

Bank Lending Rate and Performance of Nigeria Deposit Money Banks: a Study of Union Bank of Nigeria and United Bank for Africa

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Abstract

The objective of this study was to find out whether there exists a relationship between lending rates and the Performance of Deposit money banks in Nigeria. This study examined the impact of bank lending rate on the performance of Nigerian Banks between 2012 and 2016. It specifically determined the effects of lending rate and deposit rate on the performance of two Banks and analyzed how the bank lending rate policy affects the performance of these banks. The population for this study is the Nigeria banking sector while two banks were selected as sample size; data were gathered from the annual reports of the two cases study and statistical bulletin of the Central Bank of Nigeria. Analyzes of data was through the use of Simple Linear Regression model. The finding of this study suggests that the performance of the banking sector is a function of changing lending rates. The study therefore recommends that government should adopt monetary policies that will help Nigerian deposit money banks to improve on their performance and there is need to review and strengthen bank lending rate policies through effective and efficient regulation and supervisory framework. Banks can improve their profitability through charging moderate lending rates as against maximum rates as their circumstances may allow.

Keywords: *Bank, Lending rate, Bank performance, Financial system, Deposit money banks*

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Background to the Study

Financial service is an indispensable function of the Banking sector, supporting development plans through channeling funds for fruitful purpose, mobilizing and moving funds from surplus area to the area where fund is needed or in short supply as well as supporting financial and economic policies of government. Meanwhile, the success a bank is measured by its profit and the quality of assets it possesses. Bank services is not only about financing but social function is also a priority such as creation of branch networks, provision of employment for the populace, maintenance of quality asset base and increased profitability which is paramount to the continued growth of the bank and the sector as a whole.

Bank loans are referred to as the most important long-term financing sources in many countries (Freixas and Rochet, 2008), in some developed economies like Japan, long term bank loans represent more than 70% of its total long-term debt. Financial institutions are relevant in economic growth and development through provision of credit facilities for execution of economic projects. However, the major concern of any financier when advancing credit is how they can recoup the advanced from the borrower (Fleisig, 1999), and this implies that the engagement between lenders and borrowers is accompanied by certain level of risk. The desire for lending arises because of the obvious financial disequilibrium among economic system which has to do with the economic gap existing between the deficit unit and the surplus unit. Therefore, lending must be designed in a way that it provides a total benefit to all the diverse interest groups within the bank, these comprises the shareholders, depositors and the borrowers.

Lewis (1991) emphasized that granting of credit facilities to worthy borrowers is one of the most significant functions of commercial banks which is directly related to the development of an economy. Credit was referred to as the largest single income-earning asset in the portfolio of many banks (Nwankwo, 2000) as cited in (Felicia, 2011), explained the reason why most banks spend enormous resources to estimate, monitor and manage credit quality. This is understandably a practice that has great effect on the lending behaviour of banks since large amount of resources were involved.

Adedoyin & Sobodun (1991) explained that lending is seen as the heart of banking business, which means that administration of credit facilities requires considerable skills and dexterity on the part of bank management. While a bank is irrevocably committed to pay interest on deposits it mobilized from different sources, the ability to articulate loanable avenues where deposit funds could be placed to generate reasonable income; maintain liquidity and ensure safety requires a high degree of pragmatic policy formulation and application (Chodechai, 2004). Therefore, no matter the sources of the generation of income or the economic policies of the country, deposit money banks would be interested in giving out loans and advances to their numerous customers bearing in mind, the three principles guiding their operations which are, profitability, liquidity and solvency (Adolphus, 2011).

This study becomes imperative because deposit money banks in Nigeria need to understand how to manage these huge assets in terms of their loans and advances. For the banks to balance

their main objectives of liquidity, profitability and solvency, lending must be handled effectively and the banks must behave in a way that their potential customers are attracted and retained. In this study we are set to determine the effect of lending rate spread on the performance of the Nigerian banking industries. In order to achieve this, we looked at the aggregate performance of two commercial banks in Nigeria for the period of 1999-2015. This period was considered appropriate because it was the period when lending rate was liberalized in Nigeria and so gave a good picture of the effect of interest spread on the Nigerian banking industry. Also reasonable banking reforms are assumed to have taken place in Nigeria within this period. For the banking sector, lending rates play a crucial role in its activities. Lending rate by commercial banks determines the profitability of commercial banks among other factors. Therefore the single objective for this study is to examine the effect of lending rates on financial performance of deposit money banks in Nigeria.

