Effect of monetary policy instruments on commercial banks rural financing in Nigeria

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Abstract: The level of Nigerian Commercial Banks Credit availability to Rural Customers with the influence of Monetary Policy Instruments motivated this study. The study examined the relationship between Monetary Policy Instruments and Rural Financing by Commercial Banks in Nigeria. The main objective of this study is to investigate the effect of Monetary Policy Instruments on Commercial Banks Rural Loans. Regression analysis was used to analyze the data collected. Data were sourced from the Central Bank of Nigerian Statistical Bulletin. Findings revealed that the correlation coefficient was positively correlated. Findings also revealed that there is no significant relationship between Monetary Policy Instruments and Commercial Banks Rural Loans. The study concluded that the availability of credit to rural bank customers was affected by monetary policy instruments during the analysis period. The study therefore recommends that Commercial banks' lending rate should be reduced in order for investors to see commercial banks as number one source of finance, Central Bank of Nigeria should increase the minimum reserve of Commercial banks in order to facilitate an adequate credit to commercial banks customers/ investors, Commercial banks should promote a higher level of liquidity to increase their ability to cover withdrawals from their clients and to increase loans and advances to clients.

1. Introduction

Deposit mobilization is one of the main functions of bank financial institutions all over the world. This is the collection of funds or cash from the public by a bank financial institution using its savings accounts, current accounts, fixed accounts, recurring accounts and other specialized arrangements. According to Duguma and Han (2018), deposits are the least expensive and most readily available source of funding compared to other forms of funds.

Deposit services are important to consumers, financial institutions and local economies. For clients, it provides relatively safe deposit services that meet the demand of many poor people on a continuous basis. For financial institutions, taking deposits can be an essential part of financial sustainability. The success of banking and economic growth and development depends to a certain extent on deposit mobilization. The mobilization of deposits plays an important role in the provision of satisfactory services to different sectors of the economy (Hao, 2006). However, the capability of banks to stimulate growth and economic development is dependent on the health, soundness and stability of the banking system itself.

According to Adewole et al. (2022), bank deposits and bank credit are closely linked and represent, in ordinary terms, both sides of the same coin. Ogege and Boloupremo (2014) argued that a commercial bank is a for-profit company that handles money and credit. It is a financial institution that traffics money in the sense that it takes deposits of money from the public to keep them in its custody to keep it safe. So also, it deals in credit, i.e., creates credit by making advances on the funds received as deposits for those in need It In this way, it acts as a catalyst for savings in the economy.

In Nigeria, virtually all bank financial institutions, particularly commercial banks, are concentrated in urban areas, while only a few branches are located in rural areas, and this has limited their savings mobilization and credit function in the domains. The CBN Statistical Bulletin (CBN, 2020) indicates that the number of commercial banks in urban areas increased from 1,466 in 2000 to 2,765 in 2005. while those in rural areas remained 722 from the year 2000 to 2005. This means that poor households in rural areas continue to be underserved by financial services and the potential demand for rural loans remains unmet. In addition, all businesses, including small and medium-sized enterprises (SMEs), face funding challenges. For this reason, mobilizing deposits and guiding them towards the most productive ends is the main challenge, and this requires effective and efficient mobilization of deposits and loan disbursements of rural branches of commercial banks. Despite the series of strategies developed to meet the financial needs of rural populations through the rural branches of commercial banks in Nigeria, business people in rural areas still lack funding.

Monetary policy uses a variety of monetary instruments to monitor the economy, inflation, exchange rates with other currencies and unemployment. However, the services of commercial banks with regard to the granting of loans and advances may be determined by the performance of monetary policy instruments; these instruments affect banks' performance in providing loans to their deficit clients. Through these instruments, the Central Bank monitors the volume of money supply, the level of interest rates, the prices of securities, the availability of credit and the liquidity creation of commercial banks. Ajie and Nenbe (2010) observed that bank reserves are controlled by the Central Bank through its different instruments of monetary policy. The instruments include the cash reserve requirement, liquidity ratio, open market operations and primary operations. They

influence bank operations and their capacity to generate sufficient liquidity and additional funds, thus affecting the cost and availability of loanable funds.

