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PROFITABILITY OF COMMERCIAL BANK ON INTEREST RATE DEREGULATION

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ABSTRACT

This study focuses on impacts of deregulation policy of interest rate on the profitability of commercial bank, which will create competition among conventional financial institution for their traditional activities of banks (Deposits, loans and other financial institutions activities). The demand and supply will increase to encourage fund mobilization based on interest rate. Sanity becomes significant in the financial institution as utilization of fund is been judiciously encouraged and invests it to the most profitable ventures. The study explored the survey questionnaire by selecting five financial institutions and distributes twenty (20) questionnaires for each financial institution to their respective managers (experts) for their input. The simple description analysis and correlation were considered for variables comparison to achieve the research objectives. The research findings indicate that the deregulation significantly contributed to the profitability of commercial financial institution and promote competition among their counterpart. The study also reveals that the deregulation in interest rate leads to an increase in profit maximization. The study recommended the changes in the discount rate will reflect a stipulated range depending on how monetary policy pursued and the relation of a current market economy with interest rate, the sufficient control of the institutions and regulatory bodies to ensure the forces driving the economy as adequately managed and controlled.

Contribution/Originality: This study contributes to the existing literature on the interest rate deregulation. The study uses a new estimation methodology as a structural survey questionnaire which used correlation and descriptive analyses. The study is one of the very few studies based on deregulation of the interest rate on commercial bank.

1. INTRODUCTION

Before the introduction of market base policy in 1987, the interest rate management was controlled by the Central Bank of Nigeria, which restricted the minimum and maximum savings rates of lending for financial institutions. After the introduction of market policy banks were allowed to run their activities based on negotiation with customers, the banks were also directed to pay interest on current account deposits by the Central Bank of Nigeria on the deregulation context of the framework. This, obscure the indirect negotiation between the customers and their banks based on the payable interest rate for special purpose deposit held between stipulated periods of time. However, assurance of exploitation on customers is totally expelled, the Central Bank of Nigeria has directed the implementation of reducing balanced method and should be considered and applied on loan charges based on installment agreed payable. The Minimum Rediscount Rate (MRR) continued to regulate the fixed charges by the Central Bank in line with overall economic conditions. For example, MRR in August 1987 fixed the rate at 15% by December 1987 was reduced to 12.7% with the aim to improve the stimulation investment and attract a Foreign Direct Investment followers and sound monetary policy (Vaghefi *et al.*, 1991).

The MRR raised flexible interest rate to 13.2% in occurrence of flexible policy in 1989, in same year, the Central Bank of Nigeria (CBN) developed Treasury bill and Certificate (Securities), under the system that authorized dealers' submission of competitive bids that issued rate emerge. Lack of deposit and lending structure concurred the immense responsiveness in market fundamentals which manifested in 1990 declined of inflation that forced the authorities to fix a minimum spread between the cost of commercial funds and merchant fund for their maximum lending rates. Therefore, the banks were directed to ensure the minimum deposit rate of 13.5 and lending rate at 21%. The banking considered that as obviously against the government deregulatory posture, however, the reported rate considered within the guideline and was sufficient to prove the essential rate as higher as the policy was largely sideline, and that was removed January 1992 (Hien and Hanh, 2013). In 1993 the policy was retained in the course of interest rate only volatile and distorted it and raised unpredicted levels. The interest rate behavior was traceable under these factors. The high arising of domestic inflation resulted in huge fiscal deficit of the Federal Government which Central Bank of Nigeria financed. The interest rate deregulation conferred on the arbitraging activities of the market speculation. The insolvency in cash flow distress borrowing resulting to the weak banking, the system allocation, foreign exchange on both sterilization and Indus of a large fund at the CBN. In 1993, high interest prevailing, discourage investments and productive spirit of the economic and the volatile interbank undermined the efficiency of free market activities and steadiness of financial system. In 1994, major regulations were reintroduced in the management of interest rate due to the vast variation of high rate; this policy was maintained and reconsiders some modification for flexibility. Furthermore, the situation remains in 1996 and 1997. The regulation of interest rate resulted widening the deposited interest gap under the Structural Adjustment Program (SAP). However, some financial institutions argument that the cost of funds will be rising consider payable gap interest rate is not tenable as witness 1989, as regards the payment of current account of the interest rate deposits, financial institutions welcome ideas on competing to mobilizing deposits as objectives deregulation of interest rate under (SAP).