Literature Review

Lending rate is the amount of interest paid per unit of time expressed as a percentage of the amount borrowed. The cost of borrowing money, measured in naira, per year per naira, borrowed, is the lending rate. Lending rates differ mainly in term/maturity. When maturity and liquidity together with other factors are considered, many different financial instruments and so many different lending rates will emerge (Anyanwu, 1997). Lending rates can either be nominal or real. Nominal lending rate can be measured in naira terms, not in terms of goods. The nominal lending rate measures the yield in naira per year, per naira invested while the real lending rate is corrected to inflation and is calculated as the nominal lending rate minus the rate of inflation (Pandey, 1999).

There are daily reports of how Nigerian banks rip off their customers through various charges and practices. Often, customers complain and cry out for appropriate regulatory intervention, unfortunately, their complaints seem not to be attended to, because they are unaware of any positive regulatory action in response to these challenges. Due to improper regulatory action by regulator and indifference, many Nigerian banks now engage in more exploitative practices. The categories of such predatory banking practices are witnessed daily by bank customers. Often when a customer secures a loan from a bank, the latter fixes a negotiated lending rate based on the prevailing lending rate approved by the Central Bank of Nigeria (CBN).

Any change in the lending rate should be brought to the notice of the borrower except otherwise agreed. In Nigeria, however, the lending rate is rarely negotiated and, when it is reviewed upwards by the CBN, the average bank automatically applies the new rate to the outstanding loan without notifying the borrower (Okafor, 2011). Ironically, the same bank hides the fact of any downward review of the lending rate from its mostly uninformed customer, thereby illegally subjecting the customer to a higher interest regime. Often, what the bank staff present to a prospective borrower during loan negotiations as the total charges become hydra-headed once he swallows the bait. While processing loans, Nigerian banks impose on borrowers both "processing" and "administrative" fees which are duplicates.

Objectives of Sound Banking

According to Jhingan (2004) there are three main objectives, which a wise bank pursues, and these include, Liquidity, Safety and Profitability. In the same light, Crowther (n.d) in Jhingan (2004) recognized certain essentials of a sound banking system. According to Crowder (Ibid) “the secret of successful banking is to distribute resources between the various forms of assets in such a way as to get a sound balance between liquidity and profitability, so that there is cash to meet every claim, and at the same time enough income for the bank to pay its way and earn profits for its shareholders”.

Evidence from other Countries

Chizea (1994) asserted that, “there are certain aspects of fiscal and monetary policies which could affect the decision of the discerning and informed public to patronize the bank and the lending behavior of commercial banks. Paramount amongst these measures is what could be called the lending rate incentives. Lending rates have been so low in the country that they are negative in real terms. As inflation increased, the purchasing power of money lodged in deposit accounts reduce.

There is also the fear that the hike in lending rates would increase inflation rates and make a negative impact on the rate of investment. A study carried out by Samad (2004) examined commercial banks performances during 1994-2001. The focus of the study was to examine empirically the performance of Bahrain's commercial banks with respect to credit (loan), liquidity and profitability during the period. By applying t-test to the financial measure, it was shown that commercial banks liquidity performance is not at par with the banking industry. That is commercial banks are relatively less profitable and less liquid as expected.

Using dynamic panel data model, Folawewo and Tennant (2008) studied the determinants of lending rate spread in Sub-Saharan African (SSA) countries focusing on macroeconomic variables. Their results show that lending rate spread is influenced by the extent of the crowding out effect of government borrowing, public sector deficits, discount rate, inflation, level of money supply, reserve requirement, level of economic development and population size. Aboagye et al. (2008) investigated the question of the optimal spread between bank lending rates and rates that banks pay on deposits in Ghana. They found that increases in bank market power, bank size, staff costs among other factors significantly increase net interest margins, while increases in bank excess cash reserves and central bank lending rate decrease them.

