



NATIONAL OPEN UNIVERSITY OF NIGERIA

**NIGERIAN FINANCIAL SYSTEM
COURSE CODE: ECO 724**

**FACULTY OF SOCIAL SCIENCES
DEPARTMENT OF ECONOMICS**

COURSE CONTENT DEVELOPER

Anthony Ilegbinosa Imoisi (PhD)

Department of Economics

Faculty of Arts, Management and Social Sciences

Edo University Iyamho, Edo State

Course Content Editor

Ganiyat A. Adesina-Uthman, PhD., *acma, mnes, fce, fifp*

Associate Professor

Department of Economics, Faculty of Social Sciences

National Open University of Nigeria, FCT Abuja

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INTRODUCTION

The Nigerian Financial System is a two credit unit course for Postgraduate Diploma in economics. It is prepared and made available to all students in PGD Economics programme. The course is very important to you in your academic pursuit and will assist you to gain a profound knowledge of the Nigerian financial system. This course is intended to expose you to various financial institutions operating within and outside Nigeria.

This course guide enlightens you on what the financial system entails. Also, it gives you the essential information about the course, the kind of the materials you will be using and how to make good use of them to ensure adequate success in your programme. In addition, this course guide shows you how to make use of your time and how to deal with tutor-marked assignment. There will be tutorial session for the period of which your facilitator will show you how to deal with the difficult areas and simultaneously have significant interaction with your fellow learners.

COURSE CONTENT

This course familiarizes the students to the theory and practices of financial system or financial institutions which comprises of the bank financial institutions and the non-bank financial institutions. It covers current topics such as the meaning and overview of the financial system; nature and functions of financial institutions; the composition and roles of the financial markets; nature of financial assets/instruments; history and functions of the central bank of Nigeria; structure and roles of commercial banks; evolution and roles of merchant and rural banks; organization, performance and roles of development banks; an overview of microfinance banks and co-operative banking in Nigeria; insurance companies; international financial institutions; the World Bank; The International Monetary Fund and the African Development Bank

COURSE AIMS

This course acknowledges that graduates of PGD Economics will want to further their post graduate studies; in addition, they will like to act as managers/decision-makers in financial institutions. The aim of this course is to provide these potential

masters students, managers as well as decision-makers with the necessary knowledge to solve practical problems.

COURSE OBJECTIVES

To realize the aims of this course, there are general objectives. Furthermore, each unit also has specific objectives. These objectives are included at beginning of a unit, you ought to read them before you begin to go through the unit. Also, you might want to refer to them during your study of the unit to keep an eye on your progress.

Below are the broader objectives of the course as a whole. By meeting these objectives you ought to have achieved the aims of the course as a whole.

On successful completion of the course you should be able to:

- explain the meaning of financial system
- discuss the financial market
- analyse financial institutions
- explain financial assets
- describe the evolution and functions of central bank
- explain the roles and functions of commercial banks
- describe the role of merchant banks and development banks
- discuss the functions of microfinance banks
- explain the roles of insurance companies
- discuss international financial institutions
- discuss the World Bank
- examine the International Monetary Fund (IMF)
- describe the African Development Bank (ADB)

WORKING THROUGH THE COURSE

To complete this course efficiently, you are required to read the study units, referenced books and other materials on the course.

Each unit contains self-assessment exercises in addition to tutor-marked assignment. At some point in the course, you will be obliged to submit assignments for assessment purposes. At the end of the course there is a final examination. This course should take approximately 14 weeks to complete and some parts of the course are outlined under the course material subsection.

COURSE MATERIALS

The major components of the course are:

1. Course Guide
2. Study Units
3. Textbooks
4. Assignment File
5. Presentation Schedule

STUDY UNITS

This course consists of 14 units divided into three modules as given below:

MODULE ONE: AN OVERVIEW OF THE FINANCIAL SYSTEM, INSTITUTIONS, MARKETS AND SERVICES

Unit One - Meaning and Overview of the Financial System

Unit Two - Nature and Functions of Financial Institutions

Unit Three - The Composition and Roles of the Financial Markets

Unit Four - Nature of Financial Assets/Instruments

Unit Five – Meaning and Types of Financial Services

MODULE TWO: DOMESTIC FINANCIAL INSTITUTIONS

Unit Six - History and Functions of the Central Bank of Nigeria

Unit Seven - Structure and Roles of Commercial Banks

Unit Eight - Evolution and Roles of Merchant and Rural Banks

Unit Nine - Organization, Performance and Roles of Development Banks

Unit Ten - An Overview of Microfinance Banks and Co-operative Banking in Nigeria

Unit Eleven – Islamic Banking

Unit Twelve – Insurance Companies

MODULE THREE: INTERNATIONAL FINANCIAL INSTITUTIONS

Unit Thirteen – International Financial Institutions

Unit Fourteen – The World Bank

Unit Fifteen – The International Monetary Fund

Unit Sixteen – The African Development Bank

TEXTBOOKS AND REFERENCES

Every unit has a list of references and further reading. Endeavour to get sufficient amount of those textbooks and materials listed. The textbooks and materials are meant to broaden your knowledge of the course.

ASSIGNMENT FILE

There are assignments in this course and you are expected to do all of them by following the schedule set down for them in terms of when to attempt the homework and submit same for grading by your tutor.

PRESENTATION SCHEDULE

The presentation schedule included in your course materials offers you the significant dates for the completion of tutor-marked assignments and attending tutorials. Remember, you are obliged to submit all your assignments by the due date. You ought to safeguard against falling behind in your work.

ASSESSMENT

Your assessment will be based on Tutor-Marked Assignments (TMAs) and a final examination which you will write at the end of the course.

TUTOR-MARKED ASSIGNMENT

Assignment questions for the 14 units in this course are contained in the assignment file. You will be able to finish your assignments from the information and materials contained in your set books, reading and study units. Though, it is advantageous that you show that you have read and researched more extensively than the required minimum. You ought to use other references to have a wide-ranging perspective of the subject and also to give you an in-depth understanding of the subject.

When you have finished each assignment, send it, collectively with a TMA form, to your tutor. Ensure that each assignment gets to your tutor on or before the deadline set in the presentation schedule. If for any reason, you cannot finish your work on time, get in touch with your tutor before the assignment is due to talk about the likelihood of an extension. Extensions will not be granted after the due date except there are extraordinary conditions. The TMAs more often than not make up 30% of the entire score for the course.

FINAL EXAMINATION AND GRADING

The final examination for ECO 724 will be two hours duration and have a value of 70% of the total course grade. The examination will be made of questions which reveal the kinds of self-assessment practice exercises and tutor-marked problems you have beforehand encountered. All areas of the course will be assessed

You ought to use the time between finishing the last unit and sitting for the examination to revise the whole course material. You may find it helpful to appraise your self-assessment exercises, tutor-marked assignments and comments on them before the examination. The final examination covers information from all parts of the course.

COURSE MARKING SCHEME

The Table presented below indicates the total marks (100%) allocation.

Assessment	Marks
Assignment	
(Best three assignments out of the four marked)	30%
Final Examination	70%
Total	100%

COURSE OVERVIEW

The Table presented below indicates the units, number of weeks and assignments to be taken by you to successfully complete the course, Nigerian Financial System (Eco 724).

Units	Title of Work	Weekly Activity	Assessment (End of Unit)
1.	Meaning and Overview of the Financial System	1	
2.	Nature and Functions of Financial Institutions		
3.	The Composition and Roles of the Financial Markets		
4.	Nature of Financial Assets/Instruments		
5.	Meaning and Types of Financial Services		1 st Assignment
6.	History and Functions of the Central		

	Bank of Nigeria		
7.	Structure and Roles of Commercial Banks		
8.	Evolution and Roles of Merchant and Rural Banks		
9.	Organization, Performance and Roles of Development Banks		
10.	An Overview of Microfinance Banks and Co-operative Banking in Nigeria		2 nd Assignment
11.	Islamic Banking		
12.	Insurance Companies		
13.	International Financial Institutions		
14.	The World Bank		
15.	The International Monetary Fund		
16.	The African Development Bank		3 rd Assignment

HOW TO GET THE MOST FROM THIS COURSE

In distance learning the study units replace the university lecturer. This is one of the great advantages of distance learning; you can read and work through specially designed study materials at your own pace and at a time and place that suit you best. Think of it as reading the lecture instead of listening to a lecturer. In the same way that a lecturer might set you some reading to do, the study units tell you when to read your books or other material, and when to embark on discussion with your colleagues. Just as a lecturer might give you an in-class exercise, your study units provides exercises for you to do at appropriate points.

Each of the study units follows a common format. The first item is an introduction to the subject matter of the unit and how a particular unit is integrated with the other units and the course as a whole. Next is a set of learning objectives. These objectives let you know what you should be able to do by the time you have completed the unit. You should use these objectives to guide your study. When you have finished the unit you must go back and check whether you have achieved the objectives. If you make a habit of doing this you will significantly improve your chances of passing the course and getting the best grade.

The main body of the unit guides you through the required reading from other sources. This will usually be either from your set books or from a readings section. Self-assessments are interspersed throughout the units. Working through these tests will help you to achieve the objectives of the unit and prepare you for the assignments and the examination. You should do each self-assessment exercise as you come to it in the study unit. Also, ensure to master some major historical dates and events during the course of studying the material.

The following is a practical strategy for working through the course. If you run into any trouble, consult your tutor. Remember that your tutor's job is to help you. When you need help, don't hesitate to call and ask your tutor to provide the help.

FACILITATORS/TUTORS AND TUTORIALS

There are some hours of tutorials (2-hour sessions) provided in support of this course. You will be notified of the dates, times and location of these tutorials, together with the name and phone number of your tutor, as soon as you are allocated a tutorial group.

Your tutor will mark and comment on your assignments, keep a close watch on your progress and on any difficulties you might encounter, and provide assistance to you during the course. You must mail your tutor- marked assignments to your tutor well before the due date (at least two working days are required). They will be marked by your tutor and returned to you as soon as possible.

Do not hesitate to contact your tutor by telephone, e-mail, or discussion board if you need help. The following might be circumstances in which you would find help necessary.

Contact your tutor if:

- You do not understand any part of the study units or the assigned reading
- You have difficulty with the self-assessment exercises
- You have a question or problem with an assignment, with your tutor's comments on any assignment or with the grading of an assignment.

You should try your best to attend the tutorials. This is the only chance to have face to face contact with your tutor and to ask questions which are answered instantly. You can raise any problem encountered in the course of your study. To gain the maximum benefit from course tutorials, prepare a question list before attending them. You will learn a lot from participating in discussions actively.

SUMMARY

On successful completion of the course, you would have developed critical thinking and analytical skills (from the material) for efficient and effective discussion of financial system. However, to gain a lot from the course please try to apply everything you learn in the course to term paper writing in other related courses. We wish you success with the course and hope that you will find it both interesting and useful.

MAIN CONTENT

MODULE ONE: AN OVERVIEW OF THE FINANCIAL SYSTEM, INSTITUTIONS, MARKETS AND SERVICES

Unit One - Meaning and Overview of the Financial System

Unit Two - Nature and Functions of Financial Institutions

Unit Three - The Composition and Roles of the Financial Markets

Unit Four - Nature of Financial Assets/Instruments

Unit Five – Meaning and Types of Financial Services

MODULE TWO: DOMESTIC FINANCIAL INSTITUTIONS

Unit Six - History and Functions of the Central Bank of Nigeria

Unit Seven - Structure and Roles of Commercial Banks

Unit Eight - Evolution and Roles of Merchant and Rural Banks

Unit Nine - Organization, Performance and Roles of Development Banks

Unit Ten - An Overview of Microfinance Banks and Co-operative Banking in Nigeria

Unit Eleven – Islamic Banking

Unit Twelve – Insurance Companies

MODULE THREE: INTERNATIONAL FINANCIAL INSTITUTIONS

Unit Thirteen – International Financial Institutions

Unit Fourteen – The World Bank

Unit Fifteen – The International Monetary Fund

Unit Sixteen – The African Development Bank

MODULE ONE: AN OVERVIEW OF THE FINANCIAL SYSTEM, INSTITUTIONS, MARKETS AND SERVICES

Unit One - Meaning and Overview of the Financial System

Unit Two - Nature and Functions of Financial Institutions

Unit Three - The Composition and Roles of the Financial Markets

Unit Four - Nature of Financial Assets/Instruments

Unit Five – Meaning and Types of Financial Services

UNIT ONE - MEANING AND OVERVIEW OF THE FINANCIAL SYSTEM CONTENTS

1.0 Introduction

2.0 Objectives

3.0 Main Content

3.1 Meaning of Financial System

3.2 An Overview of the Financial System

3.3 Structure and Roles of the Nigerian Financial System

3.4 Essential Features of an Ideal Financial System

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 References/Further Reading

1.0 INTRODUCTION

This unit gives details as well as put in plain words the meaning of financial system. In addition, the unit gives an explanation on the overview, organization, functions and essential features of the financial system.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Define the financial system
- Explain an overview of the financial system
- Discuss the structure and roles of the Nigerian financial system
- Explain the essential features of an ideal financial system

3.0 MAIN CONTENT

3.1 Meaning of the Financial System

A nation's local financial system is a pool of instructional as well as other arrangements that transfer savings from persons that creates them to persons who eventually utilize them for productive activities such as investments or for expenditure. It is composed of the procedures for managing, organizing as well as coordinating imbursements for current and capital transactions; a procedure for pooling and transferring funds by the banking institutions and other depository institutions; procedures that includes capital markets activities regarding the issuance, buying and selling of viable and transferable long-term securities; processes that deals with the operations of money and credit markets that controls,

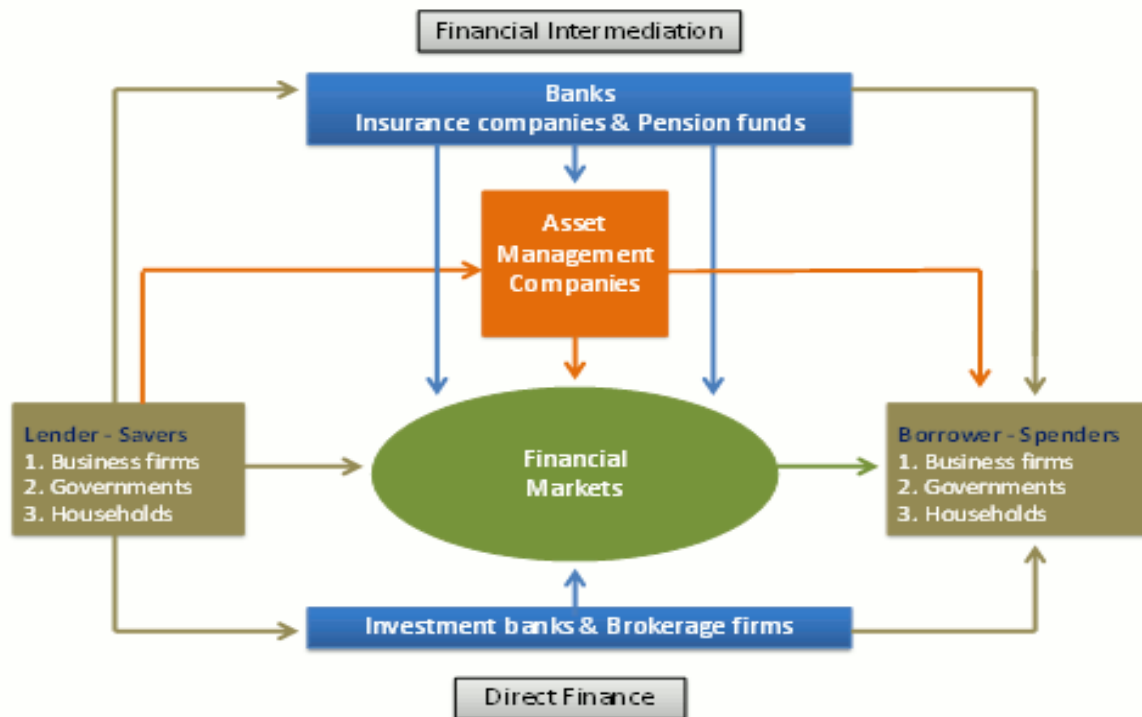
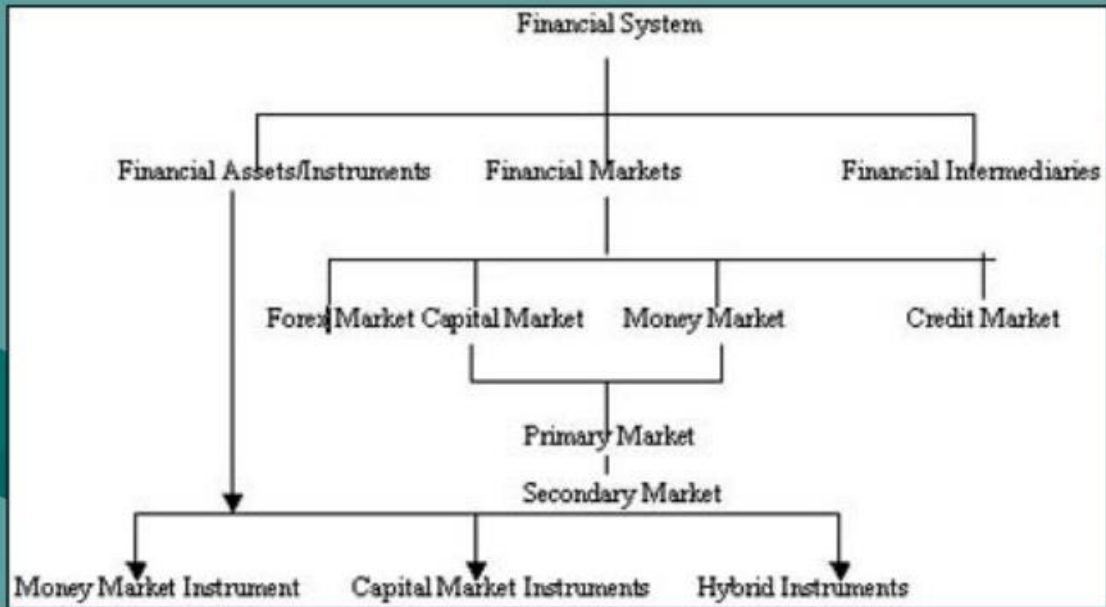
manages and supervise short-term financial instruments; and practices that involves financial market activities that harmonizes the capital market, credit and money markets, which essentially offer hedging facilities.

Each financial intermediary that functions in an economy's financial sector is included in its financial system. It is anchored on the principle that economic agents are classified into surplus and deficit economic entities. The surplus economic entities include individuals, groups or organizations functioning inside the economy that have excess funds more than their urgent needs. They make up the suppliers of surplus cash to the financial system. The deficit economic entities are those that have inadequate funds and therefore need borrowing to finance their operations. They are the users of the additional or excess cash supplied by the surplus spending entities in the financial system.

The financial system offers a milieu that is conducive for development of productive activities; advancement of financial intermediation; efficient formation of capital and effective supervision of the payments system. ***The process of financial intermediation*** comprises of savers lending to intermediaries, who in turn lend to firms as well as other fund utilization units. The saver holds claim against the intermediaries, in the form of deposits rather than against the firm. These institutions offer valuable services by lessening the cost to individuals, offering information, achieving diversification as well as attaining sufficient liquidity.

The financial system is diagrammatically depicted below and underneath it, is an illustration of the financial intermediation process.

Structure of a Financial System



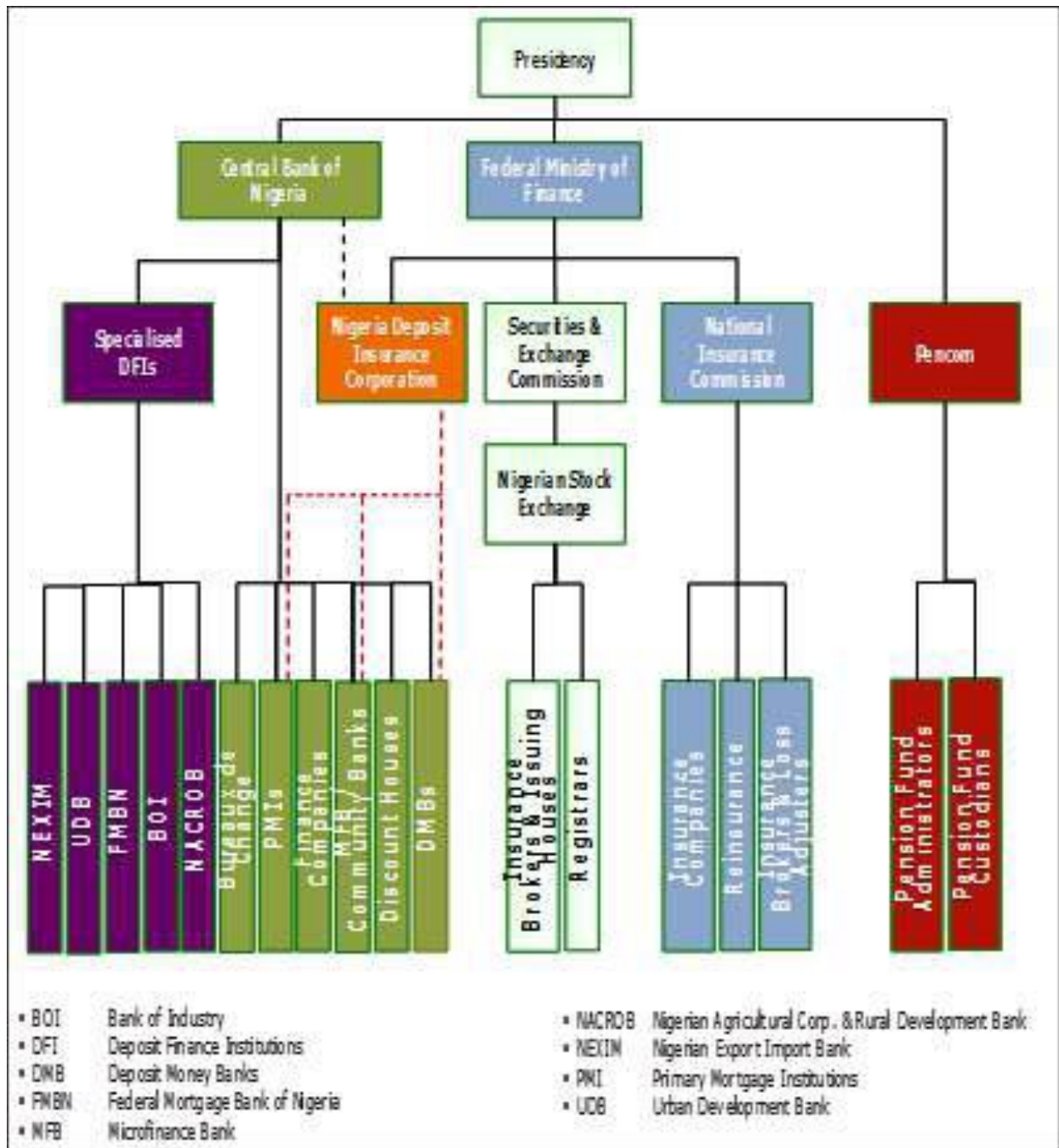
Source: CBN's Monetary Policy Department (2017)

3.2 An Overview of the Financial System

The financial system in Nigeria comprises of markets related to finance such as the money and capital markets; institutions that deals on finance and these includes the regulatory and supervisory establishments; development finance organisations for example, the Bank of Agriculture (deals on agriculture), the Bank of Industry (deals on commerce and industry); the Federal Mortgage Bank of Nigeria (deals on housing); the Nigeria Export Import Bank (deals on net foreign trade); the National Economic Reconstruction Fund (deals on long-term financing to profitable SMEs), The Infrastructure Bank (deals on provision of finance to assist long-term infrastructure projects) and other financial institutions such as Insurance companies, pension funds, finance companies, Bureau de change, and Primary Mortgage Institutions), among others (CBN's Monetary Policy Department 2017). In addition it provides instruments used in the financial markets, for example, treasury bills, treasury certificates, certificates of deposits etc.

The Nigerian Financial System's structure has been through extraordinary modifications, for instance, changes in ownership structure, variations in duration and size of financial instruments utilized, alterations in the number of institutions set up, transformation in regulatory and supervisory structures and the entire macroeconomic environment in which they carry out their operations. Furthermore, the Nigerian Financial System encompasses interrelationships among the people and the institutions that constitute the economy. Generally, commercial banks are the pertinent financial institutions that promote and mobilize savings and in addition, transfer savings into productive investment units.

Diagram of an Overview of the Nigerian Financial System



Source: CBN's *Monetary Policy Department (2017)*

SELF-ASSESSMENT EXERCISE

Define the financial system

3.3 Structure and Roles of the Nigerian Financial System

The Nigerian financial system is made up of the following:

i. **Formal Sector** – This comprises of the bank and non-bank financial institutions.
a. The banking financial institutions are made up of the central bank, commercial banks, retail banks and internet banks (Horton, 2020).

b. The non-bank financial institution does not have a complete banking license and cannot accept deposits from the general public. Though, they do facilitate alternative financial services, for instance, investment, risk pooling, financial consulting, brokering, money transmission, and check cashing. In addition, they are a source of consumer credit. Examples of nonbank financial institutions include insurance firms, venture capitalists, currency exchanges, some microloan organizations, and pawn shops (World Bank, 2016).

The bank and non-bank financial institutions will be discussed extensively in subsequent chapters

ii. **Informal Sector** –This sector cover an extensive variety of market activities. Firstly the informal sector is created by the actions of persons and families in an economy where employment opportunities are inadequate. Secondly, this sector is an outcome of reasonable behavior of entrepreneurs that wish to stay away from state regulations, which plainly means they function outside the regulatory purview of the government (CBN’s Monetary Policy Department, 2017).

The activities of this sector are not easy to measure and it cuts across a broad range of sector, such as economic, socio-economic and information covering activities like causal jobs, unpaid jobs, subsistence agriculture etc Each of these business activities have implications for the formulation and implementation of public policy. The informal sector comprises of the local money lenders, saving associations, etc

The banking financial institutions are monitored by the Central Bank of Nigeria (CBN), Federal Ministry of Finance, Nigeria Deposit Insurance Corporation (NDIC), Securities and Exchange Commission (SEC), the National Insurance Commission (NIC), and the Federal Mortgage Bank of Nigeria (FMBN).

