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# Effect of Revenue Diversification into Non Interest Income on Financial Performance of Commercial Banks in Nigeria

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**Abstract:** Diversification into noninterest income by commercial banks has been born out of the need for banks to improve their financial performance in the wake of declining revenue majorly due to dependence on interest income. Several studies have been conducted by different scholars on the effect of noninterest income on performance of banks. The study use descriptive and inference statistics. The findings of these studies have one line conclusions on the subject with clear linkage between noninterest income and bank performance. These straight forward outcomes were the basis for this study. Meaning the ability of banks to charge interest income was also capped. This has forced banks to delve further into noninterest income as a diversification strategy to stabilize performance. Based on the findings the study recommend that banks should try and diversified more into non interest income in order to fully stabilized

## I. INTRODUCTION

Commercial banks play a key role in keeping the economy of a nation running as they act as intermediaries between savers and borrowers and allow free circulation of money (Celine et al., 2013). Banks earn from both interest income and non-interest income (NII).) are Commission on loans and advances, Foreign exchange trading income, trading securities, and brokerage.

The non-interest income creates income ensuring profitability of banks in the event of a failed on interest income. Noninterest income from service charges, asset sales and leasing of property are not affected by economic and financial market cycles; neither are they controlled by interest rate laws and regulations. Noninterest income is among the significant factors influencing bank profitability, (Oniang'o, 2015). In the past banks have been earning noninterest incomes through providing traditional banking services such as checking accounts, trust, and cash management. Recently, they have been earning noninterest income from new sources which can be highly traced to securitization of the mortgages, credit cards, agency banking, mobile and internet banking, insurance underwriting, and mutual funds investment. According to Ng'endo (2012), the advancement towards noninterest income investments by commercial banks has resulted in increased competition in financial market integration, technological advancement, and improved regulations in the banking industry. Commercial banks mobilize idle savings from the few rich. By mobilizing savings, banks channelize these funds into productive investments. Thus they help in the capital formation of a developing country like Nigeria.Commercial banks help the economic development of Nigeria by faithfully following the monetary policy of the Central Bank of Nigeria (CBN). In fact, the CBN depends upon commercial banks for the success of its policy of monetary management in keeping with requirements of a developing economy. Thus commercial banks contribute much to the growth of an economy by

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granting loans tagriculture,trade and financing theindustrial sector. They provide short-term, medium-term and long-term loans to industries.

***Statement of the problem***

Commercial banks in Nigeria have lost the ability to determine the interest rates they levy on loans and other intermediation services hence losing the ability to determine the interest income. In the last three years, there was a change in the interest rate regime through a parliamentary legislation that involved capping the interest rates (Anyanzwa, 2017).

Ng'endo (2012), Mboya (2012), and Gichure (2015) looked into the relationship between non-interest income, earnings volatility and financial performance of banks in Nigeria and concluded that noninterest income results in earnings volatility because of the required expansion in fixed costs. They also noted that there were few benefits if any to be expected from income diversification from traditional banking to fee-based revenue despite growing importance of non-interest income. Murithi (2013) and Oniang'o (2015), reviewed the effects of income diversification into non-interest income on financial performance of banks in Nigeria and found out that noninterest income affected performance of commercial banks to a great extent because income diversification is associated with greater returns. These studies indicated the topic of noninterest income and how it affected performance of banks was not conclusive and had produced mixed results. Divergent conclusions from different scholars suggested that the subject was a contemporary issue more so to a developing economy like Nigeria. As such banks had diversified significantly in order to stabilize profitability and earnings volatility. This study sought to establish how the different noninterest incomes sources had aggregately influenced financial performance of commercial banks in Nigeria.

**Objective of the study**

The main objective of the study is to investigate the influence of non interest income
On the performance of commercial bank in Nigeria.
Specific objectives of the study are to ascertain:

i. The effect of bank commission on loans and advances on the financial performance of Commercial banks in Nigeria

ii. The effect of income from foreign exchange trading on the financial performance of Commercial banks in Nigeria

iii. The effect of investment income on the financial performance of Commercial banks in Nigeria.

**Research Hypotheses:**

In the course of this research, the following hypotheses were tested

**H0:** There is no significant effect of commission on loans and advances on financial performance of commercial banks in Nigeria.

**H0:** There is no significant effect of foreign exchange trading income on the performance of Commercial bank in Nigeria.

**H0:** There is no significant effect of investment income on the financial performance of Commercial banks in Nigeria.

**Scope Of The Study**

The scope of the study cover the effect of revenue diversification into non interest income on financial performance of commercial banks in Nigeria. Due to the nature of non interest income the scope further restrict to Nigeria financial system and it cover period of five years (2015-2019).