2. LITERATURE REVIEW

Interest rates are the crucial element in the transmission of Monetary Policy Action for both economics and banking activities, Adeniran *et al.* (2014). The interest rate in Nigeria has changed for example within the time frame of the regulated and deregulated regime. However, the impact of this variable on both the banking sector and economy remain controversial (Acha, 2011). According to Keynes (1923) an interest rate is a reward for not hoarding but for parting with liquidity for a specific period of time. This definition is more focused on the lending rate. Adebiyi (2002) an interest rate is a reward or yield on equity or opportunity cost of deferred current consumption into future. Lerner and Jhingan (2003) interest rate as the price which equates the supply of " credit" plus the net increase in the amount of money in the period, to the demand for "credit" plus the net hoarding in the period. Ibimodo (2005) defined interest rate as the rental payment for the use of credit by the borrower and the return for parting with liquidity by the lender. defined interest rate as the real interest rate at which inflation is stable and the production gap equal to zero. However, Allen (1977) state that the interest rate is charged based on reason, but one is to ensure that creditor lower his or her exposure to inflation. Inflation causes a nominal amount of money in the present to have less purchasing power in the future. Wurgler (2000) said that interest rate deregulation leads to more efficient allocation in the financial market. Gan (2007) stated that lending policy affects commercial bankability to grant a loan. Amassoma *et al.* (2011) indicate that deregulation affects the bankability to grand loan.

2.1. Management of Interest Rate

In 1962, the interest rate was introduced an instrument of monetary policy after the introduction of the monetary market; interest rate was made competitive to ensure repatriation in and abroad. Furthermore, the high government borrowing at that time reduced to the minimum cost of public debt. In the 1960s, interest played a significant and dominant role in enhancing and managing the monetary policy of the Federal Government. Therefore, the Structural Adjustment Programmed (SAP) was introduced with comprehensive economic restructuring in 1968. However, the government emphasized the reliance of market forces, which imitated some resolution reforms to structural amendments of monetary policy. The interest rate and foreign exchange were both important in market liberation and the financial institution sector (Fischer, 1997). The interest rate has an important role in managing monetary policy as one of the instruments uploaded by the Central Bank of Nigeria that was based on two assumptions; regulation of the interest rate and partial deregulation as interest rate remained one of the instruments of monetary policy of the Federal Government Annual Budget document or the monetary/credit policy circular of the Central Bank of Nigeria from time to time. In August 1987, the Central Bank of Nigeria liberalized the interest rate regime and adopted the policy of fixing only its Minimum Rediscount Rate (MRR). This was however modified in 1989 when the Central Bank of Nigeria CBN issues a further directive on the required spread between deposit and lending rate (Therrell *et al.*, 2012). Partial deregulation was restored in 1992 when financial institutions were required to only maintain lending rates. The central bank of Nigeria announced the removal of maximum lending in 1993, the inflation interest rate started rising to an unprecedented level, which made the banks lending rate high and volatile that led to the fiscal deficit of the government and rose of inflation (Frankel, 1979). However, the policy to maintain money in circulation is the prior objective that economic growth targeted and maintains the level of interest rate and inflation required. In 1997, the policy of interest rate deregulation retained. Then, the beginning of the year was stabled in rate that abolished the statement undermined the power of interest rate fallen that also contributed declined deposit rate in the commercial banks from the 10.1% percent to 7.5% and later to 5.6% at the end of April 1997 (Fung and Hsieh, 2000). The monetary and other financial system policies were created to manage and maintain the internal and external balance of financial institution and lead to the primarily maintain inflation rate at single digit in order to achieve the objective. Similarly, monetary policies focused on dealing with excess liquidity and enhancing the viability of the sector as well as the stability of the financial system. Other important objectives of deregulation of interest rate enhancement growth of the economy and drastically reduced unemployment. According to Central Bank of Nigeria (1978) rated the financial performance indicated deposit lending rate fluctuates downwards and liquidity beetle in the financial institution with the reduction percentage of 18% to 14%, liquidity ratio from 40% to 35% and Cash Reserve Ratio (CRR). On 5th June 2007, the Monetary Policy Committee (MPC) reviewed the major development and implementation of monetary and fiscal as well as challenges of exchange rate policies in microeconomic performance and satisfaction

