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Research Article

Effect of Letter of Credit and Bankers' Acceptance on Performance of Financial Institutions in Nigeria: Implication of Cross Border Banking

Martins Alechenu Adikwu[1], Thomas Terkaa Igyer[2] and Josephat Mgbede Idibe[3]

[1,3]Department of Banking and Finance,
Joseph Sarwuam Tarka University, Makurdi, Benue State, Nigeria.
[2]Department of Procurement Management,
Joseph Sarwuam Tarka University, Makurdi, Benue State, Nigeria.

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Abstract

Effect of letter of credit and bankers' acceptance on performance of financial institutions in Nigeria: implication of cross border banking was investigated. The study adopted the ex-post facto design. The population of the study comprised of eight (8) cross-border banks operating in Nigeria as at December, 2021. Secondary data were sourced from the published annual reports Nigerian Stock Exchange fact book which covered the period of 2015-2021. Descriptive statistics and Panel Data Analysis Radom Effect Method were used for data analysis with decision rule at 0.05 level of significant. Results of the study reveal that letter of credit has significant effect on the profitability of cross-border banks in Nigeria while bankers' acceptance has no significant effect on the profitability of cross-border banks in Nigeria. Based on these findings, the study recommended among others that letters of credit and bankers' acceptance should be outsourced to accredited private companies and individuals at a minimum monthly charge while Nigerian banks operating cross-border should consider establishing more branches to ensure larger spread and benefit from economies of scale.

Keywords: *Letter of credit, Bankers' acceptance, Performance, Cross-border, Banks.*

Correspondence to: Martins Alechenu Adikwu, e-mail: adikwu.martins@gmail.com

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Introduction

The landscape of banking has substantially changed in Africa through the expansion of regional banks over the past decades [1-2]. African economies have traditionally had a relatively high share of foreign banks on average. Over the past decade, however, African banking systems have witnessed dramatic transformations with the expansion of regional cross-border banks. Cross-Border Banking (CBB) has become an increasingly important feature of banking systems in developing and emerging economies. There has been a dramatic move toward financial liberalization and globalization in banking institutions in recent years resulting in profits through cross border banking and other capital flows in the financial market of certain countries. The local financial market of both advanced and developing countries are opened to foreign bank increasing the rate at which many banks have ventured overseas and established existence in other countries. For instance, in terms of credit deposits and returns, the market share of foreign banks on the average is 20 percent in Organization for Economic Cooperation and Development (OECD) countries and almost 50 percent in developing and emerging countries [3].

The global financial crisis of 2008 and 2009 caused multinational European and American banks to downsize their presence in emerging economies. Some banks in Nigeria therefore, took the opportunity to expand across borders aggressively, resulting in the establishment of` their presence in more than 30 African countries with 227 subsidiaries or branches [4]. Since the banking sector is the engine of growth, this development portends a good omen for the growth of the Nigerian economy through the enhanced performance of the stock market and improved foreign exchange.
Moreover, it is expected that cross-border banks should be able to put up a better performance than those which have not gone CBB because larger and diversified banking systems are in many aspects, better equipped and absorb economic shocks. CBBs will as well be able to make more profits and liquidity due to diseconomies of scale. The question is what is the situation of financial performance of the banks and CBB in the face of the recently deepened economic recession in Nigeria? The paradox is, while some scholars consider the crisis as an opportunity to facilitate banks' performance, other scholars think otherwise. In the view of this, [5] expounded that Nigerian banks have made great strides in entries into foreign countries.

However, [6] contend that cross border banks may suffer from liquidity risk related to foreign currency thereby, limiting their performance. Consequently, previous studies conducted by various researchers on this topic, for instance, the study findings of [7] shows that foreign ownership of banks does not affect their profitability and those operating CBB do not out-perform domestic listed banks. The author in [8] also found no significant difference in liquidity performance while their profitability improved in favour of CBB. Furthermore, [9-17] and others anchored their studies on determinants approach using CAMEL models while others adopted the performance approach using profitability, liquidity and market value.