Evidence from Developing Economies

In his view all the other factors which influence profitability needs to be enhanced to in order to improve the financial performance of commercial banks in Nigeria. Mang'eli (2012) using descriptive research design in his study of relationship between lending rate spread and financial performance of commercial banks points out that lending rate spread affect the performance of commercial banks, as it increase the cost of loans charged on the borrowers, regulations on lending rates have far reaching effects on performance of commercial since they determine the lending rate spread in banks and also help mitigate moral hazards incidental to

performance of commercial banks, credit risk management technique remotely affects the value of a bank's lending rate spread lending rates are benchmarked against the associated NPLs and NPLs is attributable to high cost of loans.

Onyekachi & Okoye (2013) examined the impact of bank lending rate on the performance of Nigerian Deposit Money Banks between 2000 and 2010. It specifically determined the effects of lending rate and monetary policy rate on the performance of Nigerian Deposit Money Banks and analyzed how bank lending rate policy affects the performance of Nigerian deposit money banks. The study utilized secondary data econometrics in a regression, where time series and quantitative design were combined and estimated. The result confirmed that the lending rate and monetary policy rate has significant and positive effects on the performance of Nigerian deposit money banks.

Felicia (2011) used regression analysis to investigate the determinants of commercial banks lending behaviour in Nigeria. The study discovered that commercial banks deposits have the greatest impacts on their lending behaviour. Interest Grouped (64) Sixty-Four developing countries including Nigeria into three bases on the level of their real lending rate. He then computed economic rate among which were gross savings, income and investment for countries. Applying the Mann - Whitney test, he found that the impact of real interest was not significant for the three groups.

While Adofu & Audu (2010) used ordinary least square method to ascertain the assessment of the effects of lending rate deregulation in enhancing agricultural productivity in Nigeria. The study found out that lending rate play a significant role in enhancing economic activities and as such, monetary authorities should ensure appropriate determination of lending rate level that will break the double - edge effect of lending rate on savers and local investors. Rasheed (2010) used error correction model (ECM) to investigate lending rates determination in Nigeria. The study found out that as the Nigerian financial sector integrates more with global markets, returns on foreign assets will play a significant role in the determination of domestic lending rates. Enyioko (2012) likewise, examine the performances of banks in Nigeria based on the lending rate policies of the banks.

Theoretical framework

The theoretical framework for this study is adapted from (Patnaik and Vasudevan, 1998), which tries to factor the degree of openness of an economy in the analysis of the influence of both internal and external factors on lending rate movements in a semi-open economy like Nigeria. Suppose we have a closed economy, in which there is no inflow or outflow of capital and the demand for money is the demand for real money. In such an economy, money is held by the economic units purely to finance transactions and increase the demand for money with real output.

Loan Pricing Theory

Banks cannot always set high lending rates. Banks should consider the problems of adverse selection and moral hazard since it is very difficult to forecast the borrower type at the start of

the banking relationship (Stiglitz and Weiss, 1981). If banks set lending rates too high, they may induce adverse selection problems because high-risk borrowers are willing to accept these high rates. Once these borrowers receive the loans, they may develop moral hazard behaviour or so called borrower moral hazard since they are likely to take on highly risky projects or investments (Chodecai, 2004). From the reasoning of Stiglitz and Weiss, it is usual that in some cases we may not find that the lending rate set by banks is commensurate with the risk of the borrowers.

Firm Characteristics Theories

These theories predict that the number of borrowing relationships will be decreasing for small, high-quality, information ally opaque and constraint firms, all other things been equal (Godlewski and Ziane, 2008).

The Signaling Arguments

The signaling argument states that good companies should provide more collateral so that they can signal to the banks that they are less risky type borrowers and then they are charged lower interest rates. Meanwhile, the reverse signaling argument states that banks only require collateral and or covenants for relatively risky firms that also pay higher lending rates (Chodechai, 2004; Ewert and Schenk, 1998).