The informal sector is for the most part not properly organised with the absence of any form of formal regulation. To explain the financial system and appraise its operations, one needs knowledge of its functions in the economy. With regards to the allocation of resources as well as economic efficiency, the financial system performs these vital roles, which are important to economic growth and development. These roles include

- It provides a suitable as well as effective payments system without which specialization in production would to a great extent be obstructed.
- It pools savings from net surplus economic units and channels them to productive investment.
- It augments economic performance of the players by making the general welfare of the people better.
- It offers a platform for financial infrastructure to assist in allocating resources to individuals/units that are possibly more productive, to invest those resources.
- It gives room for further efficient transfer of resources/funds. In any economy, problems of inefficient allocation of financial resources as well as information asymmetry might take place as one financial institution has superior information than the other parties.
- It offers a balance between those who have funds to invest and those in need of funds, if the problem of information asymmetry is solved.

The transfer of funds from *surplus economic units* (particularly household, corporations and governments) to *deficit economic units* (particularly business, government and a number of households) can occur directly, whereas direct finance, as the process is called is not convenient both for the final provider of funds as well as the final user of funds because the intermediation of banks is eliminated.

3.4 Essential Features of an Ideal Financial System

According to Anyanwu (1996), an ideal financial system is typified by the following strongly inter-related features: it ought to be stable, efficient, competitive, flexible and balanced. He briefly discussed these features below:

- **Stable** - It is very important for confidence to be sustained in the financial system, particularly in times of financial panic. It has to be capable in taking in macroeconomic shocks stemming from business cycles, and able to control a contractionary effect on activity and trade, as well as any inflationary impact on prices.
- **Efficient** - An efficient financial system directs savings to investments with the highest rate of return, allowing for risk. This comprises of allocative, operating, as well as dynamic efficiency.

- **Competitive** – An ideal financial system must have an adequate number of participants.
- **Flexible** - The instruments utilized as well as the procedures of operation must be capable to adapt to changes in the economic and financial structure.
- **Balanced** - A balanced financial system requires that there ought to be an optimal blend of numerous kinds of financial system with regard to both transfer of current savings and the stock of past savings. The optimal blend would be such that changes in one part can be absorbed by changes in another without having too much effect on the providers and users of savings, and giving both a sufficient period of adjustment. It is significant to note that the ideal blends of these strongly inter- related features will vary as the process of economic growth proceeds.

3.5 Financial System Stability

When systemic risks, macroeconomic shocks or crises are non-existent in a financial system, it is said to be stable. Macfarlane (1999) sees financial system stability as basically the prevention of financial crisis in an economy. In this definition, macroeconomic shocks or systemic crises are emphasized because financial instability does not only mean financial ill-health of a specific household, firm, bank but extended to the whole financial system in a country. Foot (2003), opined that for financial stability to be attained in an economy, the following have to be realized:

- the level of employment in the economy has to be close to its natural rate;
- monetary stability has to be achieved
- the general public ought to have high confidence in the operations of vital financial institutions and markets
- there has to be relative stability in the price movements of both real and financial assets.

Some time ago, inadequate wide-ranging regulatory frameworks by the regulatory and supervisory authorities to avert, and resolve the banking distress / crisis management caused a major test to financial system stability. It was against this backdrop that the regulatory authorities in Nigeria (CBN and the NDIC) made a decision in December, 2001, to establish the framework on distress resolution and deal with a number of systemic issues encountered by the financial sector.

Consequently, several policies have been put together and implemented to make the financial sector stronger and robust.

4.0 CONCLUSION

The study of financial system equips you with the knowledge of a lot of fascinating issues. In this unit, we gave a blueprint of the Nigerian financial system by discussing its structure and roles. Furthermore we discussed the essential features an efficient financial system should have in order to facilitate its financial intermediation process of transferring funds from the surplus economic units to the deficit economic units

5.0 SUMMARY

This unit has introduced you to: the meaning of financial system, an overview of the financial system, the structure and roles of the Nigerian financial system as well as the essential features of an ideal financial system.

6.0 TUTOR-MARKED ASSIGNMENT

1. Give an overview of the financial system
2. Explain the essential features of an efficient financial system?

7.0 REFERENCES/

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UNIT TWO - NATURE AND FUNCTIONS OF FINANCIAL INSTITUTIONS

CONTENTS

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
 - 3.1 What is a Financial Institution?
 - 3.2 Types of Financial Institution
 - 3.3 Advantages of Financial Institution
 - 3.4 Disadvantages of Financial Institutions
 - 3.5 Roles of Financial Institutions
 - 3.6 Problems faced by Financial Institutions
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor-Marked Assignment
- 7.0 References/Further Reading

1.0 INTRODUCTION

This unit defines and explains the financial institution. Furthermore the unit further explains the types, advantages, disadvantages, roles of financial institutions. The problems faced by financial institutions in Nigeria are also discussed.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Define what a financial institution is
- Explain the types of financial institutions
- Discuss the advantages as well as the disadvantages of financial institutions
- Give details on the roles of financial institutions
- Analyse the problems faced by financial institutions in Nigeria

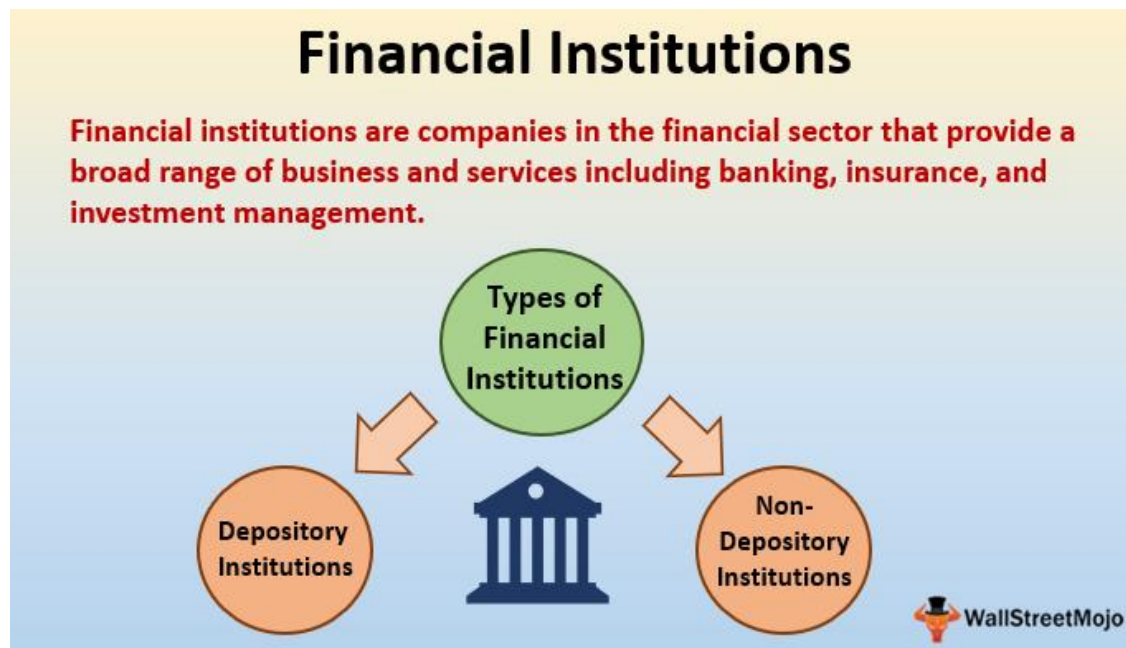
3.0 MAIN CONTENT check for plagiarism

3.1 What is a Financial Institution?

Financial institutions (FI) are engaged in the business of handling monetary, financial as well as economic transactions, for instance, credits, investments, credit exchange, loans and advances. It involves a wide range of business operations

inside the financial sector that includes banks, trust companies, insurance companies, brokerage firms, and investment dealers.

They are intermediaries between customers and the debt markets offering banking and investment services. They are a place where consumers can efficiently manage earnings and develop financial footing. Furthermore, they are private or public institutions that serve as a link between savers and borrowers of funds.



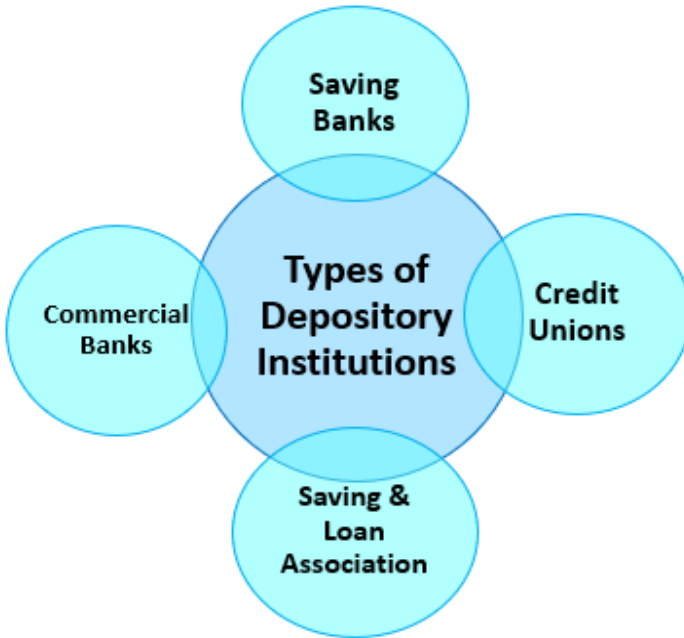
Source: www.wallstreetmojo.com

3.2 Types of Financial Institutions

There are a lot of different types of financial institutions existing in the financial market for the flows of fund. They are divided principally on the kind of transactions carried out by them, for example, some are engaged in depository whereas others are engaged in non-depository kind of the transactions. The type of financial institutions includes:

a. Depository Institutions:

Types of Depository Institutions are –



Source: www.wallstreetmojo.com

Depository institutions are financial institutions that are legally allowed to receive deposits (cash and other valuable items from consumers). They include commercial and savings banks, credit unions, savings and loan associations. The different kinds of depository institutions are briefly explained below:

- **Commercial Banks** – They receive deposits from the general public as well as provide security to their customers. As a result of commercial banks, it is no longer necessary to keep huge currency at hand. By means of commercial bank facilities, transactions can be carried out through checks or credit/debit cards.
- **Saving Banks** – They carry out the role of receiving savings from individuals and loaning them out to the other customers.
- **Credit Unions** – These are institutions which are formed by participants who willingly connect with the aim of putting aside their money and then loaning it out to members of their union only. Thus, they are non-profit institutions that enjoy tax exemptions.
- **Saving and Loan Association** – These institutions bring together the money of most small savers and thereafter loan them to people who want to buy

homes or other types of borrowers. They focus on offering assistance to people in getting residential mortgages.

b. Non-Depository Institutions:

These are the financial institutions that operate as the intermediary between savers and the borrowers but they do not receive time deposits. Such institutions carry out their lending activities to the general public either by selling securities or through the insurance policies. Non depository institutions include insurance companies, finance companies, pension funds, and mutual funds.

In the United States of America, the Federal Deposits Insurance Corporation (FDIC) ensures that the deposit accounts of people and businesses with financial institutions are safe. While in Nigeria, the Nigerian Deposit Insurance Corporation is saddled with this responsibility

Furthermore, these two types of financial institutions can be represented in three main types of financial institutions (Siklos, 2001, Robert, E. W. and Quadrini, V. (2012). They are

- Depository Institutions : They accept and manage deposits and make loans, including banks, building societies, credit unions, trust companies, and mortgage loan companies
- Contractual Institutions: These includes insurance companies and pension funds; and
- Investment Institutions: These include investment banks, underwriters, and brokerage firms.

SELF-ASSESSMENT EXERCISE

Explain the types of financial institutions

3.3 Advantages of Financial Institutions

There are several different advantages of financial institutions. Some of these are as follows:

- Financial institutions carry out key roles with regards to the new firms that might face difficulties in obtaining funds from the general public. In such situation, they can make the funds accessible to these firms. Furthermore, expansion as well as modernization can also be funded without much strain by the firms.
- They provide both risk and loan capital. These institutions provide underwriting facilities. Along with these services, professional guidance or advice can also be obtained from them for successful planning and supervision of the company's projects.
- If the companies need to import machineries or equipment outside their home country, they can make use of the support provided by financial institutions since they offer loans and guarantees for foreign currencies along with facilities of deferred payments.
- The basic facilities of repayment process and interest rates of these financial institutions are usually suitable and economical. Along with these facilities, the repayments of loans in simple installment are also made available to deserving concerns.

3.4 Disadvantages of Financial Institutions

The disadvantages of financial institutions include the following:

- There are several documentations and bureaucratic procedures through which an individual/organisation needing funds from financial institutions has to experience. This takes the time and efforts of these individuals/organisations needing the funds. Furthermore, most of the worthy individuals/organisations might be unsuccessful due to difficult conditions laid down by these institutions.
- Every now and then, clauses are included in the loan agreements for these loans given out to the parties, thus placing restrictions on the autonomy of the management of the concerned individual. Furthermore, from time to time, they are adamant on appointing their nominees in the company's board of directors.

3.5 Roles of Financial Institutions

The roles of financial institutions include the following:

- **Directing the Payment System** - One of the foremost and most public roles of financial institutions is managing the payment system. This refers to daily commercial transactions that involve individuals and businesses. Financial institutions keep the payment system in motion through checks and savings accounts, credit cards, and wire transfers. These processes of exchange allow individuals to handle their financial transactions on a daily basis.
- **Assist with Resources and Capital** - Financial institutions help people and corporations with resources and capital management by offering credit to those who are capable of paying back. Banks and other institutions can pool resources together to allow others to borrow money. Loans and credit cards allow families and companies to borrow money and pay back on a normal schedule. Acquiring capital for a new or existing business or personal project can be hard, so financial institutions allow people and businesses to have access to the capital they need to be successful.
- **Moving Financial Resources** - Another vital role of financial institutions is the moving of resources around from place to place. These institutions assist companies with huge transfers of funds, purchase of real estate, construction loans, and other larger transactions, such as paying annuities. Financial institutions can transfer resources from one party to another without difficulty and with more flexibility than people or corporations can.
- **Risk Management** - Financial institutions manage risk and uncertainty for companies and families. For example, insurance companies allow large numbers of individuals to pool and share the risk, making it less difficult to handle accidents and other difficulties that occur in business or personal life.
- **Informing Financial Decisions** - Financial institutions provide vital information that makes financial decisions easier. Rather than waiting on a central authority to provide you information about factors like interest rates, you can pay a visit to a bank or call an investment advisor. The information financial institutions offer allows individuals and corporations to make educated and secure decisions.
- **Maintaining the Market** - Financial institutions make it possible for people and other entities to invest in the stock market. Investors can make long-term or short-term ventures into the market with the aim of higher returns.

Institutions like stock exchanges allow companies to issue stock in order to have more cash flow based on investors purchasing stock. Normally, the stock market drives the pulse of the financial sector as a whole.

- An Interdependent Financial System - The roles of financial institutions work together to form a completely interdependent financial system. When every role acts healthily, the other roles work well and the monetary system in its entirety is more stable. If there is a problem with one role, it can reflect on the other roles of the financial system. The health of the financial sector rests on a subtle balance between the numerous roles of financial institutions.

3.6 Problems faced by Financial Institutions in Nigeria

Financial institutions in Nigeria face a number of problems which are discussed below:

Bad Loans – This happens when borrowers are incapable of paying back their loans as at when due. This problem affects the operations of financial institutions because it tends to tie up capital that would have been used for development and investment.

Illiteracy – Due to the high level of illiteracy in Nigeria, some of the customers of most financial institutions are illiterates and their inability to efficiently communicate sadly hampers the operations of financial transactions.

Government Policies - Government policies affects financial institutions, for instance, the government might make a policy to solve a particular problem in the economy, but this policy might in turn limit the profit making potentials of financial institutions, for example, the abolition of commissions on turnover (COT).

Inadequate Profits - Most Nigerian financial institutions encounter low profits and are yet to make adequate returns on their investment and equity. This has led to a huge retrenchment of workers in most financial institutions since they are expected to reduce costs in order to maximize profits.

Poor Customer Services - Most Nigerian financial institutions are not updated with standard modern customer service delivery. These poor service deliveries have reduced the customer base of such institutions as majority of customers requires top quality services particularly as it concerns money.

Insufficient Capital Base - Most Nigerian financial institutions particularly banks, had a capital base that was not more than US\$10 million while the largest bank in the country had a capital base of about US\$240 million. This compares unfavorably with the situation in Malaysia where the smallest bank had a capital base of US\$526 million. Their small capital base has a direct effect on every transaction, it also brings about a direct dependence on public and individual customers deposit.

Poor Ethics And Professionalism - The Nigerian financial institution particularly the banks are growing with unethical and unprofessional practices. In a bid to control the enormity of this unpleasant practices, the banking regulatory committee set up a sub-committee on “ethics and professionalism” to handle such complaints.

4.0 CONCLUSION

An in-depth knowledge of financial institutions provides you with the understanding of a lot of interesting issues. In this unit, we gave a framework of the financial institution focusing on its definition, types, advantages, disadvantages and roles. Furthermore we discussed the problems faced by financial institutions in Nigeria

5.0 SUMMARY

This unit has introduced you to: the meaning, types, advantages, disadvantages and roles of financial institutions. Furthermore the problems faced by financial institutions in Nigeria were also discussed.

6.0 TUTOR-MARKED ASSIGNMENT

1. Explain the roles of financial institutions
2. Discuss the problems faced by financial institutions in Nigeria

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UNIT THREE - THE COMPOSITION AND ROLES OF THE FINANCIAL MARKETS

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1.0 INTRODUCTION

In this unit, we shall study the financial market which comprises of the money and capital market. Our discussion shall take us to the definition of financial market. Furthermore, we shall extensively look at the definition as well as the roles of both the money and capital market.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define and explain both the money and capital market
- explain features of a developed money market and sections in a capital market
- discuss the aims for the establishment of the Nigerian money and capital market
- list and explain roles of the money and capital market
- discuss common money market instruments and participants in the capital market

3.0 MAIN CONTENT

3.1 Meaning of the Financial Market

The financial market is an arrangement where there exists an exchange of commodities, securities as well as other important items at transaction costs. A number of these securities are stocks, bonds, agricultural products and precious metals. It comprises of institutions, agents, brokers and intermediaries (banks, insurance companies, pension funds) transacting purchases and sales of securities. In the financial sector, the financial market on a regular basis refers only to markets that are employed to raise funds which might be long term, for instance, the capital market or short term, for instance, the money market. Furthermore, the term can usually be used for all markets in the financial sector, for example, the capital market which comprises of stock and bond markets, commodity market, money market, derivatives market, futures market, foreign exchange markets and spot market, interbank market.



Source: *CBN's Monetary Policy Department (2017).*

The financial market is in general divided mainly into two markets namely:

- Money Market and
- Capital Market

3.2 Money Market

This is a market where financial instruments that are deemed to be very liquid with extremely short maturities are traded. In the short term, it offers participants an opportunity to borrow and lend for a period of overnight to one year. The securities traded in the money market are specifically IOU by large corporations, governments and financial institutions and are extremely safe and liquid.

3.2.1 Features of a Developed Money Market

A developed money market is quite effective since it is open to changes in demand for and supply of finance in any of its parts, and any influence/impact that starts in any part rapidly spread to others with no significant time lags. Based on this

definition, Anyanwu (1996) was of the opinion that a money market ought to have the following features:

- Existence of a Central Bank: There must be a central bank that has the expertise to commence, initiate as well as implement monetary policy; has sufficient legal powers, adequate significant information and is a lender of last resort.
- Existence of a developed commercial banking system: A developed money market ought to have a developed commercial banking system, together with wide-ranging banking habit on the part of the general public.
- Sufficient supply of a range and quantity of financial assets: There ought to be sufficient supply of a range and quantity of short-term financial assets or instruments, for instance, trade bills, treasury bills, etc.
- Existence of well-developed sub-markets: The presence of well-developed sub-markets as well as their adequate reaction to small changes in interest rate develops the money market. If the demand and supply of specific instruments rules, the interaction between different interest rates will be limited
- Presence of specialized institutions: The presence of specialized institutions in certain kinds of assets for instance, specific discount houses, accepting bills, or specialized dealers in government securities etc can bring about competitiveness and efficiency.
- Presence of contributory legal and economics: The presence of suitable legal provisions to decrease transaction costs, safeguard against default in payments, while economic forces, for instance fast and inexpensive transmission of information, inexpensive fund remittance, and sufficient amount of trade and commerce have to exist.

3.2.2 Aims for the Establishment of the Nigerian Money Market

The following are the aims for the establishment of the Nigerian money market:

- To make the desired mechanism available for government's short-term financing requirements
- To efficiently mobilize resources with the aim of carrying out investments

- To indigenize the credit base by offering local investment outlets for the retention of funds in Nigeria as well as for the investment of funds repatriated from overseas due to the influence of government to that effect.
- As a necessary step on the path to independent nationhood, hence it was part of a modern financial and monetary system which was to allow the nation set up the monetary autonomy which is part of the mechanism of an independent, modern state.
- To carry out all the roles which money market conventionally performs in a country, for instance, providing the basis for operating and implementing an effective monetary policy.

SELF ASSESSMENT EXERCISE

Discuss the features of a developed money market

3.2.3 Roles of the Money Market

The money market performs the following roles:

- It provides the foundation for operating and executing an effective monetary policy.
- To encourage an orderly flow of short-term funds.
- To ensure supply of the essential means of expanding and contracting credit.
- It is a central pool of liquid financial resources upon which it can make payments when it holds funds surplus to its needs.
- It provides the machinery through which the banking system liquidity is sustained at the desired level.
- To provide banks with the fundamental financial requirements for efficient management of their resources. Therefore, assisting them to generalize their assets holding by offering a medium for investment of their surplus cash.
- To offer the mechanism desired for government's short-term financial requirements, hence, achieving even seasonal alternative in the usual flow of revenue.
- Mobilization of funds from savers (lenders) and transmission of such funds to borrowers (investors).
- It offers a channel for the injection of central bank cash into the economy.

- To preserve stable cash and liquidity ratios as the foundation for the operation of the open market operation (OMO).
- It assists commercial banks to reduce cash reserves through the provision of first line of defense for cash shortages through bills.

3.2.4 Money Market Instruments

The following are familiar money market instruments:

- Treasury Bills – Their issue for the first time in Nigeria (in April 1960) was provided for under the Treasury bill ordinance of 1959. They are issued by the federal government of Nigeria and are sold at a discount and mature within 91 days of the day of issue and are default-free. They offer the government with a highly flexible and relatively cheap means of borrowing cash. In addition they offer a sound security for dealings in the money market, and the Central Bank of Nigeria specifically, can operate on that market by dealing in treasury bills. Therefore, treasury bills were IOUs, utilized by the federal government to borrow for short periods of about three months, pending the collection of its revenues.
- Treasury certificates- These are like treasury bills and were introduced in 1968 to replace commercial bills. They have a maturity between one and two years. The amount paid on the acquisition of the certificate is normally less than the discount on the bill but the actual amount is repaid by the CBN at maturity.
- Commercial bills – They were introduced in 1962 and normally utilized by commodity board and it is re-discountable by the CBN. However, they were abolished in 1968 when banks declined to carry on with their involvement in the World Cocoa Market.
- Call money- They were introduced in 1962 and guarantee the payment of money on demand to the issuing bank. In addition, they allow commercial banks and non-banking financial institutions to keep their temporary surplus cash with the CBN who in turn invest the fund. It was abolished in 1974 but up till now, banks do operate it among themselves.
- Certificate of deposit – It is a time deposit, usually given to consumers by banks, thrift institutions, as well as credit unions. It was introduced in Nigeria in 1985 to channel commercial banks surplus funds into merchant banks issued in multiple of N50, 000 and re-discountable by the CBN in

case the issuing bank cannot redeem them at maturity. The maturity period ranges between 3 and 36 months. For those with maturity of less than 18 months, the discounts may be utilized in required ratio of the holding bank.

- Stabilization security - This is an efficient monetary policy introduced in 1976 to mop up banks' excess liquidity with an empowerment of CBN to issue the security and sell them by allocation to banks and other financial institution who are in turn required by law to take up any allocated amount in which failure to do so causes imposition of penalty

3.3 The Capital Market

The capital market is a group of financial institutions established with the aim of granting long-term loans. It is a market where long-term instruments are traded such as government securities, corporate bonds, corporate shares (stocks) as well as mortgage loans. In other words, it is the market for the mobilization and utilization of long-term funds for growth and development of the financial system.

3.3.1 Section of the Capital Market

There are two sections of the capital markets namely primary and secondary markets. They are briefly discussed below:

A. Primary market: It deals with issue and sales of new securities of companies which beforehand are not quoted on the stock exchange market. Means of raising funds in the primary capital market include.

- Offer for sale: A firm can sell the whole issue of shares or debentures to an issue house or merchant banker at a settled price, which is usually below the par value. The shares or debentures are later resold by issue house/merchant bankers to be public.
- Obtaining term loans: Firms can raise long term cash by getting hold of long-term loans, more often than not from financial institutions. Term loans are also called as term finance which symbolizes a source of debt finance and is usually repayable in more than one year but less than 10 years.
- Right issue: This means selling securities in primary market by issuing shares to existing shareholders.
- Private placing: The issue is sold directly to a small group of investors mostly institutional investors like insurance companies, banks, mutual funds, few private investors, etc.

- Public issue: Firms can borrow funds from primary market by means of public issue of shares and debentures. To handle its issue a firm can take the assistance of merchant bankers. The cost of raising funds via public issue is high as compared to other methods.

B. Secondary market: It is a market for buying and selling of second hand securities. In this market holders of existing shares who wish to sell them can have contact with individuals or institutions interested in buying them.

3.3.2 Aims for the Establishment of the Nigerian Capital Market

The following are the aims for establishing the Nigerian capital market:

- To launch the code of conduct, curb abuses as well as regulate the activities of operators in the market.
- To offer domestic opportunities for borrowing and lending for long-term purposes.
- To allow the authorities mobilize long-term capital for the economic and development of the nation.
- To offer services for the quotation and set marketability of shares and stocks and opportunities as well as facilities to raise new capital in the market.
- To offer overseas businesses with the facilities to offer their shares, and the Nigeria public a chance to invest and take part in the ownership of overseas businesses.
- To provide a vibrant and equally suitable environment for participation and co- operation of indigenious as well as expatriate capital in the combined effort to develop the Nigerian economy for the mutual benefit of both parties.

3.3.3 Roles of the Capital Market

The following are roles of the capital market:

- To promote speedy formation of capital.
- To provide adequate liquidity for any investor or group of investors.
- To generate built-in operational as well as allocational efficiency inside the financial system in order guarantee that resources are optimally used at fairly little costs.