## II. REVIEW OF RELATED LITERATURE

***Concept of Non-Interest Income***

Noninterest income is revenue that is derived by commercial banks from areas that are outside their lending operations or any other income to the banks that is derived from other activities other than their core business of taking deposits and extending loans to their customers at interest. This income can also be referred to as fees income as most of it is charged on customers in the form of fees (Ng'endo, 2012).Noninterest income is a bank income derived primarily from fees including deposit and transaction fees, insufficient funds fees, annual fees, monthly account service charges, inactivity fees, check and deposit fees and credit card charges (including late fees and over-the-limit fees). Noninterest income can be anything from asset sales to fees from penalties related to overdrafts or withdrawals. Some commercial banks rely heavily on fees from automated teller machines, mobile banking, and general transaction fees. Noninterest income is particularly important in business banking relationships. Banks generally charge businesses and companies more for non-interest transactions.

***Performance of Commercial Banks***

The financial influences of commercial banks looks into the subjective measure of how

commercial banks make use of their assets to generate revenues. This is the general measure of banks' overall financial health over a given period. This financial performance is highly affected by the decisions made to effectively utilize assets to increase profit, (Abreu and Mendes, 2000). The decision made by commercial banks indicates how effective the management is working with a mathematical value of the operational efficiency being the quotient of the revenues from the total assets, (Saira et al., 2011).The degree to which commercial banks rely on non-interest fees to make a profit is a function of the economic environment. Market interest rates are driven by benchmark rates such as the Inter Bank Rate (IBR). The IBR,or the rate at which banks lend money to one another, is determined by the rate at which the CBN reserve pays
banks interest. As interbank rate decreases, commercial banks make less profit from interest income hence a need to increase non-interest income. The subject still remain important area as most empirical works have focused on the causes of financial performance. To realize the same or improved performance banks must lend more at the current interest rates or diversify into noninterest income strategies. Lending above the optimal book position will portend future challenges related to credit default.

## III. THEORETICAL FRAMEWORK

The study anchored on anticipated income theory.

**The anticipated income theory**

This theory developed by Prochanov (1944) explains the theoretical underpinning the theory as related to banks performance. The theory states that loan portfolio is a liquidity source. In essence, the theory is saying that banks' liquidity can be planned if scheduled loan payments are based on future incomes of borrowers at a point in time. Thus, the theory recognizes the influence of the maturity structure of the loan and investment portfolio on the liquidity position of a bank. The use of this theory in this study is also appropriate since the money generated from non interest income can be use to generate more money through loan, hence, the need to monitor the payment of these loan should also be a concern in order to enhance performance.

**EMPERICAL REVIEW**

Muckian (2014) investigate the relationship between non interest income and systemic risk in United State of America banking sector, using data like bank size, leverage. Asset management as variable to represent non interest income, while bad debt considered as risk,using period of (2008-2013),expo facto research design was used, it was find that non interest income has a way of reduces bad debt, by using the money to reduces the debt.

Rahman*et. al*. (2015) used a sample of 25 commercial banks for the period 2006-2013 from Bangladesh, considering potential bank profitability determinants such as liquidity, on non-interest income, off-balance sheet activities, bank size, capital strength, credit risk, ownership structure, cost efficiency, and inflation. Using various measures of profitability, some of which are return on assets (ROA), return on equity (ROE), as well as net interest margin over total assets.They showed that there is a negative impact on profitability coming from cost efficiency and off-balance sheet activities; meanwhile there is a positive impact from loan intensity, non-interest income and capital strength on bank profitability.

Hashem (2016) examined the determinants of banking sector profitability in relation to non interest income in Egypt by using quarterly data over the period of 2004-2014. Study used cointegration procedure to investigate the long-run relationship between ROE and several bank-specific variables (liquidity, capital adequacy, and asset management). The author used vector error correction model to explore the short-term dynamics of the model and the speed of adjustment to long run equilibrium. It mainly concluded that banking sector profitability was inversely related to capital adequacy, non interest income and the ratio of deposits to total assets. On the other hand, it positively related to the size of the banking sector implying that the sector exhibited economies of scale. Also, the vector error correction model showed that about four percent of the disequilibrium was corrected each quarter to reach the long run equilibrium. In addition, all bank-specific factors were found to be related to bank profitability in the long run.

Amaeshi, Adi,Ogbechie and Amao (2016)Evaluation of Non-Interest Income of Commercial Banks in south African, the researcher decided to study 5 commercial banks for the period of (2010-2015).Secondary data was use in the study. Variables used are liquidity, customer deposits, tangibles, regression analysis was used, based on the analysis it was find banks that are more involved in non-interest earning activities do well as compared to other banks that are not involved in it.