Methodology

The population for this study is the banks quoted on the Stock Exchange Market while the sample size is two out of the listed banks; the reason for the choice of these two banks is because of their size and is among the oldest banks in Nigeria. The sampling technique used is the non- probability sampling method by using the two banks that is, the United Bank for Africa and Union Bank of Nigeria as sample for the entire population, because the banks in Nigeria operates in the same Market, faced the same challenges. While the choice of the period is based on the availability of Data, thus we assume it will show trend on the impact of lending rate on Performances of deposit money banks. The choice of period is based on the availability of Data. Thus we assume it will show trend on the impact of lending rate on Performances of this banks.

The nature and sources of data for this research is secondary data sources. The data for this study were obtained mainly from Union Bank and United Banks of Africa annual reports, United Bank for Africa annual report and the CBN annual statistical bulletin, the data cover a period of sixteen years from 1999 to 2015. Data were analyzed using our statistical tools of Simple Linear Regression model (using the SPSS Statistical software package) because it can be use for the purpose of prediction where the independent variable is used to obtain a better prediction of dependent variable. This enables us to determine the impact of lending rate on performance of deposit money bank in Nigeria.

Model Specifications

Following from the above discussion, the primary model showing the relationship between Bank Lending Rate and Performance of Nigerian Deposit Money is specified thus:

$PATL = a + \beta_1 LDEP + \mu$
 Dependent Variable Is Represented As
 PATL = Profit after tax/ loan
 Where independent variable is represented as
 LDEP = Loan/ Deposit
 μ = Error term
 a = Constant Variable.
 β_1 = Coefficient of parameter

The findings of this work are presented through tables and the analysis of the data which is basically by linear regression and Pearson Correlation analysis.

Findings and Interpretation of Data

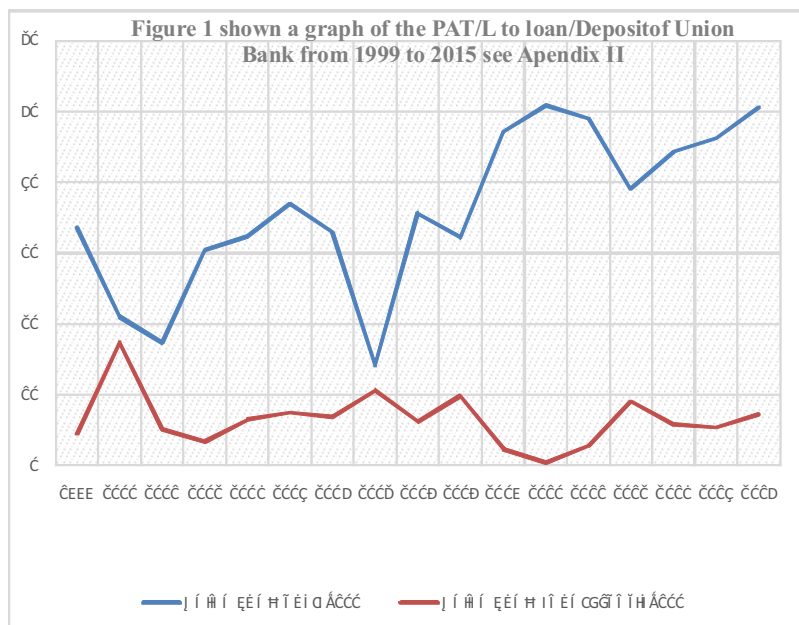


Figure 1

The above figure shows the relationship between PAT/L and Loan/Deposit of Union Bank of Nigeria, from 1999 to 2015. PAT/Loan is moving in an inverse direction between 1999 and 2001, a positive movement 2002-2004, and sharp decline in 2005 with a sharp increase in 2006-2008. But from 2009 to 2015 the percentage of PAT to loan has a witnessed a steady increase. Looking at the graph of Loan/Deposit in 1999-2000 the percentage of was high but from 2001 to 2015 the percentage had decreased. The record gathered here shows the bank has not been giving out loan as expected which due to low lending rate which explain low Profit after Tax (PAT) to loan.