There is however, a yawning gap that exists in the literature on the effect of CBB on the profitability of deposit money banks in Nigeria because to the best of the researcher's knowledge, the previous studies rarely made use of letter of credit income and bankers' acceptance income as independent variables to access the profitability of cross-border banks in Nigeria. Therefore, this study seeks to bridge this gap in literature by objectively adopting aforementioned capital structures in ascertaining the effect of the identified cross-border banking activities on the profitability of deposit money banks. The adoption of these capital structures which would have direct effect on cross-border bank profitability therefore accords the study its uniqueness and therefore makes it worth undertaking more so that cross-border banking policy is a contemporary trend in Nigeria. To this end, this study examines the effect of letter of credit and bankers' acceptance on performance of financial institutions in Nigeria: implication of cross border banking.

Theoretical Framework

In explaining the effect of CBB on profitability, the follow- the- customer theory was found relevant.

Follow –the- Customer Theory

The follow- the- customer theory was postulated by [18]. The theory states that organizations cross borders to follow their customers who are resident in those countries, thereby increasing their market share. It assumes that institutions such as banks do enlarge their operational activities outside their shores with the desire to follow large clients abroad and tighten their grasp of domestic franchise in order to have a competitive advantage. This holds true for CBB as these deposit money banks move outside their shores, following large clients and establishing presence both geographical and otherwise in order to increase their market share.

However, the theory over-concentrates on the motive for cross-border banking without expositing the rudiments and structure of cross-border banks. Moreover, the theory failed to present a clear picture of cross-border banks as to the extent to which the cross-border banks outperform those that do not engage in cross-border activities.

As related to the present study, the theory suggested that Nigerian banks cross borders primarily to increase their market share. Hence clients in foreign countries must have got attracted to the services of such institutions thereby, prompting them to extend their services to such climes.

Research Questions

The following research questions are asked to give the researcher more information on the topic under investigation. They include:

i. To what extent does letters of credit income affect Return on Assets (ROA) of listed deposit money banks in Nigeria?

ii. To what extent does bankers' acceptance income affect Return on Assets (ROA) of listed deposit money banks in Nigeria?

Research Hypotheses

This study is guided by the following hypotheses:

i. Ho_1: Letters of credit income has no significant effect on the Return on Assets (ROA) of listed deposit money banks in Nigeria.

ii. Ho_2: Bankers' acceptance income has no significant effect on the Return on Assets (ROA) of listed deposit money banks in Nigeria.

Research Method

The study employed the ex-post facto research design. This is because it involved events which have taken place and based on existing data, it cannot be manipulated. It is descriptive as well as exploratory given the fact that the concept of CBB is relatively new in Nigeria when compared to other (developed) countries. The study used secondary data collected from published annual reports of the eight (8) investigated banks and the Nigerian Stock Exchange Fact Book. The collected data were analysed using descriptive statistics such as frequency distribution test were used to analyse the study objectives. Based on the data type and previous research studies, the study uses panel data analysis and hypotheses tested at 0.05 level of significance with the aid of Stata.

Results and Discussion

Table 1. Descriptive statistics showing the effect of cross-border banking on the profitability of deposit money banks in Nigeria

Variables	Obs	Mean	Std. Dev.	Min	Max
LOCY	**56**	5243.589	2091.387	1836	9371
EXT	**56**	327.5871	68.8948	197.81	403.58
BACY	**56**	598.1607	183.8295	213	987

Table 1 presents the summary of statistics used in the analysis. It provides information about the mean, median, maximum and minimum value of the variables used in the study. Given 56 observations, the mean rate of exchange rate stood at 327.5871 with standard deviation of 68.89. The mean value of letter of credit income (LOCY) and Banker's acceptances (BACY) were 5243. 598 and 589.1687, with standard deviations of 2891. 39 and 183.83, respectively. The inference from these results is that the data set were clustered and exhibit homogenous characteristics among the study variables across the selected banks as none of these variables recorded values of standard deviation that were higher than the values of their respective means. This implies that there is no wide variation between the study variables in the respective cross-border banks.