2.2. Classical Theory of Interest Rate

According to the classical theory of interest rate is determined fork circle of the investment demand and saving schedule. This is disclosing the connection between saving and investment to the relation of interest rate. Similarly, the solution to the saving and investment were varied to a level of real income and a solution that will not be, if the investment opportunity is not there. Keynesian, attack the classical theory of interest rate by signifying the ground of undetermined from the income rise, while the saving schedule will shift to another direction. Hence, the determination of the rate of interest will not be, unless the income level is been specified and also the rate of interest, since a lower interest rate attract the larger volume of investment but a higher level of real income, the classical theory fails to offer a solution.

2.3. The Keynesian Theory of Interest Rate Determination

This theory posits that "the rate of interests determined by the intersection of the supply schedule of money and the demand schedule for money. However, this analysis is also undetermined because the liquidity preference schedule will shift up or down with a change in the income level". Thus, money supply and the demand scheduled cannot give the rate of interest unless we already know the income level hence, the same criticism of indeterminacy Keynes leveled against the classics is applicable to his theory.

2.4. The Loanable Theory of Interest Rate Determination

According to the loanable funds' theory of Dennis H Robertson, "the rate of interests is determined by the intersection of the demand and the supply schedule of the loanable funds. Here, the supply schedule is compounded of saving plus net addition to loanable funds from the new money and the dishoarding of the idle balance". However, since the saving portion of the schedules varies with the level of disposable income, it fellow that the total supply schedule of loanable funds also varies with income.

2.5. Neo Classical Theory of Interest Rate Determination

In the Pigouvian statement, "The interest rate is determined by the intersection of demand schedule of money and the supply schedule of saving". Here the pertinent supply booked is imagined as far as sparing out of current income, i.e. the abundance of aggregate pay from services in accommodating utilization. Accordingly, income, utilization, and saving, all apply to a similar period, be that as it may, regardless of whether current income bolstered in past from infusion of new money from the viewpoint of the Pigouvian or neoclassical definition. That is income whether it springs from the spending of assets obtained from bank credit assumed a job during the time spent in income creation. In this manner, in the neoclassical or Pigouvian theory 'reserve funds' is in actuality indistinguishable thing from loanable assets thus similar reactions apply to them.

3. METHODOLOGY

Data for this study were accessed from the primary data through the field survey using a structured questionnaire as a major research instrument. On the other hand, were obtained from relevant stakeholders and expertise in the field of financial institutions for the data collection. As a result of the inability of the researcher to effectively study the whole bank under study, a representative number was chosen as the sample size population. One hundred (100) people were used as the sample size. Some number of individuals were been selected from the five (5) different banks (Gtbank, First Bank, Access Bank, Unity and Union Bank) and 20 respondents from those banks, which they were classified as expert in the field. One hundred (100) questionnaires were considered as the sample size of the populations.

3.1. Method of Analysis

The data collected was efficiently analyzed for easy management and accuracy. Similarly, the analytical tools used for the research was descriptive and correlation those were used to justifies the relationship between the variables as predicted and also reached conclusion for determining the critical value of the research.