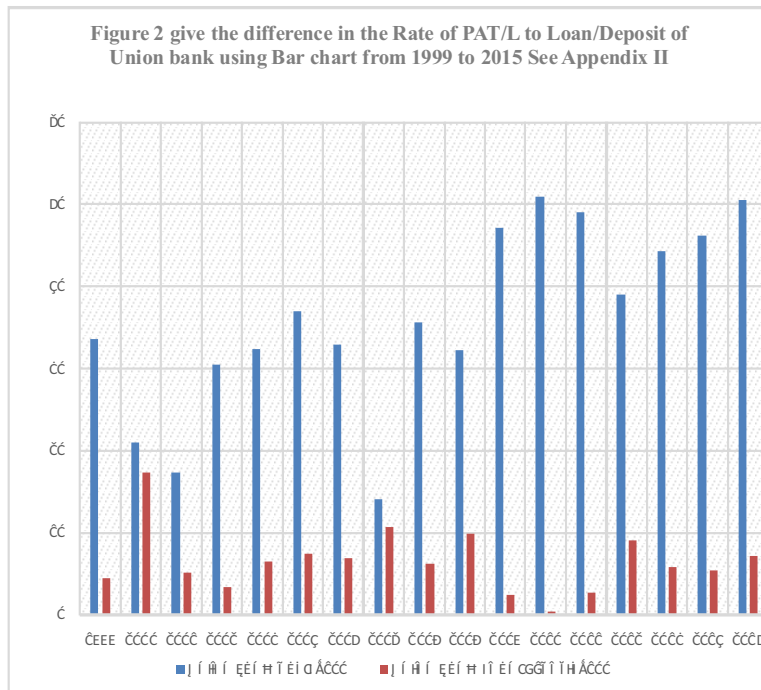
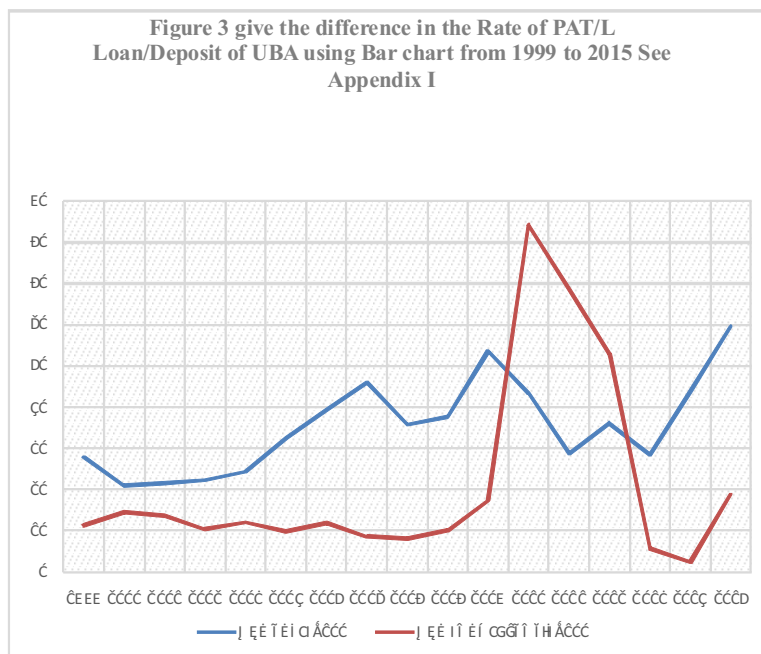


Figure 2

The chart in figure 2 shows PAT/L and L/D from 1999 to 2015, the percentage of PAT/L to the percentage of Loan/deposit is very high which implied that the Bank is not giving out credit as expected and that most of the profits of the bank are coming from other investments



Figure

The graph in figure 3 shows that PAT/L and L/D for United Bank for Africa gave a negative relationship as the L/D increases the PAT/L decreases from 1999 to 2014. In 2014-2015 a proportionate increase in PAT/L and L/Deposit was witnessed.