- To mobilize savings from various economic units for economic growth and development.
- To promote a more efficient allocation of new investment via the pricing mechanism.
- To offer alternative sources of fund other than taxes for the government.
- To expand of the ownership base of assets and the formation of a vigorous private sector.
- To promote an efficient allocation of a specified amount of tangible wealth via changes in wealth ownership as well as composition.
- To offer an efficient medium for the allocation of savings among competing productive investment projects.
- To mobilize long-term financial resources for industrial development.
- It is an essential liquidity means for investors through a formal market for debts and equity securities.

3.3.4 Participants in the Capital Market

The key participants in the capital market are the Central Bank of Nigeria (CBN), the Securities and Exchange Commission (SEC), the Nigerian Stock Exchange (NSE), and the Stock Brokers. We shall be discussing only the Securities and Exchange Commission (SEC) and the Nigerian Stock Exchange (NSE) in this subsection while Central Bank of Nigeria (CBN) will be treated as a unit.

3.3.4.1 Securities and Exchange Commission (SEC)

The Securities and Exchange Commission (SEC) is a vital institution in the capital market after the CBN. Initially called the Capital Issues Committee (1962-1972), and the Capital Issue Commission (1973-1979), SEC was established by the SEC Act of 27th September, 1979 which was re-enacted by the SEC Decree of 1988. The SEC is the apex regulatory body of the capital market and has the objectives of encouraging an orderly and efficient capital market in Nigeria by providing a suitable environment for savings and investment required for economic development; to make sure that the prices of stocks and shares are fair and appropriate; and to make sure that there is adequate protection of the investing public. However, it should be noted that unlike the CBN, SEC does not take part in the capital market as a buyer or seller of securities.

3.3.4.1.1 Roles of the Security and Exchange Commission (SEC)

In general, SEC's main roles include:

- To determine the price and time at which companies' securities are to be sold
- To register all securities planned to be offered privately with the aim that they would be held eventually other than by those to whom the offers were made
- To register all stockbrokers, investment adviser, registrars and market places in the industry such as stock exchange branches with a view of maintaining good codes of conduct as well as professionalism in the industry.
- To maintain general surveillance of the market to make sure that there is orderly, just and reasonable dealings and to take steps to forestall illegal and unethical dealings, such as insider trading at the expense of the public
- To determine the basis for allotment of securities offered to the market to ensure spread and equity; and
- Determining the volume of issue coming to the market with a view to preventing the market from being over flooded with issues.

3.3.4.2 The Nigerian Stock Exchange (NSE)

The Nigerian Stock Exchange (NSE) was established in 1961 by the Lagos Stock Exchange Act, the Lagos stock exchange was reconstituted into the Nigerian Stock Exchange (NSE) in 1977, and presently has six trading floors in Lagos, Port Harcourt, Kano, Kaduna, Onitsha and Ibadan. It is the trading floor of the capital market and it is a secondary market where there is sale and purchase of existing securities. The main participants are the stockbrokers as the dealing members with the CBN acting as the buyer of last resort of government's securities not absorbed in the market.

In terms of organization, the NSE comprises of the following:

- Council members responsible for the everyday management of the exchange and
- Dealing members who are the stockbrokers licensed by the council to deal in government and industrial securities quoted on the exchange and whose conduct are guided by the exchange's rules and regulations.

3.3.4.2.1 Roles of the Nigerian Stock Exchange (NSE)

The Nigerian Stock Exchange (NSE) performs the following roles:

- Provision of the mechanism to mobilize private and public saving as well as making them accessible for productive investment through stocks and shares.
- Provision of a meeting place for dealing members to buy and sell existing stocks and shares, plus provision of opportunities for raising new capital.
- To make the purchase and sale of securities easy.
- To make dealings in government securities easy and therefore provide government with finance for development purpose.
- Protection of the general public from crooked deals and practices through its rules, regulations, as well as operating codes, with the aim of ensuring just dealing.

4.0 CONCLUSION

The money market is a perfect place for firms or financial institutions to keep surplus funds until they are required. It also provides an efficient source of funds to firms, government and intermediaries that need short-term funds. While capital markets are institutions where intermediate and long-term funds are pooled and made available to individuals, businesses and governments. These two markets are significant to the growth and development of the Nigerian economy.

5.0 SUMMARY

You learnt in this unit the definition and explanation of roles of both the money and capital market. Furthermore, the features of a developed money market and sections in a capital market were also discussed. The aims for the establishment of the Nigerian money and capital market as well as the common money market instruments and participants in the capital market were also explained to give an in depth understanding of both the money and capital market.

6.0 TUTOR-MARKED ASSIGNMENT

1. Discuss the aims for the establishment of the Nigerian money market.
2. Explain the roles of the Security and Exchange Commission (SEC).

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UNIT FOUR - NATURE OF FINANCIAL ASSETS/INSTRUMENTS

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3.2 Types of Assets

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3.6 Liquidity of Financial Instruments

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 References/Further Readings

1.0 INTRODUCTION

In this unit, we shall study the financial assets/instrument. Our discussion ought to take us to the meaning of financial assets. In addition, we shall take a wider look at the types, features, denomination as well as the liquidity of financial assets.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define financial assets
- explain the types of assets
- discuss the features of financial assets
- list and explain they types of financial assets
- discuss the denomination as well as liquidity of financial assets

3.0 MAIN CONTENT

3.1 Meaning of Financial Assets

They are tangible liquid assets whose values are obtained from their contractual claim, for example, bank deposits, bonds, stocks, etc. In essence, they do not have

material worth unlike land, properties, commodities or other tangible physical assets. Normally, their values vary as the assets do not have value prior to being changed to cash specifically in the case of stocks.

Conversely, monetary contracts amongst interested parties that can be bought and sold, formed, moderated and even cleared up are seen as financial instruments. Examples include shares showing ownership interest or bond which signifies the contractual right to distribute or receive cash.

In addition, financial assets are usually more liquid than other assets (tangible), like commodities or real estate. Financial asset might additionally be bought and sold in financial markets. Assets that can be bought and sold and in addition serve as packages of capital are financial instruments. They could be cash, contractual rights of delivering or receiving cash or other types of financial instrument or it can be in the form of proof of ones' ownership of entity.

3.2 Types of Assets

Generally, assets are divided into tangible and intangible assets

- **Tangible assets:** These are the physical form of an asset. It includes both fixed and current assets. The fixed assets are land, buildings, machinery whereas an example of current asset is inventory. These assets are the spine of firms and enable them to carry on with production but are not accessible to clients. Fixed assets can also be described as assets that have material form such as cash, equipment, plant, property that could exist in physical form for a long period of time. Its purchase is for the operation of the business and not essentially for sale to customers.
- **Intangible assets:** These are those assets that do not take physical form, like goodwill, copyrights, trademarks, patents as well as brand recognition. They are long-term resources, but, they cannot be touched or felt as they have no physical existence. Normally, these assets are categorized into two broad groups namely:
 - a. Definite or Limited-life intangible assets, such as goodwill, copyrights and patents and
 - b. Indefinite or Unlimited-life intangible assets, like trademarks. In addition, intangible assets exist on the contrary to tangible assets like land, vehicles, equipment, inventory, stocks, bonds and cash. An example of a firm's

indefinite asset is its brand name because it stays with it all through its period of operation.



Source: CBN's Monetary Policy Department (2017).

SELF ASSESSMENT EXERCISE

List and explain the types of assets

3.3 Features of Financial Assets

Financial Assets generally have the following features

- **Moneyness:** The capacity to without difficulty change an asset into cash within a specified period of time and determinable value is known as the moneyness of the financial asset. The inference of financial assets being moneyness is the simplicity of changing it to cash in an obviously definite period of time.
- **Reversibility:** Given that they work as customers' deposit account, financial assets are tremendously reversible. There is an insignificant cost involved in investing in financial assets and its reversal. Due to this insignificant cost,

the process of reversing financial assets is over and over again seen as roundtrip or turnaround cost. The important part of these costs is called the 'bid-ask spread' for embedding delivery cost of the commission.

- **Cash Flow:** When an investor holds a financial asset, he/she is likely to obtain some returns on the basis of cash distributions of the asset to holders. A financial asset returns on investment is influenced by repayment principal in terms of debt instrument as well as shocks anticipated price alteration. In the process of calculating financial assets' anticipated returns, we will have to take into consideration non-cash payments such as yield in stock dividend and additional stock purchase.
- **Maturity:** Maturity in the context of financial assets refers to the period of time within which a financial instrument is held before it is repaid to the holder. For instance, a corporate body can hold a bond for twenty years and a government can extend the period to say eighty years before repayment to the holders.
- **Convertibility:** Financial assets and instruments that pay regular interest can be converted to other assets and instruments on the basis that prices are appreciating to a predetermined level. The convertibility feature means that a financial instrument or asset can be converted into another asset class. The conversion can be carried out by the same corporate body that held the financial asset or instrument to persist to raise money for its operations.
- **Predictable Returns:** For investors to shop for financial assets, their returns must be predictable. The percentage of interest accruable to a particular debt instrument ought to be known to investors before they are ready to risk their funds on such instrument. This is meant to keep away from manipulation of records by Boards and Managements.
- **Returns & Tax Status:** The returns associated with financial assets being taxable earnings are subject to tax status. The concern of tax authorities are in collecting of taxes on earnings associated with financial assets which are regarded as securities and investors' income. Nevertheless, the tax status on financial assets is difference for the reason that they change from one economy to another. In addition, changes of such tax rate are equally the case occasionally on financial assets and this depends on the concern of the government which is articulated by means of the tax/fiscal authority.

Furthermore, the status of tax on financial assets differs in terms of the type of security compared to the other based on the issuing institutions or companies in terms of being Federal, State, or local government.

3.4 Types of Financial Assets/Instruments

According to CBN's Monetary Policy Department (2017), generally, we have the following types of financial assets/instruments. These include:

- **Equity Instruments:** This can lawfully serve as proof of ownership right in a company such as share certificate. Usually, it is issued to shareholders of companies for funding the business. There are numerous classes of equity instruments such as common stock, convertible debenture, preferred stock, depository receipt, transferable subscription right (TSR).
- **Debt instruments:** These are assets that oblige a holder to be paid a fixed amount of money, normally with interest. Mortgages and bonds, both corporate and government, are good examples of debt instruments.

3.5 Denomination of Financial Assets

Usually, financial assets of various countries are denominated in their different currencies. For example, the Nigerian financial system financial assets are denominated in Naira. A number of these assets are treasury certificates, treasury bills, federal government loan stock, shares and corporate and state government bonds (CBN, Monetary Policy Department 2017).

The assets in U.S. are denominated in American dollars, the financial assets in France are denominated in French Franc or Euros, and those in Switzerland are denominated in Swiss Francs,. In Egypt and Kenya, they are denominated in Egyptian Pound and Kenyan Shilling respectively.

These financial assets are utilized for transactions and are denominated in different currencies. In spite of the existence of different currencies globally, a number of financial assets (currencies) are traded internationally and not just for domestic markets alone. These are the financial instruments utilized in the highly developed capital markets like U.S., U.K. Japan, France, etc. In these economies, financial assets are normally denominated in American dollars and any other international currencies like the pound sterling, euro that are acceptable all over the world. These international currencies are also said to be internationally convertible.

3.6 Liquidity of Financial Instrument

The categorization of financial instrument as near money is due to the fact that they are highly liquid. This characteristic arises from the ease at which they can be exchanged for cash. Examples of highly liquid financial instruments are; treasury certificates, treasury bills, shares of blue chip entities like UBA, Zenith Bank, etc. A financial instrument is said to be illiquid when it is hard to exchange it easily into cash. In this case, the holder might need to keep hold of it until it matures or it could only be traded at a very insignificant value in the capital markets where jobbers are keen in holding them as part of their securities' stock. Presently, jobbers do not exist in the Nigeria's Stock Exchange. Therefore, brokers in the Nigerian stock exchange are not regularly keen in trading in weak financial instruments of corporations.

4.0 CONCLUSION

A thorough knowledge of financial assets/instruments gives you an insight of how they are traded in the financial markets and how they are handled by financial institutions. In this unit, we gave a blueprint on financial assets/instruments concentrating on its definition, features, types, denomination as well as its liquidity. Furthermore we broadly looked at the types of assets

5.0 SUMMARY

This unit has introduced you to: the meaning, features, types, denomination as well as liquidity of financial assets/instruments. Furthermore types of assets were also discussed.

6.0 TUTOR-MARKED ASSIGNMENT

1. List and explain the types of financial assets/instruments
2. Discuss the denomination and liquidity financial assets/instruments

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UNIT FIVE – MEANING AND TYPES OF FINANCIAL SERVICES CONTENTS

1.0 Introduction

2.0 Objectives

3.0 Main Content

3.1 Meaning of the Financial Services

3.2 Types of Financial Services

3.3 Cost of Financial Services

3.4 Regulation of Financial Services

3.5 Productive uses and Financial Services

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 References/Further Readings

1.0 INTRODUCTION

In unit, we shall take a look at financial services. Our discussion should take us to the meaning of financial services. In addition, we shall take an extensive look at the types of financial assets.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define financial services
- explain the types of services

3.0 MAIN CONTENT

3.1 Meaning of Financial Services

A financial service is defined as the transaction performed by which an individual or business obtains a financial good (Asmundson, 2011). In other words, it includes the transaction needed to acquire the financial good. For instance, there are many things money can buy; there is a difference between a good (something tangible and can for either a long or short time) and a service (a job that someone carries out for you). Thus, a financial service is not the financial good itself such as

the mortgage loan to purchase a house or a car insurance policy, but something that the means of obtaining the financial good. According to Wikipedia, Financial services are economic services made available by the finance industry, which covers wide-ranging transactions that deals with cash, including credit unions, banks, insurance companies, consumer-finance companies, stock brokerages, investment funds, etc. Smith (2018) sees financial service as the service provided by the finance market. In addition, he opined that it is the term used to describe organizations that handles the management of money. Examples are the banks, investment banks, insurance companies, credit card companies and stock brokerages.

The Nigerian financial sector is vast and covers numerous kinds of transactions in areas such as investment funding, banking, insurance, consumer financing, real estate etc.

3.2 Types of Financial Services

According to investopedia (2019), we have the following types of financial services. These include:

i. Banking Services

Banking services especially those provided by commercial banks are the basis of the financial services group. The functions of commercial bank includes: safekeeping of deposits, issuance of credit and debit cards, and the lending of money. The banking sector is particularly interested in direct saving and lending. Banks make their revenue principally on the difference in the interest rates they charge for credit accounts and that paid to depositors. Financial services such as these mainly bring in revenue through commissions, fees and other processes

An investment bank normally carries out their operations with deal makers and wealthy customers and not the general public. They underwrite deals, secure access to capital markets, provide management of wealth and offer advise on tax issues, give advice to firms on mergers and acquisitions, and make the buying and selling of stocks and bonds easy.

ii. Investment Services

This includes the process of accessing the financial markets by individuals. Brokers facilitate the trading of securities and get a commission for their service. Annual fees might be charged by financial advisors based on management of assets and direct numerous trades in the quest of building and managing a well-diversified portfolio. Robots (software) are the most recent embodiment of financial advisors and portfolio management that have extensive computerised algorithmic portfolio allocations and trade implementations.

Mutual funds, hedge funds and investment partnerships invest funds in the financial markets and receive management fees during the course of action. These institutions need custody services for buying, selling and servicing their portfolios, plus lawful, compliance and marketing advice.

Private equity funds, venture capital providers and angel investors make investment capital to companies available in exchange for ownership stakes or profit participation.

iii. Insurance Services

This is another key subsector in the financial services industry. In the US, an insurance agent is different from a broker. The former is a negotiator of the insurance firm, while the latter represents the insured. The underwriter, examines the risk of insuring clients and offers advice to investment bankers on loan risk. Lastly, reinsurers sell insurance to the insurers themselves to assist in guarding them from calamitous losses.

Insurance services are obtainable for guarding against death or injury (e.g. life insurance, disability income insurance, health insurance), against loss of property or damage (e.g. homeowners insurance, car insurance), or against liabilities or lawsuit - among a number of other more targeted categorizations.

iii. Tax and Accounting Services

The huge financial services sector in addition includes accounting services, tax services, currency exchange services, wire transfer services, credit card machine

services and networks. Also it includes debt resolution services and international payment providers as well as exchanges that facilitate stock, etc.

An accountant uses the education or experience acquired in accounting to assess the accuracy of financial statements. Accountants make sure all financial records and statements comply with federal laws and regulations. Also, they gather the information required in preparing entries to company accounts and they record business financial transactions in due course. This information gathered is utilised in preparing weekly, monthly, quarterly or annual closing statements and cost accounting reports. Furthermore, accountants resolve discrepancies or irregularities they notice in records, statements or documented transactions. By and large, they observe established accounting control methods through an accounting system or software program.

Frequently, they are assigned other finance-related tasks in addition to evaluating financial records and statements. They are also saddled with offering recommendations to various departments regarding the competent utilisation of company resources and procedures. These recommendations are intended to offer solutions to potentially costly business financial concerns or problems. In some cases, they are saddled with the preparation and review of invoices for customers and dealers to help with prompt payment on outstanding balances. Settlement of payroll, verification of contracts and orders, preparation of a firm's budget, and the development of financial models or projections might also be part of an accountant's normal responsibilities.

Furthermore accountants prepare and file taxes for firms and individuals. They evaluate all the firm's assets, income earned/paid, or expected expenses and liabilities to get the total tax obligation for the year. With both individual and firm tax preparation and filing, accountants are likely to provide a thorough evaluation of tax efficiency or inefficiency and suggest on how to lessen total tax liabilities in the future.

The differences between these financial services in the financial sector are not straight. For instance, an individual who works in the real estate sector, such as a mortgage broker, may offer a service by assisting clients look for a house loan with a maturity and interest rate structure that goes well with their condition. But those

clients can also borrow from a commercial bank. A commercial bank accepts deposits from customers and loan out the money to get higher returns than it pays for those deposits. An investment bank assists companies in raising funds. Insurance companies take in premiums from clients who buy policies against risks such as an automobile accident etc.

SELF ASSESSMENT EXERCISE

List and explain the types of financial services

3.3 Cost of Financial Services

The manner in which individuals pay for financial services broadly differs, and the costs are not at all times obvious. For transactions that are quite simple, compensation could be on the basis of a flat-rate (say, N1000 in return for filing an application). Charges could also be fixed (N500 an hour to process loan payments), on the basis of a commission (say, 5 percent of the value of the mortgage sold), or on the basis of profits (for instance, the difference between loan and deposit rates). The incentives vary for each kind of compensation, and whether they are suitable depends on the circumstances.

3.4 Regulation of Financial Services

Financial services are vital to the performance of an economy. When they are not available, people with money to save may have difficulties finding those who need to borrow, and vice versa. Also in the absence of these services, individuals would be so focused on saving to take care of the risk that they may not purchase a lot of goods and services.

Furthermore, simple financial goods can be relatively complex, and there are frequent long lags between the buying of a service and the date the supplier has to hand over the service. The market for services relies so much on trust. Both savers and borrowers should have confidence in the advice and information they are getting. For instance, buyers of life insurance depend on the insurance company being around when they pass away. They expect there will be sufficient funds to pay the chosen beneficiaries and that the insurance company won't swindle the heirs.

The significance of financial services in an economy and the need to promote confidence among providers and consumers are among the rationale government supervise the provision of a lot of financial services. This supervision includes regulation, direction as well as licensing which differs from country to country. In Nigeria, there are a number of institutions that supervises financial services, they include: the Central Bank of Nigeria, Securities and Exchange Commission, Nigeria Deposit Insurance Corporation, etc.

The financial sector regulators implement rules and registers financial service providers. Regulation might comprise of regular documentation and assessment of accounts and providers, inspections, as well as examination of complaints. In addition, it can include compliance of consumer protection laws, for instance, limit on credit card rates and assessing overdraft charges. Nevertheless, owing to the present rapid growth in the financial sector; specifically due to new financial instruments can strain the ability of regulators and supervisors to cut back risk. Supervision and enforcement efforts cannot at all times avert failures, for instance, they might not deal with new activities, and unlawful activities every now and then escape enforcement. Due of these failures, supervisors frequently have the authorisation to take over a financial institution when needed.

3.5 Productive uses of Financial Services

Financial services assist in putting money to productive use. Rather than hiding cash under their mattresses, in holes, inside cupboards, etc. consumers can give their savings to intermediaries (such as commercial banks) who may invest them in the next great technology or allow someone to use them in starting up a small and medium scale enterprise. The procedures that intermediate these cash flows can be complex, and a good number of nations depend on regulation to protect borrowers and lenders and assist in upholding the trust that strengthens all financial services.

4.0 CONCLUSION

A methodical comprehension of financial services gives you a perception of how they are performed by financial institutions and how they are regulated and supervised. In this unit, we gave an outline on financial services focusing on its definition, types, cost, regulation and its productive uses.

5.0 SUMMARY

This unit has made you familiar with: the meaning, types, cost, regulation as well as productive uses of financial services.

6.0 TUTOR-MARKED ASSIGNMENT

1. Explain how financial services are regulated in a country?
2. Discuss the productive uses of financial services?

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MODULE TWO: DOMESTIC FINANCIAL INSTITUTIONS

Unit Six - History and Functions of the Central Bank of Nigeria

Unit Seven - Structure and Roles of Commercial Banks

Unit Eight - Evolution and Roles of Merchant and Rural Banks

Unit Nine - Organization, Performance and Roles of Development Banks

Unit Ten - An Overview of Microfinance Banks and Co-operative Banking in Nigeria

Unit Eleven – Islamic Banking

Unit Twelve – Insurance Companies

UNIT SIX - HISTORY AND FUNCTIONS OF THE CENTRAL BANK OF NIGERIA

CONTENTS

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3.2 Functions of Central Bank of Nigeria

3.2.1 Traditional Functions of the Central Bank of Nigeria

3.2.2 Development Functions of the Central Bank of Nigeria

3.3 The Core Mandate of the Central Bank of Nigeria

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 Reference/Further Reading

1.0 INTRODUCTION

Over the years, the Central Bank of Nigeria (CBN) has performed significant task in the nation's economy as well as formulation of sound macroeconomic policies. This unit shall focus on the history, functions as well as the core mandate of the Central Bank of Nigeria.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Discuss the origin of Central Bank of Nigeria
- Explain the traditional and development functions of Central Bank of Nigeria
- Evaluate the core mandate of the Central Bank of Nigeria.

3.0 MAIN CONTENT

3.1 History of Central Bank

A central bank is the authority in charge of policies that have an effect on a country's money supply and credit. More specifically, a central bank employs its

instruments of monetary policy such as open market operations, discount window lending, changes in reserve requirements to influence short-term interest rates as well as the monetary base (currency in the hands of the public plus bank reserves) to achieve modern monetary policy goals.

There are three vital goals of modern monetary policy. The first as well as most significant is price stability or stability in the value of money. Nowadays, this implies keeping a sustained low inflation rate. The second goal is a stable real economy, frequently understood as high employment as well as high and sustainable economic growth. To put it in a different way, it is to say that monetary policy is anticipated to level or even the business cycle as well as counterbalance or offset macroeconomic shocks to the economy. The third goal is financial stability. This includes a well-organized as well as efficient running payments system and the avoidance of crises in the financial system.

The story of central banking dates back at least to the 17th century, to the origin of the first organization identified as a central bank, the Swedish Riksbank. Founded in 1668 as a joint stock bank, it was licensed to provide/lend funds to the government as well as to operate as a clearing house for commerce. Some decades later, precisely in 1694, the most renowned central bank of that time, the Bank of England, was established also as a joint stock company to pay for government debt. Later in Europe, other central banks were established with the same intention, despite the fact that some were set up to manage monetary disorder or monetary hysteria. For instance, in 1800, the Banque de France was founded by Napoleon to stabilize the currency following the hyperinflation of paper money all through the French Revolution, and to assist in public finance. Ancient central banks gave out private notes which acted as currency, and they frequently had a monopoly over such note issue.

While these ancient central banks assisted in funding the government's debt, they were in addition private bodies that participated in banking activities. Since they kept the deposits of other banks, they acted as banks for bankers, making transactions easy between banks or offering other banking services. They turned out to be the repository for nearly all banks in the banking system as a result of their huge reserves as well as wide-ranging networks of correspondent banks. These

factors enabled them to become the lender of last resort during the period of a financial crisis. In other words, they became keen to supply emergency funds to their correspondents in times of financial distress. .

Central banks hold huge gold reserves to make sure that their notes could be converted into gold, as was needed by their charters. When their reserves fall owing to a deficit in the balance of payments or unfavourable domestic situation, they would increase their discount rates (the interest rates at which they lend money to the other commercial banks). Doing so would usually increase interest rates which will attract foreign investment, thus, bringing additional gold into the country.

Central banks stick to the gold standard's rule of upholding gold convertibility above all other considerations. Gold convertibility acted as the economy's nominal anchor. That is, the amount of money banks can supply was limited by the value of the gold they keep in reserve, and this determined the existing price level. Since the price level is attached to a recognized commodity whose long-run value was ascertained by market forces, expectations about the future price level were attached to it as well. Based on this, ancient central banks were solidly dedicated to price stability. They were not too concerned about one of the contemporary goals of central banking (the stability of the real economy) because they were restrained by their commitment to stick to the gold standard.

Presently, central banks also learned to act as lenders of last resort during times of financial distress when occurrence such as bad harvests, defaults by railroads, or wars caused a rush for liquidity (in which depositors ran to their banks and attempt to convert their deposits into cash). The lesson started early on in the 19th century as an outcome of the Bank of England's usual response to such panics. At the time, the Bank (and other European central banks) would frequently guard their own gold reserves first, turning down their correspondents that were in need. Doing this caused major panics in 1825, 1837, 1847, and 1857, and led to harsh criticism of the Bank. In response, the Bank adopted the "responsibility doctrine," suggested by the economic writer Walter Bagehot, which necessitated the Bank to include its private interest to the public interest of the banking system all together. The Bank adopted the Bagehot's rule, which entails lending freely based on any sound

collateral provided—but at a penalty rate (that is, above market rates) to avert moral/ethical risk. The bank learned its lesson properly because no financial crises took place in England for almost 150 years after 1866. It was not until August 2007 that the country encountered its next crisis.

The U.S. experience was most fascinating because it had two central banks in the early 19th century, the Bank of the United States (1791–1811) and a second Bank of the United States (1816–1836). Both were established on the Bank of England's model, but unlike the British, the Americans generally bore a deep-seated suspicion of any concentration of financial power, and specifically of central banks, so that in each scenario, the licenses were not renewed.