The purpose is to assess the effect of Monetary Policy Instruments on Commercial Banks Rural Loans. The question formulated to guide this study states that what is the relationship between Monetary Policy Instruments and Commercial Banks Rural Loans? The hypothesis of this study was presented in a null form which states that there is no significant relationship between Monetary Policy Instruments and Commercial Banks Rural Loans.

2. Literature review

There are many types of loans; a short-term loan is a form of rural credit that is taken to hold a brief private or business capital requirement. It is this type of credit that requires that an amount of borrowed capital and a percentage of interest be paid back on a certain date, A short-term loan is an attractive but costly option, particularly for small businesses or primarily for start-ups that still do not qualify for a bank line of credit. Medium-term loans are loans with a repayment period of two to five years; or less than 10 years. Medium-term loans are a great option for small businesses looking for traditional credit with a fixed repayment period and prepayments. The amount of the loan an individual receives may differ based on their cash flow, credit rating, and various other factors. The repayment period of the long-term loan is usually 5-20 years or even longer in some exceptional cases.

In any enterprise, long-term finance is critical to creating permanent assets that will return over time. Particularly in the agriculture sector, long-term investments include land leveling, fencing, drilling wells, permanent repairs on land, acquisition of heavy machinery such as tractors, etc. All the long-term investments suggested above need large amount of funds. Although they have considerable potential to give profits in the future private farmers cannot afford to make such expensive investments because they have few or no savings.

The performance of the loans revolves around the extent to which the loans paid by the banks are paid back at maturity. This consist of the repayment of the principal amount involved in the loan and the ability of the borrower to service the loans through the payment of interests and other bank charges, which might have been stated in the loan covenant. These principal repayments as well as interest at maturity are key indicators to determine if the loan is performing or not. Various countries around the world and Nigeria in particular have developed different methods of loan classification and have charged different bodies of the banking sector with the responsibilities of keeping the loans within the acceptable limits set by the regulatory authorities such as Central bank of Nigeria (CBN), Nigerian Deposit Insurance Corporation (NDIC) and Assets Management Corporation of Nigeria (AMCON). However, there are risks associated with lending that affecting loan performance.

According to Shavshukov and Zhuravleva (2023), National and International Financial Market Regulation and Supervision SystemsRisk is the possibility that events, expected or unexpected, may have a negative impact on the bank's profits or capital. These risks include credit, interest rate, foreign exchange, liquidity, price, transaction, compliance, strategic, and reputation. Furthermore, banks with transnational operations outside their headquarters face two additional risks: country risk and transfer risk. These risks are not mutually exclusive as any loan product or service can put the Bank at multiple risk.

Moreover, the performance of a loan or otherwise may be determined by the credit portfolio classification scheme. Banks are still able to categorize their individual loan and loan portfolios as active, substandard, doubtful and loss loans in order to monitor and manage the credit risks in the said loans. According to World Bank (2010), defines loan classification as the process by which banks review their loan portfolios and allocate loans to categories or categories based on perceived

risk, and other relevant characteristics of the loan. It also stresses that the process of ongoing review and classification of loans enables banks to monitor the quality of their loan portfolios and, where necessary, to take remedial action to counter deterioration in the credit quality of their portfolios.

In Nigeria, according to the Central Bank of Nigeria Prudential Guidelines for Deposit Money Banks in Nigeria (CBN, 2010) describes the classification of loans as active Loanable Fund Theory was developed by Dennis Robertson and Bertil Ohlin during the 1930's. The loanable fund is a theory of market interest rate. According to the theory, interest rate is determined by the demand for and supply of loanable funds which consist of all forms of credit, such as loans, savings deposits or bonds. The promoters claim that the provision of a loan fund comes from companies or individuals who want to save, and they are the lenders. While the demand for a loan fund comes from investors or entrepreneurs who want to invest or purchase capital assets, and they are the borrowers. That is in the market, some supply loanable funds while others borrow. Moreover, the loanable funds principle extends the classical theory, which determined the interest rate solely by saving and investment, in that it adds bank credit. The total amount of credit available in an economy may be greater than private savings because the banking system is able to create credit from scratch. Thus, the equilibrium interest rate is affected not only by the propensity to save and invest, but also by the creation or destruction of fiat money and credit. It thus follows that if the bank system enhances credit, it will at least temporarily diminish the market interest rate below the natural rate. The loanable fund theory was accepted for having provided an explanation on the determinants of interest rates, bank lending and investment as well as on the real performance of the sector (Asuqou and Ibiyingibo, 2021).