**RESEARCH DESIGN**

This study employed a ex-post facto research design . Descriptive statistics was adopted since it allowed the researcher to describe the population of interest. The design also allowed the researcher to describe the correlation between non-interest income and the listed commercial banks' financial performance. This enabled the researcher to understand how various non-interest income sources influence the performance of commercial banks.

**SOURCES OF DATA**

The source of data used in this study is the secondary sources.Secondary data were sources from CBN fact book, Nigeria Stock exchange fact book.

**MODEL SPECIFICATION**

ROE=$\beta_o$+ $\beta_1$COLAt+ $\beta_2$FETt+ $\beta_3$INVIt+ $\mu$j

NII (non interest income) can be proxy by the following commission on loans and advances (COLA) foreign exchange trading(FET) investment income(INVI)
Therefore the model specification for the study become.
ROE=

## IV. DATA ANALYSIS AND DISCUSSION OF FINDINGS

**Table 4.1: Descriptive statistics on UBA**

| Variables | Percentage (%) | Mean | Median | Max | Min | StdDev |
|---|---|---|---|---|---|---|
| ROE | 23 | 1.94 | 0.23 | 5.12 | 2.31 | 1.054 |
| COLA | 60 | 21.61 | 19.21 | 60.05 | 6.48 | 11.009 |
| FET | 10 | 19.91 | 17.22 | 58.13 | 8.72 | 7.274 |
| INVI | 40 | 7.02 | 6.10 | 18.08 | 4.58 | 10.229 |

**Source: researcher computation 2020**

Table 4.1 shows that in UBA return on equity account for on 23% and mean average of 1.94 contribution to the performance of the bank, commission on loan and advances (COLA) account for 60% and average mean value of 21.61 While foreign exchange trading (FET) of the bank also is noted from the table to have average mean value of 19.91 with 10% on the dependent variables. Investment income (INVI) also has average mean value of 7.02 and 40% impact on the dependent variable, This result means that there a very strong relationship of the independents variables on the dependent variable which enhances the performance of the bank over the period of time studied. The study reveal that both the maximum and minimum shows that in all situations, the variables contribute positively.

**Table 4.2: Descriptive statistics on First Bank PLC**

| Variables | Percentage (%) | Mean | Median | Max | Min | StdDev |
|---|---|---|---|---|---|---|
| ROE | 9.7 | 1.97 | 0.39 | 3.98 | 2.0 | 1.465 |
| COLA | 90 | 18.11 | 16.01 | 58.01 | 5.2 | 14.323 |
| FET | 10 | 13.00 | 11.08 | 32.23 | 7 .98 | 12.368 |
| INVI | 65 | 5.40 | 4.09 | 16.32 | 3.15 | 1.549 |

**Source: Researcher computation 2020**

Table 4.2 shows that in first bank PLC, their return on equity account for 9.7% relationship on the dependent variable with an average mean value of 1.97 on the banks performance as measure by the dependent variable. Commission on loan and advances (COLA) also has 90% relationship on the dependent variable and mean value of 18.11. This means that commission on loan and advances (COLA) also affect the performance of the bank greatly. Foreign exchange trading (FET) account for

65% relationship on the dependent variable and average mean value of 5.40,. All these is a clear indicator that the variables of the study enhance banks performance as part of non-interest income of banks. The maximum and minimum shows positive influence on ROE of the bank.

**Table 4.3: Descriptive statistics on Fidelity Bank Bank**

| Variables | Percentage (%) | Mean | Median | Max | Min | StdDev |
|---|---|---|---|---|---|---|
| ROE | 32 | 20.951 | 18.77 | 60.12 | 3.93 | 5.771 |
| COLA | 23 | 7.297 | 6.71 | 24.24 | 3.23 | 1.791 |
| FET | 1.9 | 8.451 | 6..39 | 24.10 | 13.12 | 1.349 |
| INVI | 0.1 | 40.057 | 21.46 | 62.56 | 15.10 | 11.461 |

**Source: Researcher computation 2020**

Table 4.3 indicates that return on equity of fidelity bank has a average mean value of 20.951 with 32% relationship on the dependent variable . Commission on loan and advances (COLA) has mean value of 7.297 with a percentage of 23 on the performance of the bank as measure by dependent variable. Foreign exchange trading (FET) has a mean value of 8.451 and a percentage value of 1.9% effect on the dependent variable . This implies that the variable ha a direct link on determining the performance of the bank with respect to non-interest income. Investment income (INVI) also has mean value of 40.057 and 0.1% impact on the dependent variable. This also means that Investment income (INVI has effect on performance but the effect is not so great as indicated by the percentage value. These result as well implies that the variable used in the model all have positive contribution to performance of banks in respect of non-interest income and. Hence, a good measure for non-interests income study.

