 (Hao, 2006). This finding is in line with the empirical finding of Christopoulos and Tsionas (2004) who posited that the importance of banking sector in a developing economy remains critical and recommend that Nigerian banks should further be reformed to achieve the macroeconomic goals.

CONCLUSIONS AND RECOMMENDATIONS

Conclusion

The study examined the financial intermediation and Nigeria economic growth. The required data were sourced from Central Bank of Nigeria (CBN) statistical bulletin. It considered Real Gross domestic product as a function of total commercial banks credit, total commercial banks deposit, total commercial banks investment and commercial banks credit to Small and Medium Scale

Enterprises. The coefficient of determination as shown by the regression result shows a strong relationship between the dependent and the independent variables. This was also confirmed by the f-statistics. The regression coefficient indicates that the variables were positively related to Real Gross Domestic Product. The t-statistics and the probability of 0.0022 shows that all the independent variables are significant in explaining change on Real Gross Domestic Product. This finding confirms the a-piriori expectation of the result and the theory of financial intermediation. It is in line with the various policies initiated by Nigerian government to reform and reposition in Nigerian banking industry that will facilitate the realization of Nigerian Economic growth.

From the result, the researcher draws the following conclusions:

i. That Total Commercial Banks Credit has positive and significant effect on the growth of Real Gross domestic product.
ii. Total Commercial Banks Deposit mobilization has positive and significant relationship with Real Gross domestic product.
iii. Total Commercial Banks Investment has positive and significant relationship in inducing change on Real Gross domestic product.
iv. Commercial Banks credit to SMEs has positive and significant effect on the growth of Real Gross domestic product.
v. That the relationship between the financial intermediation and Real Gross domestic product can be explained by 83.8% and 77.62% on the regression result.

Recommendations

From the above, the researcher recommends;

i. Nigerian banking sector should further be reformed and be deepened to enhance its operational efficiency for better increase in the Real Gross domestic product.
ii. The bank business environment such as the political environment, the regulatory, the macroeconomic and the monetary should properly be integrated with the operations of the commercial banks to enhance its operational efficiency in Nigeria economic growth.
iii. There should be full deregulation of banking operations such as interest rate to enhance effective allocation of financial resources by the banking sector.
iv. The regulatory authorities such as the Central Bank of Nigeria (CBN) should partner with the banking sector to enhance effective resource mobilization and allocation in Nigeria.

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