Alshebami et al. (2020) examine deposits mobilization, lending behavior and investments in the Saudi banking from 2009 to 2018. The study employed statistical model (Correlation, Regression, and ANOVA) and the intelligent model (Artificial Neural Network Practical Swarm Optimization, ANNPSO). The statistical model results revealed that a positive and significant relationship was established not only between banks investments and the mobilized deposits but also between mobilized deposits and customer's loans & advances. While intelligent model results of the study established a strong positive relationship between banks investments, customer's loans & advances, and mobilized deposits. The study found that there is a very strong relationship between study variables and outcomes.

In another study, Getachew (2017) studied the determinants of deposit mobilization in commercial banks in Ethiopia through various statistical tools. The findings of the study showed that factors such as bank profitability, credit risk and exchange rate have a significant relationship with the growth of bank deposits. Though, loan to deposit ratio (LDR) and money supply (MS) have a negative relationship with bank deposit growth.

In the work of Akuma et al. (2017), they look at credit risk, the mobilization of deposits and the profitability of Ghanaian banks. The study adopted Panel regression analysis. Dependent variable includes Return on Asset while deposit mobilization, total asset of bank, non-performing loan ratio, capital adequacy ratio inflation and growth in interest income are the independent variables. The result showed a significant positive relationship between deposit mobilization, credit risk, capital adequacy ratio, interest revenue growth and profitability of Ghanaian banks. However, the study did not conduct analytic tests such as multi collinearity and normality test.

In a similar study, Ladime et al. (2013) examined the determinants of bank lending behaviour in Ghana. The study revealed that banks that have high deposits and loans are more profitable than banks that have low deposits and loans.

Mamo (2017) conducted a study on the determinants of deposit mobilization in Ethiopian commercial banks. The study employed multiple linear regression. The independent variables are branches, competitors, loan and interest while dependent variable was total deposit. The results of

the analysis indicate that branch expansion, the provision of loans and the number of clients have a significant positive impact on deposit mobilization.

Diagne and Zeller (2001), empirically, examined the determinants of commercial banks' lending behavior in Nigeria. The results showed that the volume of deposit, investment portfolio, cash reserve ratio, liquidity ratio and interest rate has a relationship with loan and advances in the commercial banks in Nigeria.

Alshatti (2015) examined the effects of certain bank management ratios on rural lending and small enterprise finance in Nigeria. The study covered the period 1992-2007 using secondary data from CBN statistical bulletin and analyzed with the Software Package for Social Sciences (SPSS). The results revealed that significant positive relationship exists between rural loan-to-deposit ratio (RLTDR) and aggregate loan-to-deposit ratio (LTDR). The bank management variables (LR, CRR & LTDR) varied negatively with the ratio of loans to SMEs (RLSMEs). The study concludes that there is no evidence that the banks are facing the problem of information asymmetries through improved relationship lending to the SMEs in Nigeria. It therefore recommends that monetary policy should focus on compliance with prudential standards by restoring the mandatory credit allocation regime in rural areas& SME sectors and deepening the rural financial system.

2.1. Economic Growth Theory

Some of these existing growth models are Two-Gap Model, Marxian Theory, Schumpeterian Theory, and Harrods - Domar Theory of Growth, Neo-Classical Model of Growth, and Endogenous Growth Theory. The growth models relevant to this are Neo-Classical Model of Growth, and Endogenous Growth Theory, since these growth models explain the situation in developing economies such as Nigeria. The neo-classical model of growth was first devised by Robert Solow. The model believes that a sustained increase in capital investment increases the growth rate only temporarily.