4. DATA ANALYSIS, FINDING AND DISCUSSION

This section explored the study presentation and analysis of the research result as gathered through questionnaires. The data collected from the research were arraigned based on the need and description of the study. The demography and correlation information was presented in the section as adopted to test the research questions.

4.1. Demographic Analysis

Table-1. Gender of respondents.

Gender	Frequency	Percentage	Valid percent	Cumulative percent
Female	69	69.7	69.7	69.7
Male	30	30.3	30.3	100.0
Total	99	100.0	100	

Source: Author Designed.

The Table 1 shows in gender distribution of the respondent used for this study. 69 respondents represent 69.7percent of the population are female while the remaining 30 respondents represent 30.3 percent of male.

Table-2. Deregulation of interest rate has something to do with bank profit.

Stage of Acceptance	Frequency	Percent	Valid percent	Cumulative percent
Strongly agree	39	39.4	39.4	39.4
Agree	50	50.5	50.5	89.9
Undecided	2	2.0	2.0	91.9
Disagree	3	3.0	3.0	94.9
Strongly disagree	5	5.1	5.1	100.0

Source: Author Designed.

The Table 2 shows that deregulation of interest rate has something to do with bank profit. 39.4 percent have strongly agree that deregulation of interest rate has something to do with the bank profit 50.5 percent agree that as stated by Therrell *et al.* (2012). Reported that the all control on interest were removed this indicate that desired interest rate will charge by the bank to get profit. 2.0 percent were undecided 3.0 percent have disagree that deregulation of interest rate has something to do with bank profit. And 5.1 percent have strongly disagree that deregulation of interest rate has something to do with the bank profit.

Table-3. Deregulation of interest rate has increase the commercial bank profit.

Stage of Acceptance	Frequency	Percent	Valid percent	Cumulative percent
Strongly agree	49	49.5	49.5	49.5
Agree	25	25.3	25.3	74.7
Undecided	5	5.1	5.1	79.8
Disagree	10	10.1	10.1	89.9
Strongly disagree	10	10.1	10.1	100.0
Total	99	100.0	100	

Source: Author Designed.

The Table 3 shows that deregulation of the interest rate has increase the commercial bank profit. 49.5 percent strongly agree that the deregulation of the interest rate has increased the commercial bank profit. 25.3 percent agree that deregulation of the interest rate has increased the commercial bank profit. Amassoma *et al.* (2011) interest rate deregulation lead to more efficient allocation in financial market which also is in the view that it increase the commercial bank profit. 5.1 percent were undecided. 10.1 percent have disagree that deregulation of the interest rate has increase the commercial bank profit. 10.1 percent have strongly disagreed that the deregulation of the interest rate has increase the commercial bank profit.

Table-4. Lending policy affects the commercial bank ability to grant loan.

Stage of Acceptance	Frequency	Percent	Valid percent	Cumulative percent
Strongly agree	49	49.5	49.5	49.5
Agree	30	30.3	30.3	79.8
Undecided	5	5.1	5.1	84.8
Disagree	10	10.1	10.1	94.9
Strongly disagree	5	5.1	5.1	100.0

Source: Author Designed.

The Table 4 that lending policy affects the commercial bank ability to grant loan. 49.5 per cent strongly agree that lending policy affect the commercial bank ability to grant loan. 30.3 percent agree that lending policy affect the commercial bank ability to grant loan. 5.1 percent were undecided, according to Chodechai (2004) as stated that lending policy affect the commercial bank ability to grant loan because interest will be charge based on stated lending rate which affect the bank ability to grant loan. 10.1 percent disagree that lending policy affect the commercial bank ability to grant loan.

Table-5. Interest rate deregulation affects the bank ability to grant loan.

Stage of Acceptance	Frequency	Percent	Valid percent	Cumulative percent
Strongly agree	39	39.4	39.4	39.4
Agree	50	50.5	50.5	89.9
Undecided	2	2.0	2.0	91.9
Strongly disagree	5	5.1	5.1	97.0
Disagree	3	3.0	3.0	100.0

Source: Author Designed.