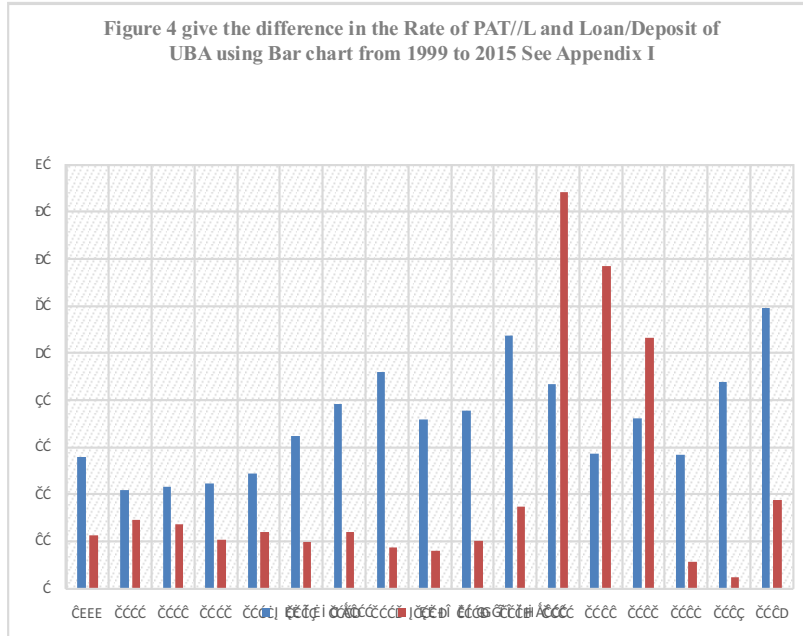


Figure 4

This chart shows the relationship between the percentages of PAT/L to that of L/Deposit, from 1999 to 2009, percentage PAT/L was higher than that of L/D while in 2010, 2011 and 2012 percentage of L/D was higher than PAT/L. 2013 to 2015 the percentage of Profit after Tax to Loan increase more than the percentage of Loan to Deposit. This finding shows that the lending rate of banks is relevant to their returns which Nigerian Banks are not paying significant attention to.

The data gathered was further analyzed through correlation and linear regression as follows;

Table 1: Correlation Matrix of the Variables

		Profit After Tax to Loan Ratio	Loan to Deposit ratio
Pearson Correlation	Profit After Tax to Loan Ratio	1.000	-.277
	Loan to Deposit ratio	-.277	1.000
Sig. (1-tailed)	Profit After Tax to Loan Ratio	.	.056
	Loan to Deposit ratio	.056	.
N	Profit After Tax to Loan Ratio	34	34
	Loan to Deposit ratio	34	34

Source: Output from SPSS 20.0v, 2017

Table 1 shows the correlation matrix of the variables using the Pearson correlation coefficients. Pearson's correlation is used to test the level of relationship between the time series variables. Coefficients greater than or equal to -1 and less than or equal to -0.5 means strong negative relationship. Coefficients between -0.5 and 0 means weak negative relationship between the variables, Zero (0) coefficient means no relationship. Coefficients between 0 and 0.5 mean weak positive relationship while coefficients greater than that but less than or equal to 1 mean strong positive relationship. From the Table, it was reported from the coefficient value that there is a weak negative relationship between Profit After Tax to Loan Ratio and Loan to Deposit ratio ($-0.277 < -0.5$). Hence, there is a weak negative relationship between bank performance and lending rate.

Table 2: Linear regression on the dependent variable

Model Summary ^b					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.277 ^a	.077	.048	.7715634	.901

a. Predictors: (Constant), Loan to Deposit ratio

b. Dependent Variable: Profit After Tax to Loan Ratio

Source: Output from SPSS 20.0v, 2017

Table 2 shows the model summary of the linear regression where Profit after Tax to Loan Ratio is the dependent variable and Loan to Deposit ratio is the independent variables. The R is shown as 0.277 and after adjusting for the errors in the model, the adjusted R squared is given as 4.8% i.e. independent variable is capable of explaining only 4.8% of the variation in Profit after Tax to Loan Ratio. The Durbin-Watson value is the result of the auto-correlation test carry out on the variables and that is used to test for the validity of the data employed. The Durbin-Watson test turns out to be positive of autocorrelation as the DW value is 0.901 (less than 2). Hence the model is not predictive. Other researchers are urged to investigate the research problem using a more econometric data