The Solow equation gives the growth of the capital-labour ratio, k (known as capital deepening), and shows that the growth of k depends on savings $sf(k)$, after allowing for the amount of capital required to service depreciation, k, and after capital widening that is, providing the existing amount of capital per worker to net new workers joining the labour force, nk. That is

$$\Delta k = sf(k) - (\delta + n)k \tag{1}$$

3. Methods

Ex-post facto research design was adopted in this study. Time Series Annual data on Monetary Policy Instruments and Commercial Banks Rural Loans from 2000 – 2020 were extracted from statistical bulletin of CBN (2020). The reason for chosen year 2000 – 2020 is to investigate the ability of commercial banks in the area of rural financing during pre and post bank consolidated era in Nigeria. Inferential statistics (i.e., parametric statistics) method of data analysis was adopted, such as regression analyses. Statistical Package for Social Sciences (SPSS) was used to present the results.

3.1. Model specification

To achieve the objectives of this study, the model concentrates on rural credit performance equation (Eq.2). The model is based on Solow's equation from the literature review's growth model (Solow, 1956).

$$\text{TRC} = \alpha_o + \alpha_1 \text{LR} + \alpha_1 \text{CRR} + \alpha_1 \text{DR} + \alpha_1 \text{BR} + e_1 \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots(2)$$

Where:

- TRC - Total Commercial Bank Credit: The total available credit that goes to a company or individual rural bank customers through commercial bank. It alludes to total sum of money that financial institutions are prepared to loan to a person or company.
- LR - Liquidity Ratio: This is the class of financial metrics used to determine a company's ability to pay off its short-terms debts obligations. Generally, the higher the value of the ratio, the larger the margin of safety that the company possesses to cover short-term debts.
- CRR - Current Reserve Ratio: This is a specified minimum fraction of the total deposits of customers, which commercial banks have to hold as reserve either in cash or as deposits with the central bank. CRR is set according to the guidelines of the central bank of a country.
- BR - Bank Rate: This bank's lending rate most closely meets up with private sector's requirements for loan funding.
- α_i - Regression Coefficients;
- e_i - Error term.

Deposit ratio is a commonly used statistics for assessing banks liquidity by dividing the banks total loans by its total deposits. This number is expressed as a percentage. If the ratio is too high, it means that the bank may not have enough liquidity to cover any unforeseen fund requirements, and conversely, if the ratio is too low, the bank may not be earning as much as it could be.

3.2. Case Study

Isa and Terungwa (2011) estimated the extent of credit rationing for French SMEs before and during the crisis using a disequilibrium model. It was observed that the percentages of fully and partially rationed firms are low before the crisis (1.3 percent of firms with no loan, and 6 percent of firms with loans, respectively) and those percentages did not significantly increase during the crisis (1.9 and 6.9 percent, respectively). Thus, it was concluded that there was no evidence of credit rationing towards SMEs during/after the crisis.

Moshi and Kilindo (1999) considered the effect of government policy on private investment over the 2000-2015 periods in Tanzania. Regression results from the ordinary least squares estimation technique among others, showed that the real exchange rate had a negative and significant effect, indicating that devaluation reduced the profitability of private investment in the Tanzanian economy during the study period.

Reinhart and Rogoff (2009) argued that debt impacted positively on the growth of a firm only when it was within certain levels. When the ratio went beyond certain levels financial crisis was very likely. The argument was also supported by Stern Stewart and Company which argued that a high level of debt increases the probability of a firm facing financial distress. Checherita-Westphal and Rother (2012) studied the effects of debt on firms and concluded that moderate debt level improves welfare and enhanced growth but high levels could lead to a decline in growth of the firm. Over borrowing can lead to bankruptcy and financial ruin. High levels of debt will constrain the firm from undertaking project that are likely to be profitable because of the inability to attract more debt from financial institutions.

However, this study intends to examine the relationship between monetary policy instruments and commercial banks rural financing in Nigeria using regression analysis to test the correlation and significant effect between the dependent and independent variables through the following data in Table 1.