Table 2. Correlated Random Effects

Variables	Coefficient	Z- Statistics	Z Sig
EXR	-0.0059214	-0.71	0.477
LOCY	-0.0000176	-2.67	0.000
BACY	-0.0000287	-0.39	0.698
Intercept	2.681206	34.51	0.000
R^2	0.2589		
Wald Chi^2	16.77		
Prob>Chi^2	0.0130		

The summary of panel regression results as presented in Table 2 shows the random effect regression has an R^2 of 0.2589 representing 25.9% explanatory powers. This implies that the independent variables jointly account for 25.9% variation in the dependent variable, ROA. The remainder (75.1%) represents variations in ROA that cannot be explained by the independent variables (EXR, LOCY and BACY). Thus, a large part of the dependent variable can still be explained by other variables not included in the study. These other variables are summed up in the error term and added to the study model. Results show that a unit increase in EXR results in 0.006% decrease in ROA which is not significant at 0,05% level. The results of the study revealed that a unit increase in LOCY results in 0.0000176% decrease in ROA which is significant at 0.05% level while a unit increase in BACY results in -0.0000287% decrease in ROA which not is significant at 0.05% level. These suggest that letters of credit and bankers' acceptance do not contribute positively to the profitability of cross-border banks in Nigeria.

Test of Hypotheses

The hypotheses of the present study were tested at 0.05 level of significance.

Test of Hypothesis One

Ho_1: Letters of credit income has no significant effect on the Return on Assets (ROA) of listed deposit money banks in Nigeria.

Based on evidence presented in Table 2, the relationship between LOCY and ROA is significant at 5% (p, 0.00<0.05). Hence, the study rejects the first hypothesis which states that letters of credit income have no significant effect on the Return on Assets (ROA) of listed deposit money banks in Nigeria. Therefore, with respect to the first hypothesis of the study, it can be concluded that letters of credit income of the cross-border banks have significant negative effect on the profitability of listed deposit money banks in Nigeria.

Test of Hypothesis Two

Ho_2: Bankers' acceptance income has no significant effect on the Return on Assets (ROA) of listed deposit money banks in Nigeria.

The results presented in Table 2 above show that BACY has no significant relationship with ROA of listed deposit money banks in Nigeria. Since the relationship is not significant at 5% (p,0.698>0.05), the hypothesis which states that bankers' acceptance income has no significant effect on the Return on Assets (ROA) of listed deposit money banks in Nigeria is not rejected. Hence, it can be concluded that bankers' credit income does not significantly affect the profitability of listed deposit money firms in Nigeria.

Discussion of Findings

Study findings show that letters of credit income have significant effect of the returns on assets of deposit money banks in Nigeria. This implies that the income domiciled with Nigerian cross-border banks by importers for transactionary purposes has impacted negatively on the banks' levels of profitability. Thus, the cost of operating cross-border banks with letter of credit income supersedes the profitability derived from the letter of credit business. The authors in [19] evaluated global liquidity and drivers of cross-border banks flow found that borrowing countries can limit their exposures to global liquidity fluctuations through adapting their macro frameworks, capital flow management tools and bank regulations. This suggestion could include exposures emanating letters of credit.

Study finding revealed that, bankers' acceptance has no significant effect on return on assets (ROA) of cross-border deposit money banks in Nigeria. Thus, despite going cross-border, Nigeria deposit money banks are yet to reap the financial gains accruable from bankers' acceptance from importers. This finding contradicts the ascertain by [20] who posits that bankers' acceptance which are operated like the US treasury bill are traded as discount to face values, accrue high profits to banks since they earn a return and can be traded like bonds on the secondary money market.

Conclusion

The study concluded that although cross-border banking is not profitable in Nigeria, the contributions of letters of credit is significant. Hence, the extent of effect of cross-border banking on the profitability of listed deposit money banks in Nigeria was premised on the letters of credit of the banks. However, the size of the cross-border banks played a significant role in determining the level of cross-border banks profitability. Based on these results, it was therefore among others, recommended that since letters of credit is an exclusive preserve of cross-border bankers, it should be outsourced to accredited private companies and individuals at a minimum monthly charge. This will make the product readily available to customers at competitive rates that will ultimately lead to higher levels of income and hence, increased profitability to cross-border banks. Moreover, bankers' acceptance should be outsourced alongside the letters of credit. The features of these instruments should be properly propagated to major marketers so that, apart from importers, these other major marketers, especially nationals residing in the host countries, who need an intermediate front for business transaction can make use of them to instill trust between the sellers and the buyers.

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