There followed an 80-year period typified by substantial financial instability. Between 1836 and the beginning of the civil war (a period identified as the Free banking era) states permitted practical free entry into banking with negligible regulation. Throughout this period, banks failed often, and quite a few banking panics took place. The payments system was disreputably incompetent, with thousands of different state bank notes as well as counterfeits in circulation. In response, the government initiated the national banking system during the civil war. Although the system made the effectiveness of the payments system better by providing a uniform currency based on national bank notes, it still offered no lender of last resort, and this era was rife with stern banking panics.

The crisis of 1907 was the straw that broke the camel's back. It led to the establishment of the Federal Reserve in 1913, which was given the mandate of providing a uniform and elastic currency (that is, one which would accommodate the seasonal, cyclical, and secular movements in the economy) and to act as a lender of last resort.

3.1.1 Brief Origin of the Central Bank of Nigeria

The history to the creation of the Central Bank of Nigeria (CBN) rests in the features as well as imperfections of the monetary system, which came before it. This was the currency board system. The West Africa Currency Board (WACB) was created in November 1912 owing to the recommendation of the Emott committee. Furthermore, due of the shortcomings and disadvantages of the board

there was a pressing necessity for the creation of an organization in the form of the Central Bank of Nigeria (CBN). The supporters of Nigeria's independence mounted pressure on the colonial government and the outcome was the setting up of the Paton commission by the colonial government in 1952. Based on the outcome of this report by the commission, the first banking legislation in Nigeria was passed in 1952 referred to as the banking ordinance of 1952.

The proposal for the creation of the Central Bank of Nigeria (CBN) was originally trounced however the call could not be completely overlooked. Therefore, Mr, J.L. Fisher of the Bank of England in 1953 inquired into the appropriateness as well as possibility of creating a Central Bank of Nigeria (CBN) though his report was not practicable in setting up a Central Bank.

Nevertheless, in 1957, Nigeria achieved an inner autonomy supported by the report of the World Bank mission on the subject matter, the federal government set up a committee led by the Mr. J.B. Loynes, again of the Bank of England in 1957, to proffer recommendations on the creation of Central Bank of Nigeria (CBN), the launching of the Nigerian currency as well as other related matters.

These recommendations culminated in the creation of CBN on March 17th 1958 by the Central Bank of Nigeria (CBN) ordinance of that year. The bank came into existence and started full operation on 1st July 1959, thus getting ahead of the country's Independence Day on October 1st 1960. At the moment, Nigeria has a Central Bank with approximately seven branches as well as seven currency centers.

SELF-ASSESSMENT EXERCISE

Discuss the origin of the Central Bank of Nigeria

3.2 Functions of the Central Bank of Nigeria

The Central Bank of Nigeria does not do business directly with the general public. It carries out its functions with the assistance of commercial banks. The Central Bank of Nigeria is responsible for ensuring financial stability as well as economic growth and development of the Nigerian economy.

Aside from this, the Central Bank of Nigeria in addition plays an important role in circumventing the cyclical fluctuations by regulating the money supply in the market. In the view of Hawtrey, a Central Bank ought to first and foremost be the “lender of last resort.”

Conversely, Kisch and Elkins accepted as true that “the maintenance of the stability of the monetary standard” is a fundamental role of the Central Bank. The functions of the Central Bank of Nigeria are generally divided into two parts, namely, traditional functions and developmental functions.

3.2.1 Traditional Functions of the Central Bank of Nigeria:

The traditional functions of the Central Bank of Nigeria include the following:

(i) Bank of Issue:

The Central Bank of Nigeria has the sole right to issue notes (currency) in the Nigerian economy. In the early years of banking, the right of issuing notes was proliferated. However, this led to numerous problems, for example, currencies were over-issued and the currency system became muddled. Thus, the federal government of Nigeria authorized the Central Bank of Nigeria to issue notes. The issue of notes by the Central Bank of Nigeria led to uniformity in currency circulation as well as balance in the supply of money.

(ii) Government’s Banker, Agent, and Advisor:

This implies that the Central Bank of Nigeria carry out diverse roles for the government. As a banker, the Central Bank of Nigeria carry out banking functions for the federal government as commercial banks does for the public by accepting the government deposits as well as giving out loans to the government. As an agent, the Central Bank of Nigeria handles the public debt, undertakes the payment of interest on debt, as well as offers all other services associated to the debt.

As an advisor, the Central Bank of Nigeria offers advice to the federal government concerning macroeconomic policy matters, financial markets as well as government loans. Aside from this, the Central Bank of Nigeria plans as well as

implements fiscal and monetary policies to control the supply of money in the economy and manage inflation.

(iii) Custodian of Cash Reserves of Commercial Banks:

The Central Bank of Nigeria deals with the cash reserves of commercial banks. Commercial banks are obliged to maintain a certain amount of the public deposits as cash reserve, with the Central Bank, and the other part is kept with commercial banks themselves.

The ratio of cash reserves is determined by the Central Bank. A specific fraction of these reserves is kept with the Central Bank with the intention of giving out loans to commercial banks. Thus, the Central Bank is also called banker's bank.

(iv) Custodian of International Currency:

The Central Bank of Nigeria keeps a minimum reserve of international currency. The major goal of this reserve is to meet up urgent situation requirements of foreign exchange as well as prevailing over the unfavourable condition of deficit in the balance of payments.

(v) Bank of Rediscount:

The Central Bank of Nigeria serves the cash requirements of people as well as businesses by rediscounting the bills of exchange through commercial banks. This is an indirect means of loaning out money to commercial banks by the Central Bank. Discounting a bill of exchange means obtaining the bill by buying it for the sum less than its face value.

Rediscounting means discounting a bill of exchange that was beforehand discounted. When the owners of bill of exchange require cash they approach the commercial banks to discount these bills. If these commercial banks themselves are in need of cash they approach the Central Bank to rediscount the bills.

(vi) Lender of Last Resort:

This refers to the most vital role of the Central Bank. The Central Bank on Nigeria in addition loans money to commercial banks. Instead of rediscounting of bills, the Central Bank offers loans against treasury bills, government securities, as well as bills of exchange.

(vii) Bank of Central Clearance, Settlement, and Transfer:

This means that the Central Bank of Nigeria assists in resolving common indebtedness amongst commercial banks. Banks depositors offer checks as well as demand drafts drawn on other banks. In such a case, it is not probable for commercial banks to approach each other for clearance, settlement, or transfer of deposits.

The Central Bank makes this process trouble-free by putting a clearing house under it. The clearing house serves as an organization where mutual indebtedness among banks is settled. The agents of different banks meet up in the clearing house to resolve inter-bank payments. This assists the Central Bank to be acquainted with the liquidity condition of the commercial banks.

(viii) Controller of Credit:

This means that the Central Bank of Nigeria has the power to control the credit creation by commercial banks. The credit creation depends upon the quantity of deposits, cash reserves, as well as rate of interest given by commercial banks. All these are directly or indirectly managed by the Central Bank. For example the Central Bank can manipulate the deposits of commercial banks by carrying out open market operations as well as making alterations in the cash reserve ratio to regulate a variety of economic conditions.

3.2.2 Developmental Functions:

This refers to the functions that are associated to the encouragement of banking system and economic development of the country. These are not obligatory functions of the Central Bank of Nigeria. They include the following:

(i) Development of Specialized Financial Institutions:

This refers to the most important functions of the Central Bank of Nigeria for the economic development of the nation. The Central Bank of Nigeria sets up institutions that handle credit requirements of the agriculture sector as well as other rural businesses.

Some of these financial institutions include Bank of Agriculture (BOA) and Bank of Industry (BOI). These are referred to as specialized institutions as they assist the specific sectors of the economy.

(ii) Influencing the Financial Market:

The Central Bank of Nigeria assists in controlling the money and capital markets. Money market is the market that deals on short term credit while capital market deals on long term credit. By regulating the activities of these markets, the Central Bank of Nigeria promotes the country's economic growth as well as development.

(iii) Collecting Statistical Data:

The Central Bank of Nigeria collects and analyzes data associated to banking, currency as well as foreign exchange position of the country. These data are very helpful to researchers, policymakers, as well as economists. For example, the Central Bank of Nigeria publishes a magazine called the Central Bank of Nigeria's Bullion; in addition to the statistical bulletin it produces yearly whose data are important for formulating diverse policies and making macroeconomic decisions.

3.3 The Core Mandate of the Central Bank of Nigeria

The mandate of the Central Bank of Nigeria (CBN) is gotten from the 1958 Act of Parliament, as amended in 1991, 1993, 1997, 1998, 1999 as well as 2007. The Central Bank of a Act of 2007 of the Federal Republic of Nigeria charges the bank with the complete management, control as well as administration of the monetary and financial sector policies of the Federal Government.

The objectives of the Central Bank of Nigeria are as follows:

- Guarantee monetary and price stability;
- Issue legal tender currency in Nigeria;
- Sustain external reserves to protect the international value of the legal tender currency;
- Encourage a sound financial system in Nigeria; and
- Serve as Banker as well as offer economic and financial advice to the Federal Government.

As a result, the Bank is charged with the obligation of administering the Banks and Other Financial Institutions (BOFI) Act (1991) as amended, with the sole purpose of making sure that there is high standard of banking practice and financial stability due to its surveillance activities, as well as the encouragement of an effective payment system.

In addition to its main functions, the Central Bank of Nigeria has over the years carried out a number of key developmental functions, focused on all the vital sectors of the Nigerian economy (financial, agricultural as well as manufacturing sectors). In general these mandates are performed by the Bank through its numerous units.

4.0 CONCLUSION

The Central Bank of Nigeria (CBN) plays a significant role in the economic growth and development of the economy. It performs a promotional, financial, operational, regulatory as well as participatory function in the Nigerian financial market. Thus, there is the necessity for a close incorporation between the Central Bank of Nigeria's policies and those of the federal government in order to achieve macroeconomic stability. In addition, there is the necessity to ensure the Central Bank of Nigeria's autonomy so that there ought not be any interference from the federal government.

5.0 SUMMARY

In this unit, you learnt the history of Central Bank of Nigeria, its authorising legislation and origin. You also learnt the functions of Central Bank of Nigeria and its policy implementation and criticism.

6.0 TUTOR-MARKED ASSIGNMENT

1. Discuss the traditional and development functions of the Central Bank of Nigeria.
2. Explain the core mandate of the Central Bank of Nigeria.

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UNIT SEVEN - STRUCTURE AND ROLES OF COMMERCIAL BANKS

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3.6.2 Factors Influencing the Growth of Commercial Banks Branches in Nigeria

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 References/Further Reading

1.0 INTRODUCTION

In this unit, the structure as well as roles of commercial banks in economic development of Nigeria shall be discussed. With reference to; history, features, types of commercial banks and factors influencing the growth of commercial banks branches in Nigeria

2.0 OBJECTIVES

At the end of this unit, you ought to be able to:

- define commercial banks

- explain the structure and roles of commercial banks
- outline the roles of commercial bank in economic development of Nigeria

3.0 MAIN CONTENT

3.1 Definition of Commercial Banks

Bank is a word gotten from the Italian word “*Banco*” which denotes “*Bench*”. Early bankers, for instance the Jews in Lombardy carried out their transactions with the aid of benches inside the market

Commercial banks are recognized as “*Joint Stock Banks*”. They are regarded as financial institutions that present themselves to the general public in a country by offering services such as acceptance of deposits as well as giving out loans and advances in addition to providing other numerous services. They are referred to as “*Branch Bank*” in the United Kingdom, whereas in the United States of America, they are referred to as “*Member Bank*”. In most West African countries, as well as Nigeria, the United Kingdom branch banking is adopted. In these countries, there exist two categories of commercial banks that are in operation, they are: *Partly Foreign Owned Banks* as well as *Fully Indigenous Banks*.

3.2 History of Commercial Banking in Nigeria

In Nigeria, commercial banking began in August 1891, with the setting up of the African Banking Corporation (ABC) branch. Basically, it was set up as a way of making the business of shipping for Elder Dempster and Company easier. Later on in 1983, this company made a purchase of the bank branch with the sum of N2,000 paid to ABC. Subsequently, it was incorporated as the Bank of British West Africa (BBWA) in 1894. Afterwards, the bank changed to Standard Bank of Nigeria, then to First Bank of Nigeria as it is called presently.

A second bank called the Anglo-African Bank was launched in 1899, though it stopped its activities with the conclusion of the merger with British Bank of West Africa. A colonial bank was launched in Nigeria in 1917 and this broke down the monopoly of banking activities by British Bank of West Africa. The Colonial Bank established branches in Jos, Kano, Lagos and Port Harcourt. This bank was taken

up by Barclays Bank and in 1925; it was called Barclays Bank DCO. Later on, it changed to Barclays Bank of Nigeria and later changed to Union Bank of Nigeria as it is known today.

A trait that was similar in these two banks was their foreign ownership. This attribute was common in Nigerian banks until the first successful indigenous bank was launched by a group of indigenous pioneers in field of banking in 1933 called the National Bank of Nigeria Limited. Its success was as a result of the careful management by the Western Regional Government. Though, earlier efforts have been made to set up indigenous banks but failed. For instance, the Industrial and Commercial Bank was set up by a group of Nigerian and Ghanaian Entrepreneur in 1929 but collapsed in 1930 due to inadequate capital, poor management, hostile and unfair competition from the foreign established banks. Furthermore, in 1931, the Nigerian Mercantile Bank was launched by another group of entrepreneurs, among who were the late Dr. A. Maja, Chief T. A. Doherty and Late H. A. Subair but failed in 1936.

The second successful indigenous bank was the Agbomagbe Bank established in 1945 by Chief Okpe and thrived as a private enterprise. It experienced challenges in 1967, but was rescued by the Western Nigerian Development Corporation (WNDC), later called IICC and currently Odua Investment Corporation who took over its business and changed its name to Wema Bank Limited as it is known today. During the same era, the Nigerian Penny Bank was set up but quickly failed in 1946 with devastating effect to depositors.

Also In 1946, Dr. Azikiwe set up the Tinubu Bank to serve the Zik Group of Companies, which was set up in 1941 called Tinubu Properties Ltd. Later on, in 1947, its name was changed to African Continental Bank and was the third successful indigenous bank with its first office in Yaba in 1949. Though the Nigerian Farmers and Commercial Bank was also set up in that year too, it collapsed in 1953. Certainly, between 1929 when the first effort in establishing an indigenous bank and 1959 when the Central Bank of Nigeria was established, quite a few efforts have been made in setting up indigenous banks, though they were not successful. Furthermore, two of the three successful indigenous banks namely: National Bank of Nigeria and African Continental Bank collapsed in 1996.

For us to have additional insight into the history of commercial banking industry in Nigeria, from the set up of the first in 1892 to date, it will be expedient to split it into three separate periods

3.2.1 Period of Unrestricted Banking 1892 -1952

As of 1892 when the first bank was set up and 1952 when the first banking ordinance was adopted, there was too much as well as unrestrained proliferation of banks in Nigeria. Nearly each and every one fizzed away prior to December 1953 as a result of:

- Insufficient capital base
- Amateurish staffing
- Badly –equipped offices
- Inexperienced management
- Failure to meet up the demands of new government regulations.

All that was required were registration of business name, office space, signposts as well as a handful of bank clerks. The event within this period is now a matter of history. The nation observed arbitrary setting up of banks all over the place and as a result disastrous closure of a lot of them. Unfortunately 22 of 24 banks that were unsuccessful were indigenous, while the remaining two were of mixed ownership that is foreign and indigenous.

3.2.2 The Period of Regulated Banking

As a result of the collapse of most banks, for instance, that of the Nigeria Penny Bank in 1946, where individuals lost their entire savings, caused public uproar and Government was compelled to establish the Paton commission of Enquiry. The recommendations of the commission were revealed in 1948, and the first banking ordinance was passed in May 1952. This ordinance as well as the Act that later substituted it attempted to provide a description of “bank” as any individual who performed banking transaction, and banking transaction is explained as the business of receiving money on current account and collecting cheques drawn by or paid in by customers as well as making advances to customers.

In addition, among other things, the ordinance instructed a minimum paid up capital of £12,500(N25, 000) if the bank headquarters is inside Nigeria or £200,000 (N400, 000) if the headquarters is outside Nigeria. The 1958 ordinance instructed a fine of not less than £50 (N100) for each day any infringement persisted. The paid up capital was again raised in 1969 to £300,000 (N600, 000) for indigenous banks and £750,000 (N1, 500,000) for foreign banks.

The next milestone in banking history was the enactment on 15th May 1958, of the Central Bank of Nigeria Act which granted the set up of a bank to issue, the notes and coins that ought to be legal tender all over Nigeria. In addition, the act granted that the Central Bank is the banker to the government and was offered clear powers over every commercial banks and financial institutions.

Another key milestone in the banking industry was promulgation of the Companies Decree in 1968, which compels every company, (including banks) functioning in Nigeria to be incorporated locally as Nigerian companies whether they were previous branches of overseas companies or bankers with headquarters abroad.

The fourth legislative milestone was the promulgation of the Nigerian Enterprises promotion Decree of 1972, which gave powers to the Federal Government to obtain (40) per cent of the equity shares in all banking companies not totally owned by Nigerians. In 1977, the decree was amended to raise Government acquisition to sixty (60) per cent. Setting up of banks within this period was followed with tremendous caution. The First Bank to be set up after the 1952 ordinance was the Muslim Bank, which was set up in 1958. It stopped business in 1969 due to the fact that it might not obey with the stipulations of the banking Decree promulgated that year. The Co-operation Bank Limited and that of Co-op & Commerce were set up, the Banque Internationale de L'Afrique Occidentale (now Afribank Nigeria Plc) was set up in 1959. The Bank of America was set up in 1960. Chase Manhattan Bank (now united with standard Bank) in 1961, Bank of India and Arab Bank in 1962. Three mixed Banks were also set up within the period they are:

The Bank of Lagos a joint venture between a number of Swedish and Nigeria nationals, the Berini Beinut Riyad Bank Ltd, and the Bank of the North Ltd, were created in affiliation with some Lebanese group of Banks. The first two of these

three banks, which was set up in 1959, have stopped operation and the Government of Northern States of Nigeria has protected the third, Bank of the North Ltd.

3.2.3 The Post Civil War Era

The end of the Civil War saw the execution of huge reconstruction projects by the numerous State Governments, as well as the setting up of state-owned banks. In 1970, the Mid-Western State currently Edo and Delta States set up the New Nigerian Bank. This was immediately followed by the setting up of the Pan African and Mercantile Banks by the Rivers State and South-Eastern State (currently Cross River State) respectively. Despite the direct negative views expressed by well-known academics in opposition to the setting up of state banks, records indicate that they were making steady progress until recently, when few became distressed. Other state banks established include the Kaduna Co-operative Bank Ltd., known as Nigerian Universal Bank as well as the Kano Co-operative Bank known as Tropical Commercial Bank both set up by the Kaduna and Kano State Governments respectively. Other banks set up within this period include Continental Merchant Bank, First National City Bank of Chicago soon after became International Merchant Bank Ltd., ICON Limited (Merchant Bankers), Societe Generale Bank (Nig.)Ltd and Inland Bank of Nigeria Plc.

3.2.4 Financial Liberation Era

The financial liberation as well as deregulation policies adopted in the wake of the Structural Adjustment Programme (SAP) introduced in 1986 caused extraordinary growth in a number of financial institutions, their volume as well as complexity of operation in addition to the number of products they offer due to innovation and increased competition. The financial sector during this era of deregulation, re-regulation as well as guided deregulation saw a rise in the number of banks in the economy.

The sudden increase in the number and types of financial institutions between 1986 and 1991 caused over stretching of obtainable managerial capability, which resulted in financial distress as well as failure for a number of financial institutions. In reacting to this unpleasant development, the regulatory/supervisory bodies withdrew two (2) banks' licenses in January 1994. One license was withdrawn in

June 1995. The most awful situation was in January, 1998 when twenty six (26) licenses were withdrawn, therefore making the total number thirty one (31) distressed banks during this period; a very sad occasion that brought indescribable hardship to every stakeholders

3.2.5 Consolidation Era

This distress observed in the commercial banking industry in the 90's damaged the confidence in the sector. Several measures were set up to make sure there was sufficient capital base for the banks. The minimum capital was raised to N2 billion in 2002. The reform agenda of the Federal Government by Chief Olusegun Obasanjo brought the banking reform of year 2004 which put the minimum paid up capital of a universal bank at N25billion.

The key goal of the reforms is to ensure an efficient and sound financial system. The reforms are created to allow the banking system develop the needed buoyancy to assist the economic development of the country by competently carrying out its roles as the fulcrum of financial intermediation (Lemo 2005). The reforms were to guaranty the security of depositor's funds, ensure banks take part in active developmental role in the economy, as well as become key players in the sub-regional, regional and global financial markets. Before the just concluded banking sector consolidation programme introduced by the CBN 13-point reform agenda, which was made known on the 6th July, 2004, the Nigerian banking system was extremely oligopolistic with notable characteristics of market concentration as well as leadership. Lemo (2005) observed that the top ten (10) banks were discovered to control:

- over 50% of the total assets
- over 51% of the total deposit liabilities; and
- over 45% of the total credits.

Therefore the system was typified by:

- Usually small-sized fringe banks with excessive overheads costs
- Inadequate capital base averaging below \$10million or N1.4billion;

- Extreme dependence on government patronage (with 20% of industry deposits from government sources)

Also, twenty-four out of the eighty-nine deposit-money banks that existed at that time showed one form of weakness or the other. Renowned among such weaknesses are under-capitalization and /or bankruptcy, illiquidity, weak asset quality, poor corporate governance, boardroom disputes, declining earnings and in several cases, loss making.

The harmful competition that existed in the market, which was brought about by the relative ease of entry into the market owing to the inadequate capital base, forced a number of banks to go into rent-seeking as well as non-banking businesses, which are unconnected to main banking functions. Quite a number of these banks were obsessed with trading in foreign exchange, government treasury bills and from time to time, indirect importation of goods via proxy companies. From the above mentioned, it was obvious that a reform of the banking system in Nigeria was unavoidable; it was just a question of time.

The CBN at that time made it compulsory that for any commercial bank to function, it must have a minimum paid up capital of N25 billion. This declaration made commercial banks to adopt strategies such as:

- Right issues for existing shareholders and capitalization of profits
- Public offers via the capital market and/or private placement
- Mergers and acquisitions; and
- A combination of the above strategies.

The economy also experienced Foreign Direct Inflow and improvement in the Nigerian capital market. The consolidation era of the commercial banking sector has brought substantial advancements as Nigeria all of a sudden became Africa financial hub, with approximately \$3 billion coming in as FDI.

SELF-ASSESSMENT EXERCISE

Discuss the history of commercial banks in Nigeria.

3.3 Features of a Commercial Bank in Nigeria

The following are features of a commercial bank in Nigeria:

- Commercial banks are incorporated and registered with the Corporate Affairs Commission.
- **Profit motive:** Commercial banks that operate in Nigeria are set up in order to make profit.
- **Limited Liability:** Nigerian commercial banks are a good example of joint stock companies. They experience liability in case of business failure, but not further than the share capital of owners of the bank
- Nigerian commercial banks belong to the money market financial system of the country. A market where short term funds are obtainable and accessible.
- Commercial banks accept deposits and other valuables from their customers.
- **Ownership:** Commercial banks are owned by private individuals, groups of individuals, organizations, state governments, etc.
- **Limited number:** Unlike the Central Bank of Nigeria which is one with branches, commercial banks in Nigeria can exist in any number. There's no restriction to their set up both in terms of number and branches.

So, those are some features of Nigerian commercial banks. A few examples of commercial banks include United Bank for Africa Plc, Zenith Bank Plc, First Bank of Nigeria Plc, Wema Bank Plc, GTB Plc, Union Bank of Nigeria Plc, Access Bank Plc, etc.

3.4 Types of Commercial Banks

Commercial banks are categorized into two groups namely: scheduled commercial banks and non-scheduled commercial banks.

The common scheduled commercial banks are categorized into three types, that is;

- **Private Commercial Bank** – These are commercial banks where most of the share capital is owned and held by private businesses and individuals. When private individuals own over 51% of the share capital, in that case, that banking company is a private one. They are banks registered as companies with limited liability.

- **Public Commercial Bank** – These are commercial banks that are nationalized by the government of a country. The key stake is held by the government. A good example is the Bank of Industry controlled by the Federal Government of Nigeria. When the Government holds over 51% of the share capital of a publicly listed banking company, in that case such bank is called a Public sector bank.
- **Foreign Commercial Bank** – These are commercial banks established in foreign countries, and run their branches in the home country and other countries

3.5 Role of Commercial banks in economic development of Nigeria

Commercial Banks have always played a significant role in the Nigerian economy. They play a crucial function in the development of Nigeria's industry and trade. They act not only as the guardian of Nigeria's wealth but also protect the resources of the economy, which are essential for the economic development of the country. Their roles in the economic development of Nigeria include:

- **Capital Formation** – Commercial banks play a vital role in capital formation, which is necessary for Nigeria's economic development. They mobilize savings of Nigerians scattered over the country via their network of branches all over the nation and make it obtainable and accessible for productive intentions. Presently, commercial banks provide very appealing schemes to attract Nigerians to save their money with them and convey the savings mobilized to the organized money market. If commercial banks do not carry out this function, savings either stay idle or are utilized in generating assets, which are low in scale of plan priorities.
- **Creation of Credit** – Commercial banks in Nigeria create credit with the aim of offering additional funds for development projects. Credit creation brings about increased production, employment, sales and prices and thus it brings about rapid economic development in Nigeria.
- **Channelizing the Funds to Productive Investment** – Commercial banks invest the savings they mobilized for productive purposes. Capital formation is not the only role of commercial banks. Pooled savings ought to be shared to the numerous sectors of the Nigerian economy with a view to raise the

productivity of the country. Only in that case, can it be said to have carried out a significant role in the economic development of the Nigerian economy. Commercial banks assist the economic development of the Nigerian economy via the capital formed by them. In Nigeria loan lending operation of commercial banks is under the regulation of the CBN. So our commercial banks cannot lend loans, as they like.