Table 1 - Rural Commercial Bank's SMEs Credit, Liquidity Ratio, Cash Reserve Ratio, Deposit Rate

Years	Rural Commercial Bank's SMEs Credit (N' Billions)	Liquidity Ratio (%)	Cash Reserve Ratio (%)	Bank Rate (%)	Deposit Rate (%)
2000	11.15	64.1	0	17.98	5.29
2001	12.34	52.9	0	18.29	5.49
2002	8.94	52.5	0	24.85	4.15
2003	11.25	50.9	0	20.71	4.11
2004	34.12	50.5	0	19.18	4.19
2005	16.11	50.2	0	17.95	3.83
2006	24.27	81.42	0	17.26	3.14
2007	27.26	41.56	0	16.94	3.55
2008	46.52	37.72	3.0	15.14	2.84
2009	15.59	26.39	1.3	18.99	2.68
2010	16.56	27.39	1.0	17.59	2.21
2011	19.98	42.02	8.0	16.02	1.41
2012	22.58	49.72	12.0	16.79	1.70
2013	739.92	46.23	12.0	16.72	2.17
2014	988.59	38.27	20.0	16.55	3.38
2015	29.17	42.35	20.0	16.85	3.58
2016	43.78	45.95	22.5	16.87	3.75
2017	530.99	54.79	22.5	17.56	4.13
2018	200.07	65.04	22.5	19.33	4.07
2019	**202.59**	**75.91**	22.50	**15.53**	**3.95**
2020	**107.52**	**67.60**	22.50	**12.32**	**3.22**

Source: CBN Statistical Bulletin (2020).

4. Results

The correlation coefficient (R) was 0.521 (Table 2). It depicted a positive correlation between dependent and independent variable. This means that despite monetary policy instruments, credit to rural customers is still distributed to a reasonable level.

Table 2- Model Summary

Model	R	R Square	Durbin-Watson
1	.521[a]	.271	1.725

Source: the authors (2023).

The coefficient of determination of 27.1% means that 27.1% variation in the dependent variable was explained by the independent variable and 72.9% of the variation in the dependent variable is explained by the disturbance term or error term. The Durbin-Watson result was 1.725, the Durbin-Watson result of this model indicated no autocorrelation since the value of 1.725 is approximately 2. $t0.05$ at $(20 - 2)$ 18 degrees of freedom was statistically significant because analysis of variance (ANOVA) p – value > 0.05; p - value = 0.253 (Table 3).

Table 3- Anova

Model	F	Sig.
Regression	1.488	.253
Residual		
Total		

Source: the authors (2023).

Therefore, H0 is accepted and H1 is rejected. There was no significant relationship between Total Rural credit and Monetary Policy Rate of Commercial Banks in Nigeria. 95% confidence level of confidence interval means that the samples data of the model reflects the fraction of calculated confidence intervals that encompass an authentic population. The Collinearity Diagnostics result reveals that Variance Inflation Factors (VIF) is 1.00 (Table 4). Since VIFs result is 1.00 in this model, it does not require further research.

Table 4- Coefficients

Model	95.0% Confidence Interval for B		Collinearity Statistics	
	Lower Bound	Upper Bound	Tolerance	VIF
(Constant)	-1067.852	1248.189		
LR	-13.384	6.484	.750	1.332
CRR	.870	28.918	.762	1.313
BR	-56.406	67.228	.673	1.485
DR	-139.911	141.525	.684	1.462

Source: the authors (2023).

6. Conclusion and Recommendations

The study concluded that the availability of credit to rural bank customers was affected by monetary policy instruments during the analysis period; it ensures that credit distributed to rural customers is not efficiently distributed. In addition, many rural bank customers do not view the Commercial Bank as the main source of financing because of the high bank rate, which is one of the monetary policy instruments. The study therefore recommends that Commercial banks' lending rate should be reduced in order for investors to see commercial banks as number one source of finance, Central Bank of Nigeria should increase the minimum reserve of Commercial banks in order to facilitate an adequate credit to commercial banks customers/ investors, Commercial banks should promote a higher level of liquidity to increase their ability to cover withdrawals from their clients and to increase loans and advances to clients.

Further study may examine: Effect of monetary policy instruments on microfinance banks rural financing in Nigeria; Effect of monetary policy instruments on Agricultural banks rural financing in Nigeria; Determinants of deposit money banks credit to rural bank customers in Nigeria.

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