The Table 5 shows that interest rate deregulation affects the bank ability to grant loan. 39.4 percent strongly agree that interest rate deregulation affects the bank ability to grant loan. 50.5 percent agreed that interest rate deregulation affects the bank ability to grant loan (Amassoma *et al.*, 2011) says that expert agree while other disagree like Ojo (1988) indicated that deregulation affect the bank ability to grant loan, this is because once interest rate was left uncontrolled it will lead to increase in profitability by charging high rate of interest.

Table-6. Government policy on commercial bank affects its ability to grant loan.

Stage of Acceptance	Frequency	Percent	Valid percent	Cumulative percent
Strongly agree	39	39.4	39.4	39.4
Agree	30	30.3	30.3	69.7
Undecided	15	15.2	15.2	84.8
Disagree	10	10.1	10.1	94.9
Strongly disagree	5	5.1	5.1	100.0

Source: Author Designed.

The Table 6 shows that government policy on commercial bank affects its ability to grant loan. 39.4 percent strongly agree that government policy on commercial bank affects its ability to grant loan. 30.3 percent agree that government policy on commercial bank affects its ability to grant loan. Allen (1977) deregulation of interest rate will cut down borrowing as interest rate will be high, this affects the bank ability to grant loan, 10.1 percent disagree that government policy on commercial bank affects its ability to grant loan. 5.1 percent disagree that government policy on commercial bank affects its ability to grant loan.

Table-7. Government policy on commercial bank should be encouraged.

Stage of Acceptance	Frequency	Percent	Valid percent	Cumulative percent
Strongly agree	49	49.5	49.5	49.5
Agree	15	15.2	15.2	64.6
Undecided	15	15.2	15.2	79.8
Disagree	10	10.1	10.1	89.9
Strongly disagree	10	10.1	10.1	100.0

Source: Author Designed.

The Table 7 shows that government policy on commercial bank should be encouraged. 49.5 strongly agreed that government policy on commercial bank should be encouraged. 15.2 percent agreed that government policy on commercial bank should be encouraged. 5.2 were undecided. 10.1 percent disagree that government policy on commercial bank should be encouraged.

Table-8. Matrix Correlation Result indicating the relationship between the variables.

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Sex	1								
Age	.877**	1							
Academic qualification	.585**	.713**	1						
Deregulation of interest	.623**	.836**	.625**	1					
Deregulation of interest increase commercial bank	.858**	.948**	.691**	.823**	1				
Leading policy affect commercial bank	.795**	.922**	.683**	.858**	.970**	1			
Interest rate deregulation ability to grant loan	.629**	.840**	.644**	.991**	.826**	.854**	1		
Government policy on commercial bank	.869**	.949	.725**	.888**	.933**	.942**	.889**	1	
Government policy on bank should be encouraged	.872**	.939**	.741**	.818**	.976**	.956**	.824**	.937**	1

Source: Designed by the Author. The level of the acceptance base on the table above is 0.7> and above, anything below <0.6 will be rejected.

The Table 8 shows the result of the correlation of the research variable which used to test the significant correlation between the variables on each other. The level of the acceptance based is 0.7 and above while anything below 0.6 is rejected.

Deregulation of interest rate has something to do with bank profit and Lending policy affects the commercial bankability to grant loan and decision shows the significant correlation between the two variables in the research since the level of the significance is 0.85 which is greater than >0.6 level of the rejection.

The correlation between Government policy on commercial bank should be encouraged the deregulation of the interest rate has increased the commercial bank profit. However, the decision indicates the strong relationship between the two variables at the high level of significance of 0.97 which is greater than the 0.6 rejection level. Age of the respondents with their academic qualification of the respondents indicates the strong correlation between the age of the respondents with their academic qualification since the level of the significance is 0.71 which is greater than 0.6 level of the rejection and that show the level of awareness of experts with the policy and activities of financial institutions.