- **Fuller Utilization of Resources** - Savings pooled by commercial banks are used to a larger degree for development purposes of numerous regions in Nigeria. It ensures fuller utilization of resources.
- **Encouraging Right Type of Industries** – The commercial banks assist in the development of the right type of industries in Nigeria by offering loans to the right people. Thus, they support not only industrialization of the Nigerian economy but in addition, the economic development of the nation. They grant loans and advances to producers whose commodities are in huge demand. The producers subsequently increase their commodities by introducing new means of production as well as help in increasing Nigeria's GDP.
- **Bank Rate Policy** – Economists in Nigeria are of the opinion that by changing the bank rates, changes can be made in Nigeria's money supply. In Nigeria, the CBN controls the interest rates paid by banks for the deposits accepted by them and in addition, the interest rates to be charged by them on the loans granted by them.
- **Bank Monetize Debt** - Commercial banks convert the loan to be repaid after a certain period into money, which can right away be utilized for business activities. Producers as well as wholesale traders cannot boost their sales without selling goods on credit basis. But credit sales might cause locking up of capital. Consequently, production might also be reduced. As commercial banks are lending money by discounting bills of exchange, business concerns are able to perform economic activities without any disruption.
- **Finance to Government** - Government acts as the advocate of industries in Nigeria for which finance is required for it. Commercial banks give long-term credit to Nigerian government by investing their funds in the government's securities and short-term finance by buying treasury bills.

- **Bankers as Employers** - Following the nationalization of big commercial banks, the banking industry has grown to a large extent. Commercial bank's branches are opened in nearly every Nigerian village, which cause the creation of new employment opportunities. Commercial banks are in addition training people for occupying numerous posts in their offices.
- **Banks are Entrepreneurs** - Presently, commercial banks have taken up the role of developing entrepreneurship specifically in developing countries like Nigeria. Development of entrepreneurship is a multifaceted procedure. It comprises of the creation of project ideas, recognition of particular projects appropriate to local conditions, encouraging new entrepreneurs to take up these well-formulated projects as well as offering counseling services such as technical and managerial guidance. Commercial banks grant 100% credit for valuable projects, which in addition is precisely feasible as well as economically viable. Therefore, commercial banks assist in the development of entrepreneurship in Nigeria.

3.6 The Structure of Commercial Banking in Nigeria

This refers to the number, organization as well as the size of commercial banks functioning inside a specified market or markets

3.6.1 Factors Affecting the Structure of Commercial Banks in Nigeria

According to Anyanwu (1997), several important factors that affects the structure of commercial banks in Nigeria include:

- The authority governing the chartering of new commercial banks
- The Central Bank of Nigeria and the Federal Ministry of Finance and Economic Development
- The dominance of branch banking
- Membership of the Central Banking System
- Concentration in banking (the high proportion of total commercial bank deposits accounted for by the three biggest commercial banks for example)
- Mixture of regulation and deregulation and supervision by such supervisory agencies such as the CBN, NDIC etc.

3.6.2 Factors Influencing the Growth of Commercial Banks Branches in Nigeria

Over the years, the number of commercial banks branches has increased tremendously. A number of factors account for this quick growth of commercial bank branches. According to Anyanwu (1997), these include:

- Indigenization policy and hence the indigenization of Nigerian banking
- The CBN rural banking scheme under which the CBN assigned a specific number of branches to a commercial bank to be opened in rural areas in a given period usually a year, the objective being to encourage banking habit in these areas
- The realities of independence in 1960 and hence the need to assert economic independence and the need to finance trade
- The oil boom and consequent monetization of proceeds there from
- Apparent political stability at independence
- Higher profits declared by existing banks – profitability there from or profit attraction
- Perceived increased awareness of the need for banking by the people
- Affluence of individual Nigerians particularly of ex-leaders and businessmen
- Reflection of development within the economy
- Expansion of the Nation's international trade
- Increasing participation of the private sector in the development process engendered by the third and fourth national development plans
- The Agricultural Credit Guarantee Scheme of 1978
- Increased sophistication of the Nigerian public due to expansion in education and other infrastructural facilities
- A spate of growth of state-owned banks especially from 1971 to date, for example, Progress Bank of Nigeria (Imo), Orient Bank (Anambra) etc
- Recent deregulation of the financial system

4.0 CONCLUSION

Commercial banks are financial institutions that play a significant role in the financial intermediation process. Thus, a developing economy like Nigeria ought

to have a well developed commercial banking system that can assist in its economic growth and development.

5.0 SUMMARY

You learnt in this unit, the meaning of commercial banks as well as the structure and roles of commercial banks in economic development of Nigeria.

6.0 TUTOR-MARKED ASSIGNMENT

1. Explain the features of a commercial bank?
2. List and explain the roles of commercial banks in economic development of Nigeria?

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UNIT EIGHT - EVOLUTION AND ROLES OF MERCHANT AND RURAL BANKS

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7.0 References/Further Reading

1.0 INTRODUCTION

In this unit, the evolution of merchant and rural banking shall be discussed. With reference to; meaning, origin and roles of merchant as well as rural banking

2.0 OBJECTIVES

At the end of this unit, you ought to be able to:

- define merchant banking
- explain the origin as well as evolution of merchant banking
- outline and discuss the roles of merchant banking
- define rural banking
- discuss the objectives of rural banking scheme
- explain the advantages and problems of rural banking

3.0 MAIN CONTENT

3.1 Meaning of Merchant Banking

The dictionary meaning of merchant banking sees it as an organization that underwrites securities for corporations, advises such clients on mergers and is involved in the ownership of commercial ventures. Merchant banking has been defined differently in different parts of the world. In the UK, it signifies the 'accepting and issuing houses', while in the USA it is recognized as 'investment banking'. The term merchant banking has been so extensively used that from time to time, it is referred to banks who are not merchants, every now and then to merchants who are not banks and at times to those intermediaries who are neither merchants nor banks. Therefore, merchant banking can be described as a non-banking financial activity similar to banking, began, developed and sustained in Europe, got enriched under American influence and at present practiced all over the world by both banking and non-banking institutions.

Under the Banks and Other Financial Institution Act, Merchant Bank is described as a bank whose business includes receiving deposits on deposit account, provisions of finance, consultancy as well as advisory services relating to corporate and investment matters, making or managing investments on behalf of any person. The Nigerian Banking Amendment Decree (No.88) of 1979 sees merchant bank as any individual in Nigeria who is involved in wholesale banking, medium and long-term financing, equipment leasing, debt factoring, investment management, issue and acceptance of bills and the management of unit trust (Anyanwu, 1997). They are as well referred to as Acceptance Houses or Discount Houses. Merchant banks manage the commercial banking requirements of international finance, long-term company loans, as well as stock underwriting. This kind of bank does not have retail offices where a customer can go and open a savings or checking account. Occasionally, it can be seen as a wholesale bank or involved in the transaction of wholesale banking owing to the fact these banks are inclined to deal first and foremost with other banks of the same category, as well as big financial institutions. (Jhingan, 2004)

3.2 Origin of Merchant Banking:

Merchant banking can be traced back to 13th century when a small number of family possessed and controlled firms engaged in buying as well as selling of goods and were in addition, discovered to be involved in banking activity. These firms did not just act as bankers to the kings of European States, financed coastal trade but in addition borne exchange risk.

With the intention of making profits, they put in their cash where they anticipated larger returns in spite of the huge degree of risk involved. They charged extremely high interest rates for financing very risky projects. In turn, they experienced huge losses and had to shut down. A number of them restarted very similar activity after acquiring financial strength. Thus merchant Banking survived as well as continued during the 13th century.

Afterwards, merchant bankers were recognized as “commission agents” who controlled the coastal trade on commission basis as well as offered finance to the owners or producers of commodities. They carry out investments in commodities produced by manufacturers and made big profits. In addition, they financed continental wars. The one and only aim of these merchant bankers was maximization of profit by undertaking investments in risky projects.

Next was the industrial revolution in England. The scope of international trade broadened to include North America as well as other continents. Most people were fascinated to start merchant banking activities to convey the machine made goods from European countries to other countries and colonies as well as bringing raw material from other countries and colonies to Europe and to finance such trade.

Throughout the early nineteenth century, merchants indulged in overseas trade and got decent reputation. They received bills of the lesser presumed traders by ensuring the holder to get full payment on due date. Over the years, this practice of accepting bills has increased with growth in trade and has turned out to be part of the merchant banking activity.

3.3 Evolution of Merchant Banking in Nigeria

In Nigeria, merchant banking will truly said to have began with the registration of both Philip Hill Nigeria Ltd on 14th September, 1960 and Nigeria Acceptance Ltd

(NAL) on 25th November, 1960. These two banks functioned in Nigeria as the only licensed merchant banks between 1960 and 1969. These two banks merged in 1969 to become the Nigerian Acceptance Ltd. NAL merchant bank remained the only merchant bank functioning in Nigeria until 1973.

The operations of merchant banks in Nigeria increased as a result of the following: indigenization decree (which requires 60:40 percent indigenous expatriate equity ownership in the banking industry), the oil boom of the 1970s and the Third National Development Plan. Not only did these factors increased the operations of merchant bank in Nigeria, they also led to a rise in the number of merchant banks in the country.

Union Dominion Trust Bank Nigeria Ltd was the second merchant bank to come into the market and was licensed in 1973. In April 1974, it changed its name to UDT Nigeria Ltd and as at 1997 its name was Nigerian Merchant Bank (NMB). Also, in 1974, the First National Bank of New York Nigeria Limited was licensed. This was followed by the First National Bank of Chicago Nigeria Limited later recognized as International Merchant Bank Nigeria Limited in 1975. Subsequent to the Federal Government's decision to take part in every foreign-owned banks functioning in the country, the First National City Bank of New York Nigeria Ltd surrendered its license in objection and brought to an end its operations in late 1976.

Two other banks namely Chase Merchant Bank Nigeria Ltd licensed in 1974 and Investment Company of Nigeria (ICON) Merchant Bankers were enlisted as merchant banks in 1975. Chase Merchant Bank subsequently changed to the Continental Merchant Bank in 1975. The Nigerian-American Merchant Bank Ltd (NAMBL) started its operations as a merchant bank in 1979. In 1982, two merchant banks namely: Merchant Banking Corporation Nigeria Ltd and Indo-Nigerian Merchant Bank Ltd started their operations despite the fact that they were granted license in 1981. Furthermore, in 1982, three merchant banks namely: Merchant Bank of Africa Nigeria Ltd, First City Merchant Bank Ltd and ABC Merchant Bank Ltd were given licenses. The first two started operations in 1983 while the third commenced its business in 1984. Also, in 1984, Grindlays Merchant Bank got its license to start its operation. In 1986, Financial Merchant

Bank Ltd was granted license. There were thirty four merchant banks operating in Nigeria by 1989, though this number significantly rose to fifty four by December 1991. However, by December 1995, this number fell to fifty one with a total branch network of one hundred and forty nine.

It is amazing that quite a few of the merchant banks that rebounded in the nation were as a result of the commercial banks SAP-induced. Therefore, a turnaround of a few of the policy thrust of SAP that were suitable for the growth as well as the development of these merchant banks rapidly hampered the development of the merchant banking subsector. This partially explains the distress syndrome that saturated this subsector, caused a complete collapse of a number of merchant banks, for instance, Kapital Merchant Bank, Financial Merchant Bank, Alpha Merchant Bank etc.

SELF ASSESSMENT EXERCISE

Define merchant banking and discuss the evolution of merchant banking in Nigeria

3.4 Roles of Merchant Banking

The roles of merchant banking include the following:

1. **Broker in stock exchange:** Merchant bankers work as brokers in the stock exchange. They buy as well as sell shares on behalf of their customers. They carry out research on equity shares and in addition, advise their customers on which shares to buy, when to buy, how much to buy as well as when to sell. Large brokers, Mutual Funds, Venture Capital companies as well as Investment Banks provide merchant banking services.
2. **Raising funds for customers:** Merchant banking assists its customers to raise funds by means of issuance of shares, debentures, bank loans, etc. It assists its customers to raise funds from local as well as foreign market. These funds are utilized in starting up a new business or project or for transformation, growth or development of the business.
3. **Give Advice on Transformation, Growth and Development of Businesses:** Merchant banks offer advice for transformation, growth and development of businesses. They provide professional advice on mergers

and acquisition, amalgamation and takeovers, diversification of business, foreign partnership and joint-ventures, upgrading of technology, etc.

4. **Project management:** Merchant banks assist their customers in numerous ways. For instance, giving advice on project location, preparation of project report, carrying out feasibility studies, drawing a plan for project financing, looking for sources of finance, giving advice on concessions as well as incentives from the government.
5. **Controlling government approval for industrial projects:** Businesses have to obtain government authorization for establishment of projects. Likewise, a company needs authorization for transformation, growth or development of their activities. For this, lots of formalities have to be completed. Merchant banks do all these for their customers.
6. **Handling public issue of companies -** Merchant bank advice as well as handle the public issue of companies. They offer the following services that are connected to public issue of securities: advice on the timing of the public issue; advice on the volume as well as the price of the issue; act as manager to the issue, and assist in receiving applications as well as allotment of securities; assist in selecting underwriters and brokers to the issue; listing of shares on the stock exchange, etc.
7. **Provide services to public sector units:** Merchant banks provide numerous services to public sector units as well as public utilities. They assist in raising long-term capital, promotion of securities, foreign partnership as well as organize long-term finance from term lending organizations.
8. **Provide special support to small businesses and entrepreneurs:** Merchant banks give advice to small businesses about business opportunities, government policies, incentives as well as concessions available. In addition, it assists them to take advantage of these opportunities, concessions, etc.
9. **Portfolio management:** Merchant banks handle as well as control the portfolios (investments) of their customers. This makes investments secure, liquid as well as lucrative for their customers. In addition, they provide professional guidance to their customers for taking investment decisions.
10. **Curing sick industrial units:** Merchant banks assist in curing sick industrial units. They discuss with other financial institutions such as banks,

term lending institutions, etc. In addition, they prepare and implement the total recovery package of these sick industrial units

11. **Corporate restructuring:** It includes mergers or acquisitions of existing companies, sale of existing companies or disinvestment. This involves suitable consultations, preparation of documents as well as conclusion of legal formalities. Merchant bankers provide all these services to their customers.
12. **Function in the money market:** Merchant banks manage as well as underwrite short-term money market instruments, such as: government bonds, certificate of deposit issued by banks and financial institutions, commercial paper issued by large corporate firms, treasury bills issued by the Government (In Nigeria, they are issued by the CBN).
13. **Management of interest and dividends:** Merchant banks assist their customers in managing their interest on debentures/loans, as well as dividend on shares. In addition, they advise their customers on the timing (interim/yearly) and rate of dividend
14. **Leasing services:** Merchant banks assist in leasing services. Lease is a contract between the lessor and lessee, where the lessor permits the utilization of his certain asset such as equipment by the lessee for a particular period. The lessor charges a fee called rentals.

3.5 Rural Banking

Rural banking can be described as the act of accepting money deposit as well as giving out loans and carrying out other services to customers in rural areas (Anyanwu, 1997). It can be brought into fruition either in two ways namely:

- Persuading, forcing or directing existing banks to establish rural branches or
- Setting up special banks that will establish their presence in the rural areas (Ojo and Adewunmi, 1982).

Therefore, a rural bank is positioned mainly in a rural area for the mobilization as well as relending of idle cash inside the area in order to develop and raise the standard of living for those living in these rural areas

3.6 An Overview of Rural Banking in Nigeria

Before 1975, the CBN embrace moral suasion by asking banks to set up branches in rural areas to assist in rural specifically agricultural development. The banks ignored this appeal, thus the CBN changed its strategy via section 4 of the Banking Decree of 1969 where banks were compelled to get approval of the CBN before setting up a new branch. As a result, banks were not given approval to set up new branches in urban areas if they refused to set up branches in rural areas at the same time (Olashore, 1979). Nevertheless, these banks refused, thus making it obvious that no persuasive or delicate means would force these banks to set up branches in rural areas.

Based on the request of the CBN, the Financial System Review Committee in 1975 suggested that the federal government of Nigeria approve a scheme of geographical spread of banks branches specifically planned to make sure that these banks infiltrate into rural areas that is the intentional and purposeful attempt to direct banks into rural areas. Therefore, the Rural Banking Scheme was launched in July 1977 with the pronouncement of allocating recognized rural areas to banks based on a formula which associated the number of each bank's rural branches to its total branch network all through the country. Thus, the basis for setting up such banks were locations in local government headquarters with a population of 5000 people or more with significant economic activities and recognized institutions such as hospitals, schools etc. The banks were to set up new branches close to their existing branches to ease communication problems. Numerous incentives were provided by the CBN to promote the setting up of rural banks. These incentives include: giving banks a reasonable monopoly period in rural branches location to allow them establish substantial branches in the same locality; not including rural bank credits from total loans and advances; ignoring feasibility study for rural branches; permitting a 5% (from April 1980) investment allowance in excess of what is usually permissible in industrial firms (normal initial 15% and annual 10% permitted by banks as industrial firms)

3.7 Objectives of the Rural Banking Programme

The specific objectives of the rural banking scheme include:

- Mobilize rural savings for the issuance of credit to the rural farmers and businesses
- Offering banking services to rural areas

- Promoting increase in banking density in the nation
- Improving development of rural areas and thus reduce the rate of rural urban migration

3.8 Phase of Rural Banking Scheme in Nigeria

Owing to the huge number of rural areas that required banking services, it was decided to phase the scheme for comfortable implementation and management

- **First Phase (1977 – 1983)** – The first phase of the scheme covered July 1977 – June 1983 with two hundred branches scheduled to be launched by nineteen commercial banks in the rural areas. By June 1980, one hundred and eighty eight branches of the two hundred branches allocated were opened. The deficits were grouped together into the second phase and had since been opened
- **Second Phase** – The second phase of the scheme was from 1980 – 1983 with two hundred and sixty six branches scheduled to be launched. Initially, this phase was designed to end on 31st December, 1983 but was pushed forward by a year to 31st December, 1984 to allow banks totally meet the directives of the CBN. Nonetheless, only two hundred and twenty nine of the two hundred and sixty six allocated were opened. Owing to the refrain of the CBN, nineteen additional branches were launched in 1985 leaving eighteen branches remaining as at the end of 1985. Under the second phase, a total of two hundred and forty eight branches of the number allocated were launched. Due to the continuous pressure by the CBN on the concerned banks to launch the remaining eighteen branches, a total of two hundred and fifty eight branches were launched as at the end of 1988 leaving eight remaining under the second phase.
- **Third Phase** - In August 1985, the scheme entered the third phase and lasted to July, 1989 with three hundred branches allocated to be launched in rural areas by the twenty eight commercial banks operating in the country by 1985 with the largest banks (First Bank of Nigeria, United Bank for Africa and Union Bank of Nigeria) being allocated twenty eight each, while the new banks got five each. As at December 31st 1989, the number of branches launched under the third phase was two hundred and ninety three with seven remaining.

3.9 Problem of Rural Banking in Nigeria

The following difficulties were encountered in establishing rural banks:

- **Inadequate Manpower** – Usually there is insufficient personnel in the of banking sector, thus extending banking services to these rural areas further stretched the capacity of these banks, therefore hindering total compliance as at when due
- **Security Challenges** – A number of rural areas do not have security facilities that are required to safeguard bank properties including cash particularly from armed robbers, hence, banks are hesitant in opening branches in these areas
- **Inadequate infrastructural Facilities in the Rural Areas** – Most rural areas lack infrastructural facilities such as electricity, good roads, portable water etc. This hinders the setting up of banks in such areas. It is hoped that later in the future, numerous rural development efforts will assist to reduce this problem
- **Low Rural Income or Poverty** – The profitability of banks in many rural areas is not ensured since the rural population income is low as a result of the rural economy not sufficiently monetized. In fact, most rural branches are unprofitable and are thus sustained by profits made in the urban areas. This does not encourage the setting up of new rural branches particularly in the period of high competition as well as profit drives
- **Customs and Poor Banking Habits** – A number of rural areas are still ancient and weighed down by customary practices of borrowing from private local money-lenders or individuals rather than from banks. Additionally, as a result of high level of illiteracy as well as poverty, there are usually poor banking habits such that a number of rural branches stay without business and hence cannot even break even talk less of making profits.
- **Inadequate Provision to Advertize the Rural Branches** – There is absence of provisions to encourage banks to advertize rural branches in order to create awareness and hence attract customers
- **Short Period of Implementation** - The rate of executing the programme is rather high (3 years) therefore consuming much of the bank's resources.

This is made much difficult by insufficiency of reasonable adjustment period between the different phases

- **Communication Problems** – The rural areas do not have sufficient communication facilities which are required for the successful operation of banks. Furthermore, poor and ineffective communication challenges in the banking industry has hindered the management of diffused branch network thus, restricting the setting up of new ones
- **Accommodation Problems** – Most rural areas do not have suitable building to house these banks and the banks are unwilling to put up their buildings due to high cost of capital involved particularly when compared with the anticipated economic returns from such rural operations. In order to reduce the accommodation difficulty, the CBN enjoined state and local governments to give maximum support to banks in finding suitable buildings or providing lands for the setting up of new building required for the successful implementation of the rural banking programme
- **High Cost of Establishing Rural Branches** – As a result of SAP, the cost of items increased significantly including building cost, rents, banking facilities, wage bills etc. Thus it became difficult to meet the required number of rural branches to be established. Moreover, this was made more difficult in the face of inflexible incentive package, for instance, while construction are increasing at a much higher rate, the allowance for investment did not change

3.10 Advantages of Rural Banking

The following are some of the advantages of rural banking

- It promotes banking habits, particularly when the people in rural areas are meant to believe in the banking system's integrity as well as efficiency
- It assists to make loans available to those in rural areas particularly to support agricultural production as well as cooperative activities
- It increases the mobilization of rural savings which are utilized for productive investments
- It aids to protect people's funds as well as other valuables not only from thieves; but also from damages such fire, etc.

- It assists to increase business activities in rural areas as a result of increased monetization and lending credit operations of banks
- It assists to further develop rural areas since banks attract other infrastructural facilities such as electricity, good roads, etc.

4.0 CONCLUSION

Merchant banks play vital role in wholesale banking, medium and long-term financing, equipment leasing, debt factoring, investment management, issue and acceptance of bills and the management of unit trust. They can assist in economic growth and development of any nation. Conversely, rural banks can be seen as the business of accepting money deposits and performing other services to customers in rural areas. They mobilize rural savings, extend banking services to rural areas and enhance development of rural areas. Thus, rural banks play a key role to curb the alarming rate of rural urban migration.

5.0 SUMMARY

You learnt in this unit, the meaning, evolution as well as roles of merchant banks. We also discussed rural banking in Nigeria, their objectives, problems and the roles they play in the economy.

6.0 TUTOR-MARKED ASSIGNMENT

1. Discuss the various phases of the rural banking scheme in Nigeria?
2. List and explain the problems of rural banking in Nigeria?

7.0 REFERENCES/FURTHER READING

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UNIT NINE - ORGANIZATION, PERFORMANCE AND ROLES OF DEVELOPMENT BANKS

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1.0 INTRODUCTION

This unit looks at the organization, performance and roles of development banks. Evolution and roles of development banks in Nigeria such as Bank of Agriculture, Bank of Industry, Federal Mortgage Bank of Nigeria (FMBN), Nigeria Export Import Bank (NEXIM), National Economic Reconstruction Fund (NERFUND) and the Infrastructure Bank were extensively discussed.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the meaning of development banks
- trace the origin of development banks in Nigeria
- analyze the functions of development bank
- discuss the features of development banks
- list the objectives of development banks
- trace the history of Bank of Agriculture
- describe the Federal Mortgage Bank of Nigeria (FMBN)
- discuss the Bank of Industry (BOI)
- state the objectives of National Economic Reconstruction Fund (NERFUND)
- list the functions of the Infrastructure Bank
- explain the facilities available to exporters from the NEXIM bank

3.0 MAIN CONTENT

3.1 Definition of Development Banks

Development banks are those banks which have been established chiefly to supply infrastructure facilities for the industrial growth of a nation. They offer financial support for both public and private sector industries. In addition they are seen as financial institutions devoted to finance new and upcoming businesses and economic development projects by offering equity capital and/or loan capital.

Anyanwu (1997) defines development banks as specific financial institutions offering medium and long term credit for the formation or growth and development of agricultural, industrial as well as commercial businesses in developing economies like Nigeria, Ghana, Sierra Leone, India etc. They are mainly set up by governments. Globally, examples of development banks include

the Islamic Development Bank (IsDB), Inter-American Development Bank Group (IDB, IADB), African Development Bank, European Bank for Reconstruction and Development (EBRD), Asian Development Bank etc. In Nigeria, they include the Nigerian Agricultural and Cooperative Bank (NACB), the Nigerian Bank for Commerce and Industry (NBCI), the Nigerian Industrial Development Bank (NIDB). In India, there is the Industrial Finance Corporation of India (IFCI), In Uganda there is the Uganda Development Bank, In Ghana there is the National Investment Bank etc. These banks are set up in Sub Sahara Africa and other developing regions to fill up the financial gap in commerce, industries as well as agriculture

3.1.1 Origin of Development Banks

Development Banking started after the destruction of the Second World War at the end of which state heads, predominantly in Europe as well United States of America came together on how to pick up their world-torn economies. This led to the establishment of the first development bank called The International Bank for Reconstruction and Development (World Bank). The World Bank was set up in 1946 subsequent to the Bretton Wood Agreement of 1944 between the World leaders at the time, and symbolizes International Development Banking at its zenith. Subsequent to this, the progress for establishing regional as well as national development banks commenced and almost immediately extended to a good number of nations globally.

In Nigeria, failure or dearth of indigenous private investments is more often than not as a result of lack of capital. Over the years, the Nigerian Government has made an attempt to solve this setback to a great extent by setting up numerous development banks or loan Boards as they were in the beginning known. These are fundamentally intended to manage government investments in chosen targeted sectors of the economy, focused on filling the gaps formed by the failure or dearth of private capital as well as investment. Hence, they have turned out to be financial institutions which design, fund as well as perform investment projects or programmes for or on behalf of the government. They have made it feasible for the nation to commence numerous thriving projects that would in no way have or else become visible, and these are positive operations.

Development banks offer the essential elements for economic growth, development as well as modifications, for instance, the required finance enterprise,

technical as well as managerial support which have been inadequate in supply. Incidentally, they carry out not just the banking role of making funds obtainable for development projects, but in addition the development function of offering technical as well as managerial support to the deprived sectors of the nation's economy.

Development Banks started to develop in Nigeria as a characteristic of the banking system immediately at roughly the time the economy began to launch development plans. The first of such development plans commenced in 1946 for the period 1943-1956, and almost immediately after that, the Nigerian Development Board was set up by the Federal Government to assist in promoting the attainment of the Plan. This Board was later dissolved in 1949 and substituted with four new boards namely: the Eastern, Western, Northern Regional Development Boards and Lagos (Colony) Development Board. These Boards took over the activities of their predecessor and almost immediately started to expand financial support to the industrial as well as agricultural sectors. In 1956, the Lagos (Colony) Development Board was dissolved and substituted with two new boards namely: The Western Region Finance Corporation and The Federal Loan Board. Furthermore in the same year, the Eastern Nigerian Development Corporation (ENDC) and the Northern Nigeria Development Corporation (NNDC) were set up and charged with likewise responsibilities in their respective regions. Presently, all these boards have stopped existing.