## V.SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

### SUMMARY OF FINDINGS

The findings of the study concluded that listed commercial banks have moderately diversified their income from the core bank business into noninterest income. The findings also showed that there is a great relationship between non-interest income and financial performance of commercial banks as indicated by the autonomous value return on equity. The findings of the study established that increasing noninterest income increases RoE. The findings agreewith studies contacted by Murithi (2013) and Oniang'o (2015), on the effects of revenue diversification intonon-interest income on financial performance of banks in Nigeria and found out that noninterest income affects performance of commercial banks to a great extent. The findings of the study were also consistent with studies carried out by Njenga, (2014) on determinants of non-interest income in Kenya's commercial banks and Gichure, (2015) on the relationship between non interest income and financial performance of commercial banks in Nigeria. The studies concluded that there was a positive relationship between noninterest income and financial performance of commercial banks. The findings of the study were not in agreement with a study by Mndeme (2015) on impact of noninterest income on bank performance . The findings concluded that increase in share of noninterest income has a positive impact on bank performance across all types of banks. However, the results supported the hypothesis that diversification was better for the performance of banks. On the other hand Ng'eno (2012) found out that expansion into fee-based services will diminish ROE and enlarge earnings volatility.

### *Conclusion*

The study concluded that there was a positive relationship between non-interest income and financial performance of commercial banks. The study also concluded that non-interest income influenced commercial banks financial performance.

The study concluded that bank commission on loans and advances had a positive and significant influence on the financial performance of Commercial banks listed on the NSE. The hypothesis that bank commission on loans and advances had no significant influence on the financial performance of Commercial banks listed on the NSE is therefore rejected. The study also concluded that foreign exchange trading income had a positive and significant influence on the financial performance of Commercial banks listed on the NSE. The hypothesis that foreign exchange trading income had no significant influence on the financial performance of commercial banks listed on the NSE is therefore rejected. The study further concluded that investment income had a positive and significant influence on the financial performance of Commercial banks listed on the NSE. The hypothesis that investment income had no significant influence on the financial performance of Commercial banks listed on the NSE is therefore rejected.

## VI. Recommendations

The study found out that commission on loans and advances, foreign exchange trading income and transaction and account related income had diverse significance on effect of the financial performance of commercial banks listed at the NSE. The study therefore recommends that commercial banks in Nigeria can rely on noninterest items such as commission on loans and advances, foreign exchange trading income, and transaction and account related income as reliable sources of income for the banks. Income from investment has positive relationship with financial performance. Commercial banks should be prudent when diversifying into investment income because of the likehood the returns would move in the opposite direction with the overall performance of banks.

The study also recommends that commercial banks should look for more alternative sources of income other than their core activities and those noninterest income streams discussed in this study.

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## Appendix

*DATA PRESENTATION*

**UBA Plc**

| Year | ROE(M) | COLA(M) | FET(M) | INVI(M) |
|---|---|---|---|---|
| 2015 | 2.13 | 28.56 | 20 | 0.1 |
| 2016 | 2.22 | 28.54 | 19 | 0.5 |
| 2017 | 3.0 | 29.60 | 20 | 1.2 |
| 2018 | 3.10 | 32.1 | 22 | 1.08 |

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| | | | | |
|---|---|---|---|---|
| 2019 | 4.01 | 34.2 | 24 | 1.12 |

**First Bank Plc**

| Year | ROE(M) | COLA(M) | FET(M) | INVI(M) |
|---|---|---|---|---|
| 2015 | 0.06 | 1.21 | 8.0 | 6.02 |
| 2016 | 0.26 | 5.36 | 7.1 | 6.09 |
| 2017 | 0.28 | 6.01 | 6.2 | 7.6 |
| 2018 | 2.01 | 7.02 | 5.6 | 7.8 |
| 2019 | 2.49 | 7.89 | 4.8 | 8.2 |

**Fidelity BankPlc**

| Year | ROE(M) | COLA(M) | FET(M) | INVI(M) |
|---|---|---|---|---|
| 2015 | 20.81 | 8.02 | 9.5 | 48.3 |
| 2016 | 20.9 | 8.06 | 9.8 | 48.36 |
| 2017 | 22.3 | 9.06 | 10.2 | 45.61 |
| 2018 | 25.8 | 9.7 | 10.3 | 45.61 |
| 2019 | 26.9 | 9.19 | 10.5 | 46.89 |