PDF - BANK SPECIFIC DETERMINANTS OF CAPITAL ADEQUACY OF LISTED DEPOSIT MONEY BANKS IN NIGERIA - researchcub.info**CHAPTER ONE**

INTRODUCTION

1.1Background to the Study

Banks occupy an important position in the financial sector and their activities are subject to regulation and supervision for the purpose of preserving financial stability. The banking sector of an economy stimulates the economic competence by mobilizing savings to investment channels. It serves as a bridge between savers and borrowers and to execute all tasks concerned with the profitable and secure channelling of funds. Beyond the intermediation function, the financial performance of banks has significant implications for economic growth of an economy as sound financial performance rewards the investors and other stakeholders for their investment and encourages additional investment. On the other hand, poor banking performance may lead to banks' failure and collapse which could negatively impact on the economic growth of the economy. Banks serve as means of transmitting monetary policy of the federal government at the macroeconomic level. At micro economic level, banks are major source of financing for businesses and individuals. Banks therefore facilitate spending and investment that fuel growth in the economy.

The soundness of banking systems plays a vital role not only for local depositors but for foreign creditors and investors as well. If there is an increase in bad loans and investments, the liabilities of the domestic banks will exceed the real value of their assets and depositors will likely engage in bank run which will precipitate a banking crisis. Although the risk can be avoided through a government's deposit insurance, complete reliance on the deposit insurance can encourage banks to engage in riskier lending

(Feldstein, 2003). A systemic collapse can also hinder the ability of the deposit insurance fund to cover all of the deposits. It is not possible to eradicate bank failure completely, but governments want to make the possibility of default for any given bank very small. Through this, it is hoped to boost the confidence of private individuals and

businesses in the banking systems by creating a stable economic environment. A major difference exists between bank and non-bank firms in terms of bankruptcy. The bankruptcy of large non-banking firms has relatively lesser impact on the economy as a whole compared with the collapse of a bank. The bankruptcy of a bank results in a systemic crisis that adversely affects the economy at large. This is mainly because bank failures adversely affect investors‘ confidence in the financial system and this will decrease credit supply which in turn results in economic recession. Furthermore, the banking business depends to a large extent on public confidence which helps banks to attract deposit and invest same in profitable investment opportunities.

Banks are expected to have adequate amount of capital in order to support its business expansion; to serve as a buffer to prevent any unexpected loss that banks might face and also to absorb losses arising from a various risks that they face. Banks are also required to have a buffer according to the provisions of the minimum capital requirement set by the regulatory authorities.

Bank regulators everywhere in the world are concerned with the safety of depositors‘ funds. It is for this reason the capital adequacy becomes relevant and important. Capital adequacy refers to the amount of equity capital and other securities which a bank holds as reserves against risky assets as a hedge against the probability of bank failure (Greuning & Sonja, 2003). It also refers to the extent to which the assets of a bank exceed its liabilities, and is thus a measure of the ability of the bank to withstand a financial loss. Capital adequacy in banking business gives protection against sudden financial losses. According to the Capital Adequacy Standard set by Bank for International Settlements (BIS), banks must have a primary capital base equal at least to eight percent of their assets.

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