The recent stance in Nigeria is that the Federal Government has from time to time established development banks to develop particular sectors of the economy. According to the Central Bank of Nigeria, the development financial institutions in Nigeria presently include: The Bank of Agriculture, The Bank of Industry, Federal Mortgage Bank of Nigeria (particularly for housing), The Nigeria Export-Import Bank (NEXIM), National Economic Reconstruction Fund (NERFUND) and the Infrastructure Bank. Let us briefly discuss them

3.2 The Bank of Agriculture (BOA)

It is a federal government of Nigeria's sponsored bank that offers credit facilities to both small as well as large scale farmers and small businesses in rural areas. It is an upshot of the restructuring of federal government's sponsored microcredit institutions, the bank was established in 2000 and took up the assets of the National

Agriculture and Cooperative Bank (NACB), People's Bank and the Family Economic Advancement Project (FEAP).

3.2.1 A Brief History of the Bank of Agriculture (BOA)

The history of Bank of Agriculture can be traced to the setting up of the Nigerian Agriculture Bank (NAB) in 1973. NAB was a federal government's plan to finance agriculture development projects in the nation, especially small-scale farm holders that might not possess sufficient collateral to acquire credit facilities from commercial banks. At the time, most farmers were deemed high risk borrowers by commercial lenders and NAB was set up to offer microcredit to small farmers and on-lending to agricultural firms. When Umaru Mutallab was cooperatives minister in 1977, the federal government of Nigeria kicked off new guidelines for financing cooperatives. Furthermore, the federal government of Nigeria offered additional capital to NAB to assist cooperative societies in the nation. Afterwards, NAB was converted into the Nigerian Agriculture and Cooperative Bank (NACB). In addition, the federal government specified new guidelines for commercial banks to reserve a minimum percentage of their loan portfolio to the agricultural sector. Banks that were not able to meet up the threshold transferred the remainder of funds to the Central Bank of Nigeria for onward disbursement to farmers by means of NACB.

In 2000, the federal government merged the activities of NACB, People's Bank and Family Economic Advancement Programme to form the Nigerian Agriculture Cooperative and Rural Development Bank (NACRDB). Prior to the merger, all three institutions were involved in micro-financing.

Bank of Agriculture has struggled to manage the number of non-performing loans in its portfolio which has hindered its capacity to offer sustainable assistance to the agricultural sector.

3.2.2 Roles of Bank of Agriculture

Some functions of Bank of Agriculture include:

- Provision of agricultural credit to assist every part of agricultural value chain activities.

- Provision of non-agricultural micro-credits to poor people from rural areas.
- The bank facilitates the mobilization of savings
- Capacity development through promotion of co-operatives, agricultural information systems, as well as the provision of technical support and extension services.
- Provision of opportunities for self-employment in the rural areas, thus reducing rural-urban migration.
- Inculcation of banking habits at the grass-roots of the Nigerian society

3.2.3 Strengths of the Bank of Agriculture

The key strengths of the Bank of Agriculture include:

- Nigeria's largest development finance institution and leading agricultural finance institution.
- Development Financial Institution with the highest rural operational coverage nationwide, with 201 outlets nationwide, 6 zonal offices and a head office.
- Highest interaction/interface with rural farmers with deep institutional knowledge of rural and agricultural finance.
- Over 40 years experience in rural and agricultural finance.
- Strategic partnerships with USAID markets, IFAD, World Banks, RUFIN, and ECOWAS funds, Federal Ministry of Agriculture and Rural Development, Federal Ministry of Women Affairs, State and Local Governments, etc.

SELF ASSESSMENT EXERCISE

Discuss the origin of development banks?

3.3 The Bank of Industry (BOI)

Bank of Industry is the oldest and biggest Development Financial Institution presently operating in Nigeria. It is owned by the Ministry of Finance Incorporated (MOFI) Nigeria (94.80%), the Central Bank of Nigeria (CBN) (5.19%) and private

shareholders (0.01%). The bank has 11 members on its board and its chairman is Aliyu Abdulrahman Dikko.

3.3.1 A Brief History of the Bank of Industry

Bank of Industry Limited commenced its operations in 1959 as the Investment Corporation of Nigeria (ICON) Limited. In 1964, ICON Limited metamorphosed to become the Nigerian Industrial Development Bank (NIDB) Limited under the leadership of the World Bank. At first, International Finance Corporation (IFC) held 75% equity in NIDB and brought the first Managing Director. However, the equity arrangement was reduced in 1976 owing to the indigenization decree.

In 2001, the Bank of Industry was restructured out of the merger of the Nigerian Industrial Development Bank (NIDB), Nigerian Bank for Commerce and Industry (NBCI) and the National Economic Reconstruction Fund (NERFUND). Though the bank's share capital was in the beginning set at ₦50 billion in the wake of NIDB's reconstruction, it was increased to ₦250 billion in 2007.

3.3.2 Roles of Bank of Industry

The following are some of the roles of the Bank of Industry

- Provision of financial support for the set up of large, medium and small projects
- Provide assistance in the expansion, diversification and modernization of existing enterprises
- Helps in the rehabilitation of existing enterprises
- Lays emphasis on prudent project selection as well as management
- Supports of quality projects with high developmental impact such as job creation and poverty alleviation to enhance the socio-economic standard of Nigerians.
- Strategic positioned to manage foreign grants and aids that are given to facilitate attainment of the nation's developmental aspirations.

3.3.3 Project Financed by the Bank of Industry

Nwagbara (2015) is of the opinion that the Bank of Industry finances the following kinds of projects:

- Projects in areas where Nigeria has comparative advantage
- Projects that involve the efficient conversion of local raw materials into finished products
- Ventures that can manufacture good quality products with the least production cost, and which can be successfully marketed locally or internationally.

3.3.4 Products and Services Delivered by the Bank of Industry

According to Nwagbara (2015), products and services delivered by the Bank of Industry include:

- Medium as well as long term loans/financing
- Working capital finance
- Equity Financing
- Funds Management
- Loan Guarantees
- Co-financing
- Investment in Corporate Boards
- Business Development Services
- Lease Financing
- Trusteeship
- Stock Brokerage
- Foreign Exchange Dealership
- Insurance Brokerage
- International Trade Finance

3.4 The Federal Mortgage Bank of Nigeria (FMBN)

It was set up in 1956, at that time recognized as the Nigerian Building Society. With the launch of the Indigenization Policy, the Federal Government through the Indigenization Act of 1973 assumed 100% ownership acquisition of the Nigerian Building Society and as a result renamed it as the Federal Mortgage Bank of Nigeria. The Bank function as an efficient tool for enhancing the mobilization of long term funds, lending volume as well as increasing mortgage lending services to

every section of the Nigerian populace. It was set up as a corporate entity with powers to sue as well as be sued, to obtain and to seize and get rid of properties for the achievement of its goals, and for the execution of its roles. The Federal Mortgage Bank of Nigeria commenced the running and management of the contributory savings scheme, recognized as the National Housing Fund (NHF) set up by Act 3 of 1992. The National Housing Fund is a kitty that mobilizes long term funds from Nigerian employees, banks, insurance companies as well as the Federal Government to advance loans at low interest rates to its contributors. The Federal Mortgage Bank of Nigeria through the promulgation of the FMBN Act 82 of 1993 as well as the Mortgage Institutions Act 53 of 1989 obtained the rank of the apex mortgage institution in 1994, and therefore gave up its retail function to an autonomous corporation named the Federal Mortgage Finance Limited (FMFL), which was cut out from the Federal Mortgage Bank of Nigeria itself and completely owned by the Federal Government of Nigeria.

With the reform of the housing sector rooted in the Federal Government's 2006 National Policy on Housing and Urban Development, the Federal Mortgage Bank of Nigeria was restructured into a Federal Government sponsored Enterprise (FGSE) with extra concentration on secondary mortgage as well as capital market roles. It plays a significant function in developing a healthy mortgage finance system for the nation.

3.4.1 Functions of the Federal Mortgage Bank of Nigeria

The Federal Mortgage Bank of Nigeria performs the following main functions:

- Openly offer long term credit facilities to individual Nigerians who desire to get houses of their own at such rates and upon such terms as perhaps decided by the Board in line with the policy of the Federal Executive Council
- Provide long term credit facilities to mortgage institutions to allow these institutions give comparable facilities to Nigerian citizens that desire to have possession their houses
- Supports and develop mortgage Institutions, both at the National and State levels
- Manage as well as control mortgage institutions in Nigeria in line with such directive as might be given by the FMBN on behalf of the Federal Executive Council;

- Offer credit facilities at competitive commercial interest rates to commercial Property Developers, Estate Agents and Developers of offices and other particular kind of buildings (with the approval of the Minister of Housing).

3.4.2 Power of the Federal Mortgage Bank of Nigeria

To successfully carry out its functions, the FMBN was given the following powers

- Accept term deposits as well as savings from primary mortgage institutions, trust funds, and private Individuals as the Board of the FMBN may decide.
- Encourage savings mobilization from the general public.
- Carry out investment in firms involved in the manufacturing or production of building materials in the nation
- Give financial advice as well as offer or support in providing managerial, technical and administrative services for firms involved in building, construction and development in the nation
- Guarantee loans from private investment sources for building development
- provide guarantees including guarantees in respect of promissory notes and other bills of exchange issued by licensed banks in the nation as well as discounting such notes and bills
- Give out its own securities including debentures as well as bonds under Federal Government guarantees, and give out promissory notes and other bills of exchange with the intention of raising funds from finance institutions
- Set up a sinking fund for the redemption of the securities given out by it as well as take care of contribution by it to the sinking fund
- Perform research on mortgage finance activities as well as building construction in the nation
- Perform research targeted at making the pattern and standard of housing and in both urban and rural areas of the nation better
- Coordinate and operate in partnership with trustworthy insurance companies, a mortgage protection system planned to ensure liquidity to mortgage institutions and present them the opportunity of having liberal premium terms
- Do anything to take part in any transaction which in its opinion is essential to guarantee good performance of its functions as found in the National Housing Policy

- With the authorization of the Minister of Housing, borrow from any source, any fund needed for meeting up its responsibilities as well as carrying out its functions under the National Housing Policy 2006.

3.5 The Nigeria Export-Import Bank (NEXIM)

The Federal Government of Nigeria has complete ownership of the Nigeria Export-Import Bank with an authorized share capital of fifty billion naira, equally subscribed to by the Federal Ministry of Finance and the Central Bank of Nigeria. The NEXIM was set up by the NEXIM Act 38 of 1991 as an Export Credit Agency. The NEXIM is different from other banks for the reason that it is a development finance institution and does not accept deposits like the regular banks. Its major focus is on the developmental role of creating jobs as well as assisting the exports of Nigerian goods and services. It is not in competition with the commercial banks, but complements their roles in growing and developing the economy. It deals mostly on non-oil exports in different sectors of the market as compared to the regular banks. More often than not, there are new sectors of the market which the commercial banks are not prepared to service.

3.5.1 Roles of Nigeria Export-Import Bank (NEXIM)

The roles of NEXIM include the following:

- To provide export credit guarantee to investors seeking to invest in the country within this sector.
- Empowered to provide funds in local money, that is, the Naira to support export business operations in Nigeria.
- Setting up and management of funds associated with exports.
- Conservation of a foreign exchange revolving fund for lending to exporters who need to import foreign inputs to facilitate export production.
- To provide domestic credit insurance where such a facility is probable to support exports.
- Maintenance of a trade information system in support of export business

3.5.2 Facilities Available to Exporters from the NEXIM Bank

- Rediscounting and Refinancing Facility –this is a facility planned to support exporters and banks to offer pre-and post-shipment finance in local currency. Usually, it is obtainable for a hundred and eighty days

- Stocking Facility – this facility is disbursed in local currency and allows manufacturers of exportable goods to obtain sufficient quantities of local raw materials required to continue production at an optimal level during the period of scarcity.
- Direct Lending Facility – the short term direct lending facility is available for the financing of commodities and value – added exports whereas the long term direct lending facility is available to companies involved in marketing and production of exportable goods. These are for a maximum tenor of 180 and 365 days respectively.
- Local Input Facility – this is a medium or long term facility disbursed in local currency with the aim of asset acquisition/modernization, as well as growth of accessible production units for exports. It can be for a maximum tenor of seven years.
- Foreign Input Facility - this Facility offers manufacturers funds to import machinery, raw materials as well as other parts to create finished commodities for export. The facility has a maximum tenor of seven years, including a supervision period of less than two years. It is repayable in foreign currency.
- Export Credit Guarantee Facility – this is managed as a guarantee offered to banks regarding credit given to exporters to encourage the export of goods and services from Nigeria. In addition, it allows Nigerian exporters to gain easy access to credit globally on terms that are more competitive than that offered inside the local market
- Export Credit Insurance Facility – this facility covers exporters against risk of non-payment by buyers, while such default is as a result of commercial/economic causes. Payment defaults owing to political reasons are covered independently by the NEXIM Bank for the account of the Federal Government of Nigeria

Other facilities rendered by the NEXIM bank include:

- a. ECOWAS Inter-State Road Transit Scheme
- b. ECOWAS Trade Support Facility
- c. Nigerian Creative and Entertainment Industry Stimulation Loan Scheme

3.6 The National Economic Reconstruction Fund (NERFUND)

The National Economic Reconstruction Fund (NERFUND) was set up by Decree No. 2 of 1989 to operate as a catalyst in the direction of stimulating the rapid rise of real production enterprises in the nation. Specifically, the NERFUND was given the authorization to offer long/medium term loans to entrepreneurs through commercial/merchant banks for Nigeria's industrial growth. The National Economic Reconstruction Fund (NERFUND) grand objectives are to increase the quantum of goods and services available for local consumption and export, provide needed employment, expand our production base and add value to the economy. Up to now, the NERFUND has granted loans for one thousand four hundred and ninety seven projects, worth over five billion naira (N5b) and disbursed to one thousand three hundred and thirty two projects, worth four billion, five hundred million naira (N4.5b). This figure does not include those of legacy projects which were sanctioned in the first decade of the Fund's operation between 1989 and 1999.

3.6.1 The Rationale for the Establishment of NERFUND

Despite of the acknowledgement of the functions of small and medium scale enterprises (SMEs) in advancing economic growth and development through the encouragement of indigenous technology, employment-generating activities as well as expansion of the production base, the influence of Nigerian SMEs on economic development has been less than desirable. A vital cause for this is their limited access to institutionalized credit owing to banks' opinion of SMEs as high-risk ventures. Certainly, in spite of the directive of the Central Bank of Nigeria that banks grant not less than 16 per cent (up till end 1989) and afterwards a minimum of 20 per cent (from January 1990) of their total loans and advances outstanding to small enterprises, the banks granted less than 10 per cent of their loans and advances outstanding to small enterprises within the period 1980-1986. With the launch of the Structural Adjustment Programme (SAP) and the unavoidable devaluation of the naira, most SMEs found it very hard to deal with the attendant high cost of production, due to high cost of imported inputs, higher interest rates. Furthermore, banks' loans to SMEs were likely to be short-term in nature due to their portfolio structure. Thus, SMEs were inclined to borrow short for some of

their long term financing requirements. In addition, they experienced limited access to foreign exchange.

With the intention of bridging the perceived gap in banks' lending to SMEs, the Federal Government established the National Economic Reconstruction Fund (NERFUND) through the NERFUND Decree No. 2 of 9th January, 1989.

3.6.2 Objectives of NERFUND

NERFUND is aimed at offering soft, medium to long term finance for fully Nigerian-owned small and medium scale enterprises. SMEs are seen as those with new investment cost up to, but not more than N10 million. SMEs via NERFUND have access to local as well as foreign loans over a period of five to ten years. Specifically, the objectives of NERFUND are to

- Fix any perceived insufficiencies in the provision of medium or long-term funds to small and medium scale industrial enterprises (SMEs), particularly manufacturing and agro-allied enterprises, mining, quarrying, industrial support services, equipment leasing as well as other ancillary projects.
- Offer medium to long term loans to participating commercial as well as merchant banks for on-lending to SMEs.
- Facilitate the provision of loans with 5-10 years maturity including a grace period of 1-3 years, depending on the type of enterprises or project.
- Offer loan in local and/or foreign currency depending on the funds available to NERFUND and the project being funded.

3.7 The Infrastructure Bank

It is initially recognized as Urban Development Bank of Nigeria Plc, the Infrastructure Bank Plc was set up in 1992 under decree No. 51 of the 1992 constitution of the Federal Republic of Nigeria. The Infrastructure Bank Plc is the country's dedicated infrastructure bank offering financial solutions to assist crucial long term infrastructure projects, that includes transportation infrastructure, municipal common services, mass housing and district development, solid waste management and water provision, and power and renewable energy projects.

The ownership structure of the Infrastructure Bank Plc is unique. It is owned majorly by the private sector but in addition has the Federal Government, State

Governments and Local Governments as well as the Nigeria Labour Congress as its shareholders. Thus, the Bank is a government sponsored but private sector led development finance institution

3.7.1 Functions of the Infrastructure Bank

The infrastructure bank offer the following products and services, which include

- Development Loans - The Bank concentrates on financing commercially feasible projects that have major developmental influence on the economy.
- Project Finance Advisory and Arranging – The bank provide modified advisory services to customers to support them in packaging their projects for attracting needed competitive funding both locally as well as internationally. Their role is to collaborate with project promoters in starting, planning, structuring as well as setting up funds for projects that have high developmental impact and are financially as well as economically feasible.
- Proprietary Equity – The Bank makes equity and /or quasi-equity (mezzanine financing) investments in projects that need risk capital to commence and grow. With the Bank taking the lead in some of these chosen projects, such proprietary investments will permit and facilitate the strengthening of strategic partnerships with other Development Finance Institutions as well as promote private sector participation, particularly from the commercial banking sector environment in the provision of long term risk capital for infrastructure projects
- Fund Management – The Bank provides fund management services to both domestic and external agencies, funding assigned particularly for infrastructure development. External targets might include international commercial finance and Development Finance Institutions as well as bilateral and multilateral funds, while domestically, the Pension Funds, Sovereign Wealth Fund, Federal Government of Nigeria intervention Funds, as well as Nigeria’s external reserves are accessible funding sources.
- Capacity Building and Technical Assistance – The development difficulty facing the Federal Government is not just that of finance, but also that of delivery abilities. Capacity restraints are obvious all over the country particularly at the sub-national government level. The bank encourage, arrange as well as fund support programmes that offer technical assistance, capacity building, advice and other value adding services to strengthen the

institutional and delivery capacities of ministries, departments and agencies, as well as sub-national governments to maximize the developmental effect of the bank's financial interventions.

3.8 Features of Development Banks:

The following are the major characteristics or features of development banks:

- It is a specialized financial institution, offering medium and long-term finance to business units.
- It does not accept deposits from the public like commercial banks; it is not just a term-lending institution. It's a multi-purpose financial institution.
- It is fundamentally a development-oriented bank. Its main goal is to foster economic development by promoting investment as well as entrepreneurial activity in a developing economy. It supports new and small entrepreneurs and seeks balanced regional growth.
- It offers financial support not just to the private sector but also to public sector undertakings; it aims at encouraging the saving and investment habit in the nation.
- It does not compete with the usual finance channels, i.e., finance previously made accessible by the banks and other regular financial institutions. Its main function is of a gap-filler, i.e., to fill up the shortages of the previous financial facilities.
- Its purpose is to serve the general public interest rather than to make profits. It acts in the general interest of the nation.

3.9 Functions of Development Banks

Some vital functions of development banks are as follows:

- **Financial Gap Fillers:** - Development banks do not offer medium-term and long-term loans only but they assist industrial firms in numerous other ways too. These banks subscribe to the bonds and debentures of the companies, underwrite their shares and debentures and, guarantee the loans gotten from foreign and domestic sources. Also, they assist undertakings to get machinery from within and outside the country.

- **Undertake Entrepreneurial Role:** - Developing countries are short of entrepreneurs who can begin the job of establishing new projects. It might be as a result of inadequate expertise as well as managerial capability. Development banks were given the task of entrepreneurial gap filling. They assume the task of finding investment projects, promotion of industrial enterprises; provide technical and managerial support, undertaking economic and technical research, carrying out surveys, feasibility studies, etc. The promotional function of development banks is very important for increasing the rate of industrialization.
- **Commercial Banking Business:** - Development banks usually offer medium and long-term funds to industrial enterprises. The working capital requirements of the units are met by commercial banks. In developing countries, commercial banks have not been capable to commence this task correctly. Their traditional approach in dealing with lending proposals and assistance on securities has not helped the industry. Development banks extend financial assistance for meeting working capital requirements to their loan if they fail to organize such funds from other sources. So far as taking up other functions of banks such as accepting of deposits, opening letters of credit, discounting of bills, etc. there is no uniform practice in development banks.
- **Joint Finance:** - Another characteristic of the development bank's operations is to take up joint financing along with other financial institutions. There might be restraints of financial resources and legal problems (prescribing maximum limits of lending) which may compel banks to relate with other institutions for taking up the financing of some projects jointly. Also, it might not be possible to meet all the requirements of concern by one institution; thus, more than one institution might join hands. Not only in large projects but also in medium-sized projects it may be desirable for a concern to have, for example, the requirements of a foreign loan in a particular currency, met by one institution and under the writing of securities met by another.
- **Refinance Facility:** - Development banks also extend the refinance facility to the lending institutions. In this scheme, there is no direct lending to the enterprise. The lending institutions are provided funds by development

banks against loans extended to industrial concerns. In this way, the institutions which provide funds to units are refinanced by development banks.

- **Credit Guarantee:** - The small scale sector is not getting proper financial facilities due to the element of risk since these units do not have adequate securities to offer for loans, lending institutions are cautious to extend the loans. To overcome this challenge many nations including Nigeria, India and Japan have devised the credit guarantee scheme and credit insurance scheme.
- **Underwriting of Securities:** - Development banks obtain securities of industrial units through either direct subscribing or underwriting or both. The securities might also be obtained through promotion work or by converting loans into equity shares or preference shares. These banks do not hold these securities permanently. They try to disinvest in these securities in a systematic way which should not influence the market prices of these securities and also should not lose managerial control of the units.

3.10 Objectives of Development Banks:

The main objectives of the development banks are:

- They promote industrial growth.
- Grow and develop backward areas.
- Create additional employment opportunities.
- Encourage additional exports as well as encourage import substitution.
- Promote modernization and improvement in technology.
- Encourage more self-employment projects.
- Revive sick industrial units.
- Enhance the management of large industries by providing training.
- Remove regional disparities or regional imbalance.
- Promote science and technology in new areas by providing risk capital
- Improve the capital market in the country.

4.0 CONCLUSION

Development banks are financial institutions that promote industrial growth as well as entrepreneurship, create employment opportunities and revive sick industrial units. They underwrite securities; fill financial gaps, refinance facilities and offer joint finance. Therefore, development banks administer a mixture of financial and development services.

5.0 SUMMARY

In this unit you learnt the meaning of development banks, the origin of development banks in Nigeria and the functions of development banks. The discussion also took you to the study of the history of Bank of Agriculture, Bank of Industry, the Federal Mortgage Bank of Nigeria, the Nigeria Export Import Bank, the National Economic Reconstruction Fund and the Infrastructure Bank

6.0 TUTOR-MARKED ASSIGNMENT

1. Discuss the functions of development banks.
2. List and explain the features of development banks in Nigeria.

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UNIT TEN - AN OVERVIEW OF MICROFINANCE BANKS AND CO-OPERATIVE BANKING IN NIGERIA

CONTENTS

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
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 - 3.3 The Stakeholders in the Microfinance Subsector in Nigeria
 - 3.4 Challenges Facing Microfinance Banks in Nigeria
 - 3.5 Prospects of Microfinance Banking in Nigeria
 - 3.6 Reforms of the Microfinance Bank Subsector in Nigeria
 - 3.7 Co-operative Banking
 - 3.8 Evolution of Co-operative Banks in Nigeria
 - 3.9 Roles of Co-operative Banks in Nigeria
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1.0 INTRODUCTION

This unit shall discuss microfinance banks and co-operative banks. Microfinance banks will be discussed in terms of their aims, challenges, prospects as well as reforms carried out in this subsector so that their services can be accessed by small and medium scale businesses. While co-operative banks will be discussed with respect to their evolution and roles in the Nigerian economy

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Discuss an overview of microfinance banks in Nigeria
- Explain the rationale for the formulation of the national microfinance policy
- Elucidate the aims of the microfinance policy

- List the stakeholders in the microfinance subsector in Nigeria
- Discuss the challenges facing microfinance banks in Nigeria
- Explain the prospects as well as the reforms of microfinance banks in Nigeria
- Discuss the evolution and roles of co-operative banking in Nigeria

3.0 MAIN CONTENT

3.1 Definition of Microfinance Banks

A Microfinance bank is any financial institution licensed by the Central Bank of Nigeria (CBN) to carry out the business of providing microfinance services such as savings, loans, domestic funds transfer, and other financial services that are needed by the economically active poor, micro, small and medium enterprises to conduct or expand their businesses as defined in the guideline for microfinance banks in Nigeria. In 2005, the Central Bank of Nigeria (CBN) put together the National Microfinance Policy and this gave birth to the formal microfinance subsector in Nigeria.

3.2 An Overview of Microfinance Banks in Nigeria

Microfinance banks were established as a result of the observed shortcomings in the existing financing programmes for the poverty stricken populace as well as small businesses. They were licensed to commence operations in 2007 and existing community banks and non government organization microfinance institutions that met the conditions specified by Central Bank of Nigeria for licensing were permitted to transform into microfinance banks.

To qualify for a microfinance license an existing community bank was obliged to increase its paid-up capital from N5m to N20m. Not like the community banking policy framework which compulsorily restricted every community banks to unit banking, the microfinance banking guidelines allowed the branching of microfinance banks inside a state. For microfinance banks with the intention of establishing branches inside a state, their paid-up capital was put at N1 billion. A further point of divergence between the community banks and their microfinance successors is in those which the regulatory guidelines permit to own them. In addition to individuals, group of individuals, community development associations, private corporate entities which can own community banks, foreign investors and commercial banks, foreign investors can also own microfinance banks.