Table 3: Analysis of Variance table

ANOVA ^a					
Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	1.584	1	1.584	2.660	.113 ^b
Residual	19.050	32	.595		
Total	20.634	33			

a. Dependent Variable: Profit After Tax to Loan Ratio

b. Predictors: (Constant), Loan to Deposit ratio

Source: Output from SPSS 20.0v, 2017

The analysis of the variance of the model is shown in Table 3, where the sum of square, degree of freedom, mean square, the F-statistics and the F-statistics probability is shown. From the F-statistics and the probability which shows a value of 2.660 and 0.113 (>0.05) respectively which is statistically insignificant at the significant level of 0.05. Hence, the overall fitness of the model is not achieved.

Table 4: Coefficients of the linear regression model

Coefficients					
Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
1 (Constant)	.641	.231		2.778	.009
Loan to Deposit ratio	-1.090	.668	-.277	-1.631	.113

a. Dependent Variable: Profit After Tax to Loan Ratio

Source: Output from SPSS 20.0v, 2017

Table 4 shows the coefficients of the linear regression model showing the B as the coefficient, the standard error, the beta, the t-statistics and its probability. The model specification formulated earlier in this study is rewritten as:

$$PATL = 0.641 - 1.090LDR$$

The above model signifies that a unit increase in loan to deposit ratio will influence a decrease of 1.090 in firm performance (Profit to Loan Ratio).

Conclusion

The study investigated the effect of lending rate on the performance of deposit money bank using some selected banks as case study. From the result of the findings, it is established from table 4 presented above that there is a negative (inverse) insignificant relationship between bank lending rate and the performance of the bank with a t-cal value of -1.631 and a probability value of 0.113. Thus, there is a negative insignificant relationship between bank lending rate and their performances.

Recommendations

After much empirical investigation into the study, findings are established and conclusions were drawn. The study finds it necessary to make the following recommendations.

- 1) Banks should improve their brand to attract more customers and by the way increase customers deposit and reduce the effect of loan given out to the customers on the bank performance.
- 2) Banks should peg the rate of loans given out to customer to the most minimum level to improve their performance.
- 3) The apex bank of Nigeria should find should encourage banks lend at single digit percentage to lenders rather than the double digit lending rate to improve the performance of the Nigerian Banking sector, since this increase loan and advances, enhanced loan repayments which will result to increase performance.
- 4) This study further urges other researchers to investigate this research problem in order to shed more light and proffer practical solution to the empirical problem.

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Appendix 1

UBA		
YEAR	PAT/L*100	LOAN/DEPOSIT*100
1999	27.8881051	11.33556625
2000	20.901875	14.5517398
2001	21.596472	13.63574814
2002	22.2591964	10.39001011
2003	24.3194694	12.09677419
2004	32.4266821	9.893027649
2005	39.2417374	11.9147476
2006	45.9792883	8.647251422
2007	35.78674	8.117769923
2008	37.7070968	10.10312647
2009	53.6677699	17.45702205
2010	43.4592471	84.19925266
2011	28.7416391	68.55815034
2012	36.1098118	53.13941728
2013	28.4192073	5.731409966
2014	43.7785964	2.437201953
2015	59.5887914	18.88005503

Source: Annual Report Of UBA

Appendix II

UNION BANK		
YAER	PAT/L*100	LOAN/DEPOSIT*100
1999	33.6224678	4.505565938
2000	20.9954192	17.39105339
2001	17.355316	5.119882282
2002	30.4362004	3.391055189
2003	32.3506077	6.487108256
2004	36.9488379	7.455109021
2005	32.9628004	6.88211803
2006	14.1527607	10.69835998
2007	35.6741094	6.192755809
2008	32.2359615	9.86388519
2009	47.1979505	2.372402165
2010	50.8739901	0.380634872
2011	49.0301362	2.747054691
2012	39.0597421	9.019754203
2013	44.3391922	5.847476981
2014	46.2584298	5.399694999
2015	50.5632245	7.251055678

Source: Annual Report of Union Bank