4.2. Discussion

This study examined the impact of the profitability of commercial bank in Nigeria on interest rate deregulation, the author used simple percentage to analyze the research variable and also correlation was used to test the significance of the variable relationships. This study was made to check whether the commercial bank is earning profit from the market base interest rate, this is due to the fact that before 1986 the rate of interest on both the lending and deposit was regulated by the government, which commercial bank has no power on the interest rate determination. But after the deregulation of 1986, the rate to be given and the rate to be charged was based on force in the market.

The researcher used the appropriate method to determine and analyses the outcome, the research also reveals that 69% of the respondents are male and which are actively participating in the banking activities and the business that in the one hand or the other has relationships with bank profit on deregulation policy period. It has also observed that the respondent have to see both the era of the regulation and the deregulation of the interest rate which reveal that commercial bank earned profit more during the deregulation of the interest rate because their ability to grant loan has increased.

In addition, it has also agreed that deregulation of the interest rate has something to do with bank profit, this is suggesting that commercial bank is earning more profit only during the deregulation period of the interest rate (Therrell *et al.*, 2012) when all the control were removed, commercial bank will gain profit, this is because all restriction by the government was removed which lower the profit of the bank. With the deregulation of the rate of interest, then the bank will charge interest base on the level of saving and lending, this proves that deregulation has contributed to the profit of the commercial bank. It has also been observed that deregulation of the interest rate has increased the commercial bank profit, in the sense that the rate of interest will now be determined by the market force. Government intervention will be all removed so that the commercial bank will increase the fund by raising the interest on saving so that it will have more to lend to the businesses will, in turn, raise its profit. Nwankwo (1989) shows that deregulation leads to more efficient allocation in the financial market which also increase the commercial bank profit, this is also evident that 70% of the respondents agreed that deregulation gas increases the bank profit.

The regulation period of interest rate was not beneficial to the commercial bank this is because all the interest rate to be charge are determined by the government authority, Gan (2007) also stated that lending policy by government affect the bank to grant loan, since bank will not be in the position to grant loan due to such restrictive policy on the interest, the commercial bank profit is very low, this is also from the research that 79% agreed that government policy reduced the bank profit.

This deregulation of interest rate has serious positive effect on the profit made by commercial bank because deregulated rate of interest encourage rate of interest on saving and also lending rate will be raised to make profit from the fund given out for loan, Ojo (1988) shows that when interest rate was left to be determined by market, then the bank will charge high-interest rate which will positively increase the profit of commercial bank. It has witnessed that any attempt by the government to control the rate of interest will negatively lead to falling down on interest which will affect the profit of the commercial bank. Emphasis should be made on deregulation which enhances the business environment to grow and led to an increase in the bank profit.

We can expect that deregulation has a large impact on the real economy only if there are important changes in the structure and efficiency on the banking industry resulting from the reform .although the key changes are as fellows; relaxing the restriction on the bank and expansion of the led to larger bank operation across the country. Following such idea of deregulation, we can see that under the deregulation, commercial bank profit increasing more and more but within the regulation period, the commercial bank is earning a low profit when compared to the deregulation period of the interest rate.

5. CONCLUSION

Based on the study finding, we have seen how deregulation of interest rate contributed to the commercial bank profitability. So the researcher hereby concludes that interest rate deregulation has contributed reflectively to the profitability of the commercial bank. It has also engendered competition in the midst of the bank and other institution of deposit. Saving enlistment has been encouraged through demand and supply that resolute the interest rate. Perhaps, it's induced the financial institution to spring for idle funds, and sending to deficit area to gingered loan in advance. Sanity is been encouraging in some bank area as they are now beat on sensible used of this available funds and hence allocated to most profitable venture.

The research recommended for further research on deregulation on commercial banking under time series, granger causality and financial reports on banking sectors.

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