These alterations in the policy framework of setting up microfinance were as a result of the observed failure of the existing microfinance framework. Adeyemi (2008) summarized this as thus, “in spite decades of public provision and direction of provision of microcredit, policy orientation, as well as the entry of new players, the supply of microcredit is still inadequate”. He identified some of the difficulties which microfinance institutions encounter that intrude on their capability to act to include; undercapitalization, inefficient management and regulatory and supervisory loopholes. In addition to these (Mohammed, and Hassan 2009) included usurious interest rates as well as poor outreach. Further reinforcing the difficulties microfinance banks encounter, Nwanyanwu (2011), identified diversion of funds, insufficient finance, regular changes in government policies, huge transaction costs, enormous loan losses, inadequate capacity and poor technical skill in the industry as obstacles to the growth and development of this subsector. These challenges most of which played a part in the failure of previous microfinance programmes are still bedeviling the microfinance banking programme in Nigeria.

3.2.1 Rationale for the Formulation of the National Microfinance Policy

The Central Bank of Nigeria provided the following rationales for the formulation of the National Microfinance Policy: These rationales include:

- **Insufficient Capital Base:** The insufficient capital base of previous microfinance institutions could not offer protection against the risk associated with the lending activities of micro institutions.
- **Weak banking culture as well as inadequate financial literacy:** A number of people particularly in rural areas that are not financial literates do not see microfinance institutions as business enterprises but merely a source for loans and advances. These people have never had any banking experience in their lives either as a result of remoteness from bank locations or complete ignorance of what banking involves. This inevitably lead to poor banking culture which affect their views about microfinance
- **The rising interest of indigenous and foreign investors in microfinance:** Most indigenous as well as foreign investors have shown interest in investing in the nation’s microfinance sector.
- **Poor Institutional as well as Network Capacity:** The lingering sub optimal operations of most former community banks, microfinance as well as

development finance institutions is due to the ineffectual management, poor in-house controls and inadequate deposit insurance schemes. Other factors include deplorable corporate governance, insufficiency of well-defined roles and restrictive regulatory/supervisory pre-requisites.

- **The Presence of an Enormous un-served market:** The size of the un-served market by previous financial institutions is huge. For example in 2005, the Nigeria's total microcredit facilities comprised of approximately 0.2 percent of Gross Domestic Product (GDP) and below one percent of aggregate credit to the economy. This exposed the presence of an enormous gap in offering financial services to a huge number of the poverty stricken populace as well as low income groups.
- **Financial Empowerment of the Poor:** Internationally, micro small and medium enterprises (MSMEs) are recognized to play an active role in alleviating poverty via their ability to create employment. As individuals become employed, they earn money from which their basic necessities of life are met. However, in Nigeria, the employment creation abilities of small businesses have been badly restricted by inadequate access to finance to start up, increase or re-engineer their current capacities of economic activities in order to create employment
- **Urban Prejudice in banking services:** A good number of the accessible banks are found in urban area and numerous endeavours made previously to encourage them to set up branches in the rural areas did not yield the required outcome. With a high rate of Nigerians still dwelling in the rural areas, it has become completely vital to develop an institutional framework to get to the hitherto un-served population with banking services.

3.2.2 Aims of the Microfinance Policy

The major aims of the microfinance policy include:

- Generation of employment opportunities as well as increase in the productivity of the poor in the nation thus advancing their personal household income as well as increasing their living standards.
- Improvement of service delivery by every microfinance institutions to micro small and medium scale enterprises and offering of specialized services such

as payment of salaries, gratuities and pensions licensed by the Central Bank of Nigeria.

- Encouragement of linkage programmes between microfinance institutions on one hand and deposit money banks, development financial institutions and specialized funding institutions on the other.
- Encouraging the synergy and mainstreaming of the informal microfinance subsector into the formal financial sector, thus, making sure of efficient organized and focused participation of the poor in socio economic development and resource allocation.
- Mobilization of savings for intermediation and contribution to rural transformation.
- To provide diversified affordable and reliable financial services to the poor to enable them commence as well as develop long term sustainable entrepreneurial activities.
- To provide sustainable opportunities for the management the micro credit programmes of government and high net worth persons on a non recourse basis, as well as the encouragement of a conducive environment for microfinance service providers to network and exchange viewpoints and experiences on their products and processes

SELF ASSESSMENT EXERCISE

Discuss the rationale for the formulation of the national microfinance policy?

3.3 The Stakeholders in the Microfinance Subsector in Nigeria

The stakeholders in the microfinance subsector in Nigeria can be categorized as government regulatory authorities, investors, development partners, financial institutions, technical assistance providers as well as donor agencies. These are:

- Regulatory Environment Stakeholders: this includes the Central Bank of Nigeria, the Nigeria Deposit Insurance Corporation, Securities and Exchange Commission, Federal and State Departments of Cooperatives, and apex associations like the National Association of Microfinance Banks.

- Donor Agencies as well as Funds Providers like Human Rights Organizations and Corporate Establishments using microfinance to achieve their corporate social responsibility objectives.
- Microfinance Institutions and Operators: which includes Microfinance Banks, NGO-MFIs, Cooperative Societies, Community Based Development Institutions, Deposit Money Banks offering microfinance services, Development Banks, Government Intervention Programmes and Trade Associations.
- Microfinance support institutions comprising professional service providers in accounting, audit law and technology, and
- Microfinance beneficiaries or microfinance clients who are basically low income people and micro entrepreneurs.

3.4 Challenges Facing Microfinance Banks in Nigeria

Microfinance encounters numerous challenges and some of these include:

- Inadequate basic infrastructure: This compounds the operational difficulties of microfinance banks, which normally encounters high operational costs due to the nature of business. By managing many small customers, microfinance banks' cost of transactions are more often than not higher than those of conventional banks. Regrettably, microfinance banks are also compelled to encounter additional costs to provide themselves with electricity and water. Inadequacy of good roads particularly in the rural areas also interferes with their outreach. All these challenges drive the cost of operations up and put them at a very big competitive disadvantage.
- Insufficient banking culture in the rural areas and among the urban poor: Usually, these people borrow money from friends as well as relatives and repay the same amount of money borrowed no matter the tenure of such loans. Thus, they find it hard to understand the payment of interest on bank loans. In the northern part of the nation, the problem of frowning at interest on loans assumes a religious dimension. This part of the country is populated by mostly Muslims, a religion which hates usury. This has hindered the growth and development of microfinance banking in that part of the nation. This was buttressed by (Mohammed and Hassan 2009) who were of the opinion that traditional micro financing defies Islamic principles by charging interest. This issue is of concern for Muslims owing to the outcome of

dealing with interest (riba). This might account for the lopsided location of microfinance banks in nation as above 75% of them are located in the southern part of the nation while the northern part with a higher incidence of poverty has less than 25% .

- The failure of most community banks and the withdrawal of the license of 224 microfinance banks in 2010 have gravely harmed the public confidence in these banks. A number of microfinance banks set up in communities where failed community banks existed are confronted with an uphill job of proving to these communities that they will not go through the ill-fated experience of losing money in a bank failure. The immediate withdrawal of the license of 224 of these banks has increased the lack of the general public confidence which community banks bequeathed them. Most of the customers of these banks have abstained from dealing with them in fearing the same fate would befall them. Conversely, the Central Bank of Nigeria has continually assured the public that it will not allow any commercial bank to fail; this, places the microfinance banks at a great disadvantage by tilting public confidence in favour of commercial banks that are usually bigger and stronger.
- Limited assistance for human and institutional capacity building. The scarcity of human capacity in the microfinance sub-sector in Nigeria has been a major concern from the days of community banking. One of the key challenges of the microfinance sub-sector is recruitment of effective and suitable manpower. This is as a result of the inability of the sector to sufficiently remunerate staff. Other human resource challenges encountered by microfinance banks include insufficient training opportunities as well as poor conditions of service. The quality of manpower in these banks is revealed in the poor performance of most of them, inefficiency and high levels of frauds and forgeries. In addition, these banks suffer from high labour turnover a further sign of inadequate staff motivation as well as poor personnel practices.
- Corruption is a cankerworm that has caused havoc in most sectors of the Nigerian economy. The microfinance sub-sector is not excluded from the ravages of corruption. This is illustrated in many ways, for instance, corporate governance failures, frauds and forgeries, theft and refusal by

customers to repay loans. The standard of corporate governance in a number of microfinance banks in Nigeria is poor. Board members are identified to use their positions wrongly to get facilities way above the regulatory limit for insider related loans and worse still with no intent of repaying such facilities. Furthermore, they use their positions to overly influence and manipulate the recruitment processes in favour of their cronies. Frauds and forgeries by both insiders and outsiders to the banks are rife and people normally get loans with no intent to repay.

- It is significant to note that there is over nine hundred microfinance banks presently in Nigeria and they are regulated and supervised by the Central Bank of Nigeria (CBN). The CBN in addition has the responsibility of supervising commercial banks, development finance institutions, primary mortgage institutions, and bureau de change and credit bureaus. The multiplicity of the institutions as well as their diverse nature possesses a regulatory challenge. This is against the backdrop that given that for example, commercial banks and microfinance banks differ in operational method and scope, a regulator trained to inspect/supervise the functions of one may be limited in the supervision of another.
- The appearance of miracle or magic banks every now and then has done a lot of disservice to microfinance banks image. These banks spring up with no any license, guarantee to pay bizarre interest on deposits, mobilize deposits from uninformed and/or greedy and disappear. Most of the victims of these scams are customers that microfinance banks ought to service although become cynical about banking after their miracle bank experience. Many others do not see any difference between those magic banks and the licensed microfinance banks.
- Copying, competing as well as mimicking the practices of commercial banks: A number of microfinance bank managers and other management staff were initial commercial banks' staff who were either retired or sacked by their former employers. To these staff, microfinance banking is merely an extension of the commercial banking they know. In addition, they come with their organizational orientation, viewpoint and philosophy. They refuse to understand that micro finance is not micro-commercial banking but a different type of banking that requires a different approach, philosophy and

client base. This might be why most microfinance banks spend huge amount on office complex, exotic cars and the wardrobe of their staff. Furthermore, they take part in inordinate competition with the commercial banks. This class of staff lack orientation as to the real meaning of microfinance.

- The continuous change in government policy offers its set of difficulty to microfinance banks. In 2007, commercial banks were consolidated; they became so huge clearly leaving the not too wealthy client segment to microfinance banks. Presently, banks have been reclassified into regional, national and international, increasing fears that the regional banks might be in direct competition with microfinance banks. Furthermore, Islamic banks are being licensed and might end up in the same market segments as microfinance banks.
- The rate of interest charged by microfinance banks leaves a lot to be desired. Microfinance banks charge between 30% - 100% interest on loans while they pay 4.5% to 6% on savings. Microfinance banks rates are way too high and may not augur well for the smooth development of this sector.

3.5 Prospects of Microfinance Banking in Nigeria

There are a lot of opportunities for the microfinance subsector in Nigeria. Academics as well as macroeconomic policy makers all agreed that there is a huge untapped market for microfinance banks. It is estimated that approximately 70% of the Nigerian population is engaged in the informal sector or agricultural production. With the country's population of over one hundred and fifty million people we can infer that approximately one hundred and five million are in this sector. In the same line though differing in figures, Mohammed and Hassan (2009) were of the opinion that microfinance banks in Nigeria only serve fewer than one million people against the over 40 million that need their services. Furthermore, the gap in this subsector was shown when it was revealed that microcredit facilities in Nigeria account for approximately 0.2 percent of GDP and less than one percent of total credit to the economy.

The situation above is implies that there is a huge market which microfinance banks can take advantage of. This huge untapped market in the microfinance subsector is additionally enhanced owing to the fact that more than 65% of the total Nigerian populace has no access to banking services. To say that this leaves a

large vacuum for existing microfinance banks to enlarge their operation capacity as well as for new ones to come into the market will be stating the apparent fact.

The federal government of Nigeria renewed interest as well as enhanced regulatory environment in the microfinance sub-sector in addition improves the prospects for the development and success of microfinance banks. One indication of this is the implementation of training programmes for regulators, promoters as well as practitioners by the Central Bank of Nigeria (CBN). In addition, the Central Bank of Nigeria subsidizes the training of practitioners in the sector to decrease the financial load on the banks. Presently, the Central Bank of Nigeria pays 60 per cent of the cost of training the management staff of these banks; this is targeted at enhancing the capacity in the industry. The programme which the Central Bank of Nigeria administers in collaboration with Nigerian Deposit Insurance Corporation (NDIC) will conclude in these managers passing a certification examination set by the Chartered Institute of Bankers of Nigeria (CIBN). The regulators are taking this certification/human capacity building programme so seriously that they have authorized a guideline that only certified persons will qualify to manage microfinance banks in the near future.

Another indication of the regulatory will to guarantee vibrancy in the micro financing banking subsector is the inclusion of microfinance banks' deposits in the deposit insurance scheme. This has increased public confidence in the subsector. In addition, the review of the deposit insurance limit from one hundred thousand (N100, 000.00) naira as stipulated by the NDIC Act of 2006 to two hundred thousand (N200, 000.00) naira is a further sign of regulatory intention to build confidence in these banks.

3.6 Reforms of the Microfinance Bank Subsector in Nigeria

A number of efforts have been made to reform and the microfinance bank subsector for improved service delivery and these include:

- Strengthening on site regular inspection
- Withdrawal of the operating licenses of one hundred and three microfinance banks in 2010
- Incessant sanitization of the microfinance banks operating in the country as well as revocation of licenses of failed microfinance banks
- Implementation of firm sanctions as well as penalty system

- Facilitation of the setting up of a top association for the subsector; the National Association of Microfinance Banks in Nigeria
- Recommendation of prosecution for criminal activities of delinquent directors as well as management staff found guilty of mismanagement of the affected banks
- The setting up of the Microfinance Certification Programme to develop capacities in the subsector.
- Zero tolerance for regulatory violations
- The review of the Microfinance Policy framework
- The adoption of risk based supervision in the subsector

3.7 Co-operative Banking

These are financial institutions particularly set up to provide better access to savings as well as borrowing facilities for co-operative societies and their members at moderately cheaper costs and terms than those offered by the conventional banking institutions (Ojo and Adewunmi, 1980). Since conventional commercial banks are seen as serving the interests of big businesses as well as the wealthy in the society, such co-operative banking institutions are referred to as People's Bank in Canada as well as Germany, whereas in Britain, they are recognized as Consumer's Bank

3.8 Evolution of Co-operative Banks in Nigeria

Co-operative Bank of Western Nigeria later known as Co-operative Bank Limited established formally as a bank in 1961 was the first co-operative bank in Nigeria. It was followed also in 1961 by the establishment of Co-operative Bank of Eastern Nigeria later called Co-operative and community bank of Nigeria and co-owned by Imo and Anambra States.

The North Central Co-operative Bank later called Kaduna Co-operative Bank and in 1988 called the Tropical Commercial Bank Limited was set up in 1975. The Sokoto Co-operative Bank started operation in 1983 but in 1988 changed its name to Gamji Bank of Nigeria Limited. In 1987, the Co-operative Development Bank Limited was set up. As a result of the country's emphasis on the use of co-operative societies for the social and economic development, the federal

government of Nigeria transferred the Nigerian Agricultural and Co-operative Bank (NACB) to the Co-operative division of the ministry of trade. Under this special arrangement, NACB was directed to be in charge for financing viable co-operative projects of numerous types in addition to its conventional role of financing agriculture, including agricultural co-operatives. In this fashion, NACB has emerged as a significant co-operative institution in the nation.

It is informative to observe that although co-operative banks in Nigeria, in numerous cases, channel their resources to co-operative institutions, they more or less function as conventional commercial banks with profit motive the principal objective.

Based on this development, there is the need to formulate as well as implement separate co-operative banking regulations with the NACB as the controlling institution. Though some people may argue that the people's bank as well as the community bank now performs some of the roles of co-operative banks. This can be partially true.

3.9 Roles of Co-operative Banks in Nigeria

The roles of co-operative banks in Nigeria include the following:

- Co-operative banks are meant to fill the financial gaps left by the conservative as well as the profit-oriented financial practices of traditional/commercial banking institutions in Nigeria which resulted in the neglect of large majority of the masses in the provision of financial resources needed for development activities of the country. These co-operative banks, thus, provide for these neglected groups who have organized themselves into co-operative societies.
- Co-operative banks provide increased access to banking facilities and resources to cooperative societies and their members at both lower costs and a better terms than those offered by traditional commercial banking institutions
- Employing established co-operative principles and practices, co-operative banks provide primarily for the economic well-being of its members

- With proper managerial and professional thrust they can efficiently tap the rural resource potential in the country in a massive way

4.0 CONCLUSION

Microfinance is essential to economic growth and development of any nation, thus, there ought to be renewed efforts by all tiers of the Nigerian government to ensure that the microfinance policy and its reforms are implemented effectively. Furthermore, the roles co-operative banks play in the Nigerian economy should not be neglected and government should ensure that co-operative societies are encouraged in one way or another to improve the living standards of their members.

5.0 SUMMARY

In this unit, you have discussed an overview of microfinance banks in Nigeria; explained the rationale for the formulation of the national microfinance policy; learnt the aims of the microfinance policy; listed and explained the stakeholders in the microfinance subsector in Nigeria; discussed the challenges facing microfinance banks in Nigeria; explained the prospects as well as the reforms of microfinance banks in Nigeria and discussed the evolution and roles of co-operative banking in Nigeria

6.0 TUTOR-MARKED ASSIGNMENT

1. Explain the reforms of microfinance banks subsector in Nigeria?
2. Discuss the evolution and roles of co-operative banks in Nigeria?

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UNIT ELEVEN – ISLAMIC BANKING IN NIGERIA

CONTENTS

1.0 Introduction

2.0 Objectives

3.0 Main Content

3.1 Origin of Islamic Banking in Nigeria

3.2 Specific Forms of Islamic Banking Activities

3.3 An Outlook on Islamic Financial Systems

3.4 Challenges facing Islamic Banking System in Nigeria

3.5 Prospects of Islamic Banking

4.0 Conclusion

5.0 Summary

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7.0 Reference/Further Reading

1.0 INTRODUCTION

This unit shall discuss Islamic banks in Nigeria. They will be discussed in terms of their origin, specific form of their activities and roles in the Nigerian economy

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Discuss the origin of Islamic banks in Nigeria
- Explain the specific forms of Islamic Banking activities
- Discuss the Islamic Financial System in Perspective
- Explain the challenges confronting Islamic banking system in Nigeria
- Analyse the prospects of Islamic banking in Nigeria

3.0 MAIN CONTENT

3.1 Origin of Islamic Banking in Nigeria

In the early 1970s, Islamic banks came into existence as key participants in the field of finance. However, the rules and regulations that preside over Islamic banking system have been there for centuries. The foundation of Islamic banking is the prohibition of Riba (interest). Similarly, in non-Muslim literature, such as the Old and New testaments deem interest as vile.

During the 19th century, scholars such as William Shakespeare, Saint Thomas Aquinas, Charles Dickens, etc constantly were against money lenders and interest. In addition, renowned Indian authors like Rabindranath Tagore, Munshi Premchand, and Sarat Chandra illustrated the evil associated with the occurrence of interest charges in an economy.

Islamic finance became prevalent and was extensively acknowledged and put into practice during the Middle Ages. In Muslim societies, it assisted in promoting trade and businesses. Also, during this era, Islamic merchants performed a significant role in the commercial liberation of southern Europe that includes Spain, Baltic States and the Mediterranean. Islamic financial became more renowned when key cities of the Islamic Caliphate at that time became main commercial centres that drew the attention of European interests and capital. Though, the increasing pressure of capitalism and the free market economic principle in Europe overshadowed the Islamic financial system.

Around 1975-1976, saw the renaissance of the Islamic banking owing to increased earnings from crude oil exports that gave Middle East oil producing countries the financial power to look for other banking and financial systems. Those that championed this course were mostly from the private sector. The 'Dubai Islamic Bank', a private institution, was established in 1975 by a collection of businessmen from a number of countries. In 1977, two additional private banks were set up with the name 'Faisal Islamic Bank' in Egypt and Sudan. Also in the same year, Kuwait finance house which was the first government Islamic financial institution was established by the Kuwaiti Government. Within a decade of setting up the first privately owned Islamic bank in Dubai, over fifty Islamic banks have been established. However majority of these are in Muslim nations, though there were quite a few in Western Europe specifically in the UK, Denmark, Switzerland and Luxembourg. As previously mentioned above, apart from the Kuwaiti bank the setting up of Islamic banking, had been by private individuals and restricted to the start up banks. However, in Iran and Pakistan, it was set up by government covering the entire banks in both countries. In 1981, the governments in these nations concurrently took steps to initiate Islamic Banking, on a global scale.

Islamic banking in Nigeria commenced in January 2012, when the Central Bank of Nigeria practically approved Jaiz Bank to function as a local interest-free bank in the northern part of the country. Accordingly, Jaiz bank became the foremost and

the only developed Islamic bank in the nation. If you take into account how famous this phenomenon is, and the number of Muslims in Nigeria, it is expected that in due time, the number of Islamic banks will increase in Nigeria.

The most significant difference between this and other banks in Nigeria is that Islamic banks firmly adhere to the norms customs and values of Islam, in which lending with interest (usury) is forbidden. Each and every one of Islamic financial instruments is designed in such a way to satisfy this clause and at the same time to earn profit from their activities.

3.2 Specific Types of Islamic Banking Activities

According to www.legit.ng, the following are specific types of Islamic banking activities. These include:

- **Musharakah** - It is a dual execution of a project by the bank and an entrepreneur. In the outline of this process, the bank sponsors a particular project. The origin of these operations dates back to the caravan trade when a number of merchants made goods available, others distributed it to their various destinations and put them up for sale.

Under musharakah, the bank performs financing that is not connected to the collection of a specific percentage but takes part in the profits obtained. The sharing of profits is as follows: a specific part is given to the partner in payment for his job, managerial skill or additional contribution in the transaction or project. The other part is shared between the partner and the bank that provided the financing, in a ratio proportional to the payment of each participant, to the entire costs of the project. Losses are shared in proportion to contribution in financing.

- **Mudarabah** - This is a contract in which a customer of a bank transfers funds to the bank for later investment of this fund into a particular project or kind of activity. The profit gotten during the execution of the project is shared in a specified amount. This process is an analog of an inert banking procedure — raising money. Islamic distinctiveness lies in the fact that the customer is aware of where his money goes. The bank cannot invest in forbidden activities such as the production and selling of alcoholic drinks,

the running of gambling-houses, or other prohibited acts. In addition, *mudarabah* does not include interest in pure form.

- **Murabaha** - It entails the funding of saleable transactions, diverse collection of the contract of sale. The bank obtains a particular good for resale. Such activities do not contradict the Shariah as trade involves certain individual participation and endeavours. The bank takes over the management of transactions, storage, transport, etc. For instance, the bank obtains goods at its own cost for the customer's order. In this case, the bank takes up the whole risk of the trading operation. Afterwards, the bank resells the product to the customer at a price that includes the additional cost specified in the contract. This markup turns out to be the income of the bank.

Other activities that are distinctive to Islamic banking include:

- **Ijar** — long-term lease, an analog of leasing operation.
- **Salam** — advance funding, mostly in the agricultural sector.
- **Ijarah-wal-iqtina** — a contract in line with which a customer gets the right to buy earlier leased machineries and facilities for the purpose of production.
- **Sunset** - According to the Koran, this is an obligatory tax (2.5%), levied on the assets of rich Muslims and directed to assist the poor populace of the Muslim community and generate projects for making daily life better.
- **Qard al Hassan** - This is an interest-free loan. The bank gives an interest-free loan to an individual or institution that is paid back on a specific time. The bank can assign an interest-free loan to the government or institution for the execution of community projects (building of roads, plant, fundamental amenities/facilities).
- **Bai bi Sila** – It is an onward transaction in which the buyer pays part of the advance for goods.
- **Sukuk** (interest-free Islamic bonds) - This is given out for a particular tangible asset, where the issuer is deemed as a shareholder of the asset. The earnings of Sukuk rely on the profit on the fundamental asset, and the issuer gives the investor an irreversible entitlement to repurchase the asset at a fixed cost. The benefit of this kind of bond is also in the low instability and tendency of investors to hold these securities prior to maturity. According to global researchers, presently, the world goes well with Sukuk in the amount

of US\$90 billion, and the start of the fall in the volume of their issue in 2008 (three times compared with 2007 - from \$50 to \$15 billion) was related with the fatwa of Islamic theologians, who acknowledged 80% of the entire volume of Sukuk releases that do not meet the Sharia customs. A damaging feature affecting the Sukuk's attractiveness is the reality that the lower boundary of the volume of loan, which decides the convenience of giving out the Sukuk, is the bar of US\$100 million.

SELF ASSESSMENT EXERCISE

Discuss the specific types of Islamic banking activities

3.3 An Outlook on Islamic Financial Systems

The ideas, theories and perceptions with respect to Islamic financial system sent a wave down the foundation of financial systems that were based on capitalist principles. The notion of a financial system that is interest free appears quite attractive but those that were used to the regular/normal financial system believed that a financial institution with no interest could not last.

The individuals who attached significance to ethics, beliefs, morals and other societal values disapproved of the regular financial system as depending a great deal on capitalistic procedures. Standard financial system engineers the charging of high interests on loans and advances, vehemently seizing buildings if the loans are not paid back, maltreatment of those who fails to payback, are all being complied with as on the amiss part of the law. Financial institutions are pestered by human rights bodies and new rules and regulations support the customers. Customers are unwilling to cope with institutions which do not provide appropriate recognition to moral values and ethics. They detested investments in unethical activities as well as those activities harmful to the society.

Islamic banking system has produced a gateway to invest morally and in a useful way to the society, consequently increasing its acceptance. Socio-demographic tendencies have been the means for continuous growth in Islamic banking and financial system. The rise in population growth rate in Islamic communities globally has been supported by rising wealth and affluence, specifically across Asia. With this development, customers are looking for Islamic banking and Islamic moral and ethical values as described in Shari'ah law, while providing the advantages of diversification and a full variety of banking products.

3.4 Challenges facing Islamic banking System in Nigeria

According to Olaoye, Dabiri, and Kareem (2013) some of the challenges facing Islamic banking system in Nigeria include:

- **Awareness**

There is seemingly inadequate consciousness, knowledge and familiarity of Islamic banking concept in Nigeria. Therefore, for a banking system that is free of interest to work competently in the country, there is an immense necessity for sensitization of all the stake holders (government, private establishments and the general public) by Islamic experts, scholars and economists. This is due to the fact that Nigeria is a secular state. For this reason, government ought not to be seen as attempting to Islamize the nation's banking system. This denotes that the inclination of non-Muslims to misunderstand the philosophy or ideology owing to its religious diversities and thus, this calls for a nation-wide awareness.

- **Manpower**

It is commendable to note that for Nigeria to institutionalize Islamic banking system there is a necessity to include this idea into the Nigerian university prospectus or set of courses to set up a decent foundation as well as human resources for the business of Islamic banking system. In other words, scholarship can given to students to go abroad for useful training from those nations that have succeeded in the execution of the Islamic banking. For example, Malaysia, Bahrain, Saudi-Arabia. Etc.

- **Requisite legal framework**

The Central bank of Nigeria which is the overseer as well as the watchdog of the banking industry is anticipated to come up with adequate details of regulations that control the operations of Islamic banking in Nigeria (legal frame work) that agrees with the beliefs of the Qur'an and Hadith of the holy prophet Muhammed (SAW). Nonetheless, the policy framework ought to be such that allows the Islamic banks to be competitive with the regular banks. More significantly the validation for the existence of an alternative is to put out the thirst of Muslim faithful for banking services that will be in complete adherence to the law of Islam.

- **Societal Belief and Socio-Political Environment**

Due to the society's belief on banking services that generates interest; it would be difficult to be eradicated. For example, a good number of the rich and wealthy in the society frequently make up the key shareholders in most or if not all banking

institutions. Therefore, to get rid of such interest from what they have been benefiting from might become a knock on their affluence and an assault on their sources of riches and prosperity. However, if the federal government is really honest about this course of action as commanded by the Almighty Allah, then, the concerned authorities might enact laws that will put down the foundation for the setting up of Islamic banking system in Nigeria.

- **Equity Capital/Cash Requirements and Orientation Challenge**

Owing to the risk involved in putting large sum of money for setting up Islamic banking, individuals tend to be unwilling to make such investments. For example, the current CBN's bank capitalization or cash requirement for international License of banks is N50billion, National license (N25billion) and regional license (N10billion) respectively. Thus, one would barely notice businessmen investing such amount of money on uncertainties, simply in the name of Qur'an and Hadith of the holy prophet (SAW).

3.5 Prospects of Islamic Banking

The prospect for Islamic Banking is extremely vivid. Globally, Muslims are clamouring for this system of banking. For example, in Bangladesh, approximately 80% of the regular banks opened separate Islamic banking windows in recent times. The Islamic Bank of Bangladesh Limited has one hundred and thirty two branches in the nation and five hundred applications are pending with Islamic Bank Bangladesh Limited for starting up of new branches

The state of affairs might not be similar across countries. But if Islamic Banking thrives in any nation, the arrangement might be the same in all Muslim-populated nations. This signifies that the first Islamic Bank in Nigeria ought to be properly managed, controlled, coordinated and successful so that individuals would have adequate confidence in the system. The country ought to go into effective working relationships with nations that have established Islamic Banks to provide capable and experienced officials to help out in setting up Islamic Banks. According to Olaoye, Dabiri, and Kareem (2013), the following points summarizes the advantages as well as the opportunities for the setting up of an Islamic bank in Nigeria: These include

- **Population**

According to the 2006 census in Nigeria, the population of Muslims was approximately 50 percent of the entire populace in the country. This is an effective source of patronage; furthermore, Islamic banks will not only cater for Muslims

but also impoverished non-Muslims who would use the opportunity to build micro, small and medium scale enterprises with slight concern for their sustainability owing to high rate of interest.

- **Economic Growth**

The setting up of the Islamic banks will assist in advancing trade and businesses among a good number of the most susceptible of the population resulting in a rise in the growth as well as development of the real sector of the economy. Nevertheless, it ought to be noted that when a business does well, it provides opportunities for employment generation, increase in GDP, development of human capital and productivity.

- **Attraction of Investors**

An environment that is conducive as well as interest free will obviously attract investors who will likely gain from the backing of the interest free financial system. Investment can only flourish fruitfully in an environment in the absence of strict conditions attached to obtaining money to fund investment. This implies that the Islamic banking system has the ability and means to facilitate and accelerate the growth and development of infrastructures which the nation has been longing for.

- **Egalitarian Society**

Islamic banks have the propensity to promote equity in the distribution of income as well as wealth in the society. This will facilitate the transformation of the Nigerian economy into a more balanced state with a decrease in poverty rate. A feeling of fitting in would also be generated owing to the funding of the business of customers based on the modus operandi of Islamic financing.

- **Prevention of Fraud**

Lately, the Central Bank of Nigeria has emerged with the record of bank executives that have been involved in un-secured loan lending that resulted in the bankruptcy of a good number of sound conventional banks. This act could be traced to the fact that they were not directed by the set of laws of the Qur'an as well as the Hadith. Islamic banks are operated on the basis of trust and there are calamitous outcomes, both spiritual and physical, for breaking the laws that guide such trust.

4.0 CONCLUSION

Islamic banking system has created an opportunity to morally, ethically and decently performed banking services in a helpful way to the nation, thus increasing its acceptance as well as recognition. The increased rate in population growth particularly in Islamic societies globally has been aided by increasing affluence, riches as well as wealth. With this occurrence, customers are seeking for Islamic banking as well as Islamic moral and ethical values as depicted in Shari'ah law, whilst providing the benefits of diversification and a complete range of banking products.

5.0 SUMMARY

In this unit, you have discussed the origin of Islamic banks in Nigeria, explained the specific forms of Islamic Banking activities, talked about Islamic Financial System in Perspective, give details on the challenges confronting Islamic banking system in Nigeria as well as examined the prospects of Islamic banking in Nigeria

6.0 TUTOR-MARKED ASSIGNMENT

1. Explain the challenges facing Islamic banking system in Nigeria?
2. Discuss the prospects of Islamic banks?

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UNIT TWELVE - INSURANCE COMPANIES

CONTENTS

1.0 Introduction

2.0 Objectives

3.0 Main Content

3.1 Meaning and Evolution of Insurance Company

3.2 Roles of Insurance Companies

3.3 Operations and Regulations of Insurance Companies

3.4 General Features of Risks Insured by Insurance Companies

3.5 Types of Insurance Products

3.6 Advantages of Insurance Policies

3.7 National Insurance Commission

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 References/Further Reading

1.0 INTRODUCTION

This unit shall focus on insurance companies. Insurance companies will be discussed in terms of their evolution, roles, features, types, operations as well as regulations so that we can understand how they provide safety and put up with the risk of its clients. In addition, how they offer protection in the occasion of a likely unfavourable outcome will also be discussed.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Explain the meaning and roles of insurance companies
- Discuss the evolution of insurance companies in Nigeria
- List the features and types of insurance companies
- Explain the benefits of insurance companies
- Discuss the operations and regulations in Nigeria

3.0 MAIN CONTENT

3,1 Meaning and Evolution of Insurance Company

An insurance company is a company that provides safety and put up with the risk of its clients. It is an institution that offers protection in the occasion of a likely unfavourable outcome. It includes numerous insurance agents that normally concentrate on one type of insurance such as health insurance, life insurance, or multiple types of insurance. Also it can be seen as a company that offers coverage in the form of compensation due to damages or injuries. It makes up one of the significant segments of the Nigerian financial system.

They have been operating in Nigeria for a long period of time. Before the late 1950s, the insurers were just expatriates and by late 1950, indigenous companies began to appear.

The insurance company act was enacted in 1961 to formalize, regularize as well as lay down the modalities for insurance practice. The Nigerian insurance industry has illustrated unexceptional growth since the 1960s when its regulatory outline was made official by law.

The business of insurance commenced in Nigeria in the colonial era and prior to 1950 was only performed by foreigners. In 1961 the Insurance Company Act was approved to officially regularize and adopt the modalities for the practice of insurance business with the Federal Ministry of Finance responsible for the licensing of new insurance companies. The insurance sub-sector, which mobilizes long-term investible funds, is the second largest sub-sector in the Nigerian financial system, after the banking sub sector.

Insurance companies pool and handle risks on behalf of their clients. Thus, insurance provides a risk transfer medium for household individuals, business firms as well as government agencies. As a result of risk exposure an individual faces each day, insurance companies have developed various policies that cover almost all the risks. They handle the risks of individuals and allow people to share their liabilities by pooling individual risks and decreasing the chances of suffering financial lost. Its activities cover section of life insurance, health, automobile, security, homes, profit and claims among others.



Source: *insurancemarketz.com*

Insurance is based on the tenet of large numbers and the engagement of the hitherto overlooked informal sector can play an important part in building the numbers. By this way, insurance companies have to work more on their customer service and claims management in order to yield decent returns.

As a consequence of the bank consolidation exercise embarked on by the CBN, the insurance sub-sector companies were also required to recapitalize, raising the minimum capital requirement to N2.00 billion, N3.00 billion and N10.00 billion for life, non-life and reinsurance businesses respectively, to enable the sub-sector meet the challenges of an increasingly global financial system.



Source: CBN Monetary Policy Department 2017

SELF ASSESSMENT EXERCISE

Discuss the evolution of insurance companies in Nigeria

3.2 Roles of Insurance Companies

- To mobilize long term funds in the form of premium by providing life or non- life protection to customers
- To encourage economic growth by investing its premium and other income in the economy
- To promote the insurance business by giving part of its income to a fund in the Nigerian Re-insurance Corporation
- They operate pension schemes on behalf of companies
- They grant loans on mortgages
- They act as underwriters in the capital market
- Insurance policies are used as collateral securities for bank loans
- Insurance companies facilitate risk transfer
- They help to improve the balance of payments position of the country by insuring imports and exports and through re-insurance
- Through their life and pension businesses they help to develop the financial market

3.3 Operations and Regulations of Insurance Companies

A good number of insurance operations are regulated by the states, but there are certain areas where the federal government uses its regulatory authority. For instance, federal law imposes penalties for fraud as well as false statements made in connection with insurance transactions. Anybody who is involved in the insurance business and makes a false statement with the intention of manipulating their actions can be subject to punishment. Also, several federal regulations and actions have an effect on insurance directly, for instance, the Fair Credit Reporting Act and some programs that make coverage for horrible losses available, such as FEMA's (Federal Emergency Management Agency) National Flood Insurance Program, insurance is regulated mainly at the state level.

Operations:

The operations of an insurance company are as follows.

- Rate making
- Underwriting
- Claim settlement
- Re-insurance etc

It is the state that regulates insurance using some guidelines such as:

- Rates must be adequate
- Rates must not be excessive
- Rates must not be unfairly discriminatory

3.4 General Features of Risks Insured by Insurance Companies

An Entrepreneur who gets insurance against every likely risk of business, frees himself/herself from the risk against which he/she has taken the insurance and therefore makes he/she available for more vital as well as urgent work.

An insured entrepreneur feels safe and free. Anyone who adopts a life policy or general policy such as fire, natural calamity, accident etc. is free from family liabilities. Thus, the features of risks insured by insurance company include;

- Huge number of similar objects - A huge similar risk pool is desired for insurance companies.
- Losses are accidental/unintentional - Needs to be unintentional in nature, avoid moral hazard/not gambling
- Losses can be determined/measured - If data is available, easier to make predictions

- Losses should not be disastrous - When one random event results in many losses, the insurance company has a great problem
- Huge Loss Principle - Maximum possible loss needs to be sufficient (people do not buy insurance for inexpensive property/things).

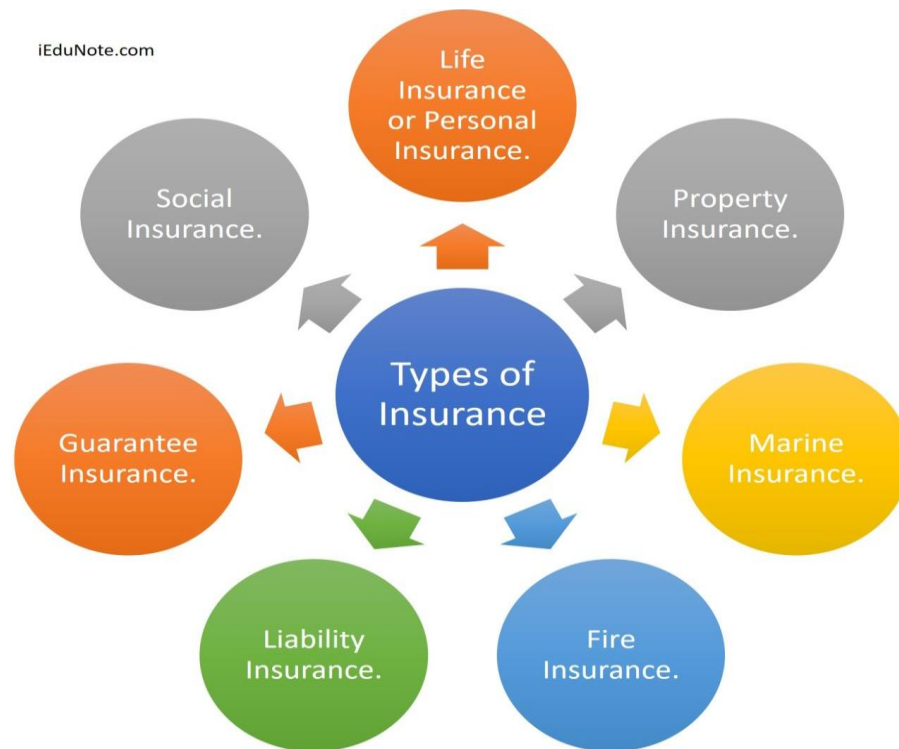
3.5 Types of Insurance Products

Various types of insurance products exist and they differ across countries. Such as

- Home insurance and Car insurance
- Travel insurance
- Life insurance, critical illness,
- Income protection and Payment protection
- Private medical and dental Insurance
- Pet insurance
- Fire insurance
- Property insurance
- Marine insurance
- Guarantee insurance
- Social insurance
- Liability insurance
- Workers injury benefit insurance

3.6 Advantages of Insurance Policies

- Life insurance offers cash for handling the difficult financial consequences of the insured's death.
- The policy protects family and employees against the risk of premature death.
- Unlike any other financial instrument, Life insurance enjoys favorable tax treatment.
- Education policies make available cash on death or disablement of workers while the child is in college/university.



Source: *iedunote.com*

3.7 National Insurance Commission (NAICOM)

The National Insurance Commission was established in 1997 to guarantee the efficient administration, supervision and regulation of insurance business in Nigeria as well as regulate transactions between insurers and reinsurers within and outside Nigeria.

The responsibility to set the standards for the conduct of insurance business in Nigeria was granted to commission for proper monitoring and inspection in order to ensure stability in the industry. It determines and approves the rates for premiums and commissions in the insurance industry and protects policy holders and other beneficiaries of insurance contracts.

It advises the Federal Government on insurance matters and ensures that government assets are protected. It also contributes to insurance the education programmes of the Chartered Insurance Institute of Nigeria and the West African Insurance Institute.

4.0 CONCLUSION

Insurance firms constitute one of the important segments of the Nigerian financial system. The primary objective of insurance companies is to protect their customers

against insured risks by selling insurance policies to them. By doing this, they help businesses in the form of compensation as a result of damages or loss. This inevitably can lead to economic growth and development. Thus, the role insurance companies play in an economy cannot be overemphasized.

5.0 SUMMARY

In this unit, you learnt the meaning and roles of insurance companies; evolution of insurance companies in Nigeria; types of insurance companies; benefits of insurance companies; operations and regulations of insurance companies in Nigeria

6.0 TUTOR-MARKED ASSIGNMENT

1. List and explain the benefits insurance companies.
2. Discuss the regulations and operations of insurance companies in Nigeria.

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MODULE THREE: INTERNATIONAL FINANCIAL INSTITUTIONS

Unit Thirteen – International Financial Institutions

Unit Fourteen – The World Bank

Unit Fifteen – The International Monetary Fund

Unit Sixteen – The African Development Bank

UNIT THIRTEEN – INTERNATIONAL FINANCIAL INSTITUTIONS CONTENTS

1.0 Introduction

2.0 Objectives

3.0 Main Content

3.1 Meaning of International Financial Institutions

3.2 Multilateral Development Banks (MDBs)

3.3 Bretton Woods Institutions

3.4 Regional Development Banks

3.5 Other Regional Financial Institutions

3.6 Bilateral Development Banks and Agencies

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 References/Further Reading

1.0 INTRODUCTION

In this unit, we shall discuss international financial institutions. The International Financial Institutions or IFIs include the Multilateral Development Banks, Bretton Woods Institutions, Regional Development Banks and Bilateral Development Banks and Agencies can respond more actively to the requirements of developing nations to make sure that growth opportunities get to the citizens of these nations and inevitably improve their standard of living.

2.0 OBJECTIVES

At the end of this unit, you ought to be able to:

- Define the meaning of international financial institutions
- Give a description of multilateral development bank
- Give examples of the Bretton Woods institutions
- Explain regional development banks and other regional financial institutions
- Explain bilateral development banks and agencies.

3.0 MAIN CONTENT

3.1 Meaning of International Financial Institutions

These are financial institutions that is set up by more than one country, and for the reason are subjects of international law. Their owners are usually national governments, though other international institutions as well as other organizations occasionally play a part as shareholders. The most well known International Financial Institutions are formations of multiple nations, though a number of bilateral financial institutions exist and are in principle International Financial Institutions. The best recognized International Financial Institutions were set up after World War II to assist in the rebuilding of Europe as well as offer the means for international cooperation in running the international financial system.

Presently, the world's largest International Financial Institution is the European Investment Bank, with a balance sheet size of €573 billion in 2016. This compares to the two components of the World Bank, the IBRD (assets of \$358 billion in 2014) and the IDA (assets of \$183 billion in 2014). For assessment, the largest commercial banks each have assets of \$2,000-3,000 billion

3.2 Multilateral Development Banks (MDBs)

These are institutions formed by a group of countries that offers financing as well as professional advising for the reason of development. Multilateral Development Banks have huge memberships including both developed donor nations and developing borrower nations. Multilateral Development Banks funds projects in the form of long-term loans at market rates, very-long-term loans (also known as credits) below market rates, and through grants.

The following are more often than not classified as the main Multilateral Development Banks:

- World Bank
- European Investment Bank (EIB)
- Islamic Development Bank (IsDB)
- Asian Development Bank (ADB)
- European Bank for Reconstruction and Development (EBRD)
- CAF - Development Bank of Latin America (CAF)
- Inter-American Development Bank Group (IDB, IADB)
- African Development Bank (ADB)
- New Development Bank (NDB)

- Asian Infrastructure Investment Bank (AIIB)
- Arab Petroleum Investments Corporation (APICORP)
- Eastern and Southern African Trade and Development Bank (TDB)

In addition, there are more than a few sub-regional multilateral development banks. Their membership typically includes only borrowing nations. The banks lend to their members, borrowing from the international capital markets. Since there is efficiently shared conscientiousness for repayment, the banks can over and over again borrow more economically than could any one member nation. These banks include:

- Caribbean Development Bank (CDB)
- Central American Bank for Economic Integration (CABEI)
- East African Development Bank (EADB)
- West African Development Bank (BOAD)
- Black Sea Trade and Development Bank (BSTDB)
- Economic Cooperation Organization Trade and Development Bank (ETDB)
- Eurasian Development Bank (EDB)

Furthermore, there are more than a few multilateral financial institutions (MFIs). Multilateral Financial Institutions are like Multilateral Development Banks except that they are every now and then separated because they possess more limited memberships and frequently concentrate on financing specific kinds of projects.

- European Commission (EC)
- International Finance Facility for Immunisation (IFFIm)
- International Fund for Agricultural Development (IFAD)
- Nordic Investment Bank (NIB)
- OPEC Fund for International Development (OFID)
- Nederlandse Financieringsmaatschappij voor Ontwikkelingslanden NV (FMO)
- International Bank for Economic Co-operation (IBEC)
- International Investment Bank (IIB)
- Arab Bank for Economic Development in Africa (BADEA)

SELF ASSESSMENT EXERCISE

Define the concept, international financial institutions

3.3 Bretton Woods institutions

The most recognized International Financial Institutions were set up after the World War II to assist in the rebuilding of Europe as well as offer means for international cooperation in running the international financial system. They include the World Bank, the International Monetary Fund, and the International Finance Corporation. Presently in the world, the biggest International Financial Institution is the European Investment Bank which lent 61 billion euro to worldwide projects in 2011.

3.4 Regional Development Banks

They are made up of quite a few regional institutions that have roles that are similar to the World Bank group's functions, although with specific focus on a particular region. Shareholders are normally made up of the regional nations in addition to the main donor nations. The most famous of these regional banks include regions that generally match up to the United Nations regional groupings, including the Inter-American Development Bank, the Asian Development Bank; the African Development Bank; the Central American Bank for Economic Integration; as well as the European Bank for Reconstruction and Development. The Islamic Development Bank is among the leading multilateral development banks. After the World Bank, the Islamic Development Bank is the only multilateral development bank that is universal in terms of its membership. Fifty six member countries of the Islamic Development Bank are spread over Asia, Africa, Europe and Latin America.

3.5 Other Regional Financial Institutions

Financial institutions of neighboring nations set up themselves globally to engage in as well as fund activities in those areas of mutual interest; a good number of them are central banks, followed by development and investment banks. Some institutions were conceived and started working informally 2 decades before their legal inception (e.g. the South East Asian Central Banks Centre)

3.6 Bilateral Development Banks and Agencies

A bilateral development bank is a financial institution set up by one individual country to fund development projects in a developing country and its emerging market, hence the term bilateral, as opposed to multilateral. Examples include:

- The Netherlands Development Finance Company FMO, headquarters in Hague; one of the largest bilateral development banks worldwide
- The DEG German Investment Corporation or Deutsche Investitions- und Entwicklungsgesellschaft, headquartered in Köln, Germany
- The French Development Agency Agence Française de Développement, and Caisse des dépôts, founded 1816, both headquartered in Paris, France.

4.0 CONCLUSION

The International Financial Institutions or IFIs includes the International Monetary Fund, World Bank, Multilateral Development Banks, and other international development agencies can become more receptive to the needs, wants and requests of developing countries and make sure that they promote growth opportunities to reach the world's poorest people. The International Financial Institutions are key sources of financial and technical assistance for developing countries. While their effect on development outcomes is frequently less than their more active critics argue, it can be fairly considerable, specifically in smaller low-income countries. However, the policies of these institutions are for the most part determined by the main shareholders, which include the rich countries that provide majority of the capital, rather than the borrowers. This irregularity ought to be dealt with so that borrowers can have their say in the operation of the International Financial Institutions.

5.0 SUMMARY

In this unit, you learnt the meaning of international financial institutions, the multilateral development banks, the Bretton Woods institutions, the regional development banks as well as bilateral development banks and agencies. With this knowledge, you can now understand how most international financial institutions function and how they assist developing countries in attaining adequate economic growth and development.

6.0 TUTOR-MARKED ASSIGNMENT

1. Differentiate between multilateral development banks and regional development banks
2. Differentiate between Breton Woods Institutions and Bilateral Development Banks or Agencies

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UNIT FOURTEEN - THE WORLD BANK CONTENTS

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7.0 References/Further Reading

1.0 INTRODUCTION

This unit shall focus on the World Bank. The World Bank will be discussed in terms of its definition, history, purpose, objectives, functions, organizational structure as well as its agencies so that we can have a better understanding of the roles they play in developing countries. In addition, criteria of becoming a member in the World Bank will also be discussed.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Discuss the meaning and history of the World Bank
- Discuss the purpose and objectives of the World Bank
- List the functions of the World Bank
- Explain the organizational structure of the World Bank
- Discuss the roles of the agencies of the World Bank

3.0 MAIN CONTENT

3.1 Description of the World Bank

World Bank is an international organization affiliated with the United Nations (UN) and designed to finance projects that improve the economic growth and development of member states. Headquartered in Washington, D.C., the bank is the largest source of financial assistance to developing countries. In addition, it provides technical assistance and policy advice and supervises on behalf of international creditors the implementation of free-market reforms. Together with the International Monetary Fund (IMF) and the World Trade Organization, it plays a central role in overseeing economic policy and reforming public institutions in developing countries and defining the global macroeconomic agenda.

3.2 A Brief History of the World Bank

The World Bank was officially established on 27th December 1946 following international ratification of the Bretton Woods agreements, which came out from the United Nations Monetary and Financial Conference (1–22 July 1944). In addition, it provided the foundation of the Oslander Committee in 1951, responsible for the preparation and evaluation of the World Development Report. Commencing its operations on 25th June 1946, its loans assisted European countries rebuild after the end of World War II. As a result of this, it became the world's first multilateral development bank.

The World Bank was funded through the sale of World Bonds. It approved its first loan on 9th May 1947 (US\$250M to France for postwar reconstruction, in real terms the largest loan issued by the Bank to date). The World Bank has also provided loans to other European countries. During the 1970s, it loaned money to India, Mexico as well as Chile to build power plants and railways. By 1975, its loans had assisted with a broad range of concerns such as family planning, pollution control and environmental protections.

The lending activities of the World Bank became contentious. A lot of countries used their loans to prevent a sovereign debt default. Their debt was over and over again as a result of profligacy, overspending, extravagance as well as extensive

borrowing. Regardless of the World Bank's assistance, a lot of countries devalued their currencies and this led to hyperinflation. To tackle this problem, the World Bank needed austerity measures, for instance, the country had to consent to curtail its spending as well as support its currency. Regrettably, this more often than not brings about a recession, making it difficult to repay the Bank's loans.

3.3 Purposes of the World Bank

The purpose for the establishment of the World Bank includes the following:

- To create an environment that is a pro-investment.
- To improve economic stability by reducing poverty.
- To achieve sustainable growth.
- Increase opportunities for jobs and businesses in member nations which are underdeveloped.
- To promote the socio-economic status of the society.
- To ensure that the judicial and legal systems are developed and individual rights are protected
- To strengthen the government of its member nations by promoting education.
- To fight corruption and to make sure that there are adequate training opportunities and research facilities.
- To provide loans with low-interest rates and interest-free credits.

SELF ASSESSMENT EXERCISE

Give a brief history of the World Bank

3.4 Objectives of the World Bank

The objectives of the World Bank includes the following

- Offer long term capital to its member nations for economic development and reconstruction.
- Assist in inducing long term capital for improving the balance of payments and thereby balancing international trade.
- Assist in providing guarantees against loans granted to large and small units and other projects for the member nations.

- Ensure that development projects are implemented. Thus, it brings a sense of transparency for a nation from war-time to a peaceful economy.
- Promotes capital investment for member nations by providing a guarantee for capital investment and loans.
- If the capital investment is unavailable then it provides the guarantee and then IBRD provides loans for promotional activities on specific conditions.

3.5 Functions of the World Bank

The Bank performs the following functions:

I. To help in the construction and development of the territories of its members by facilitating investment of capital for productive purposes, including the ‘restoration of economies destroyed or disrupted by war’, and the encouragement of the development of productive facilities and resources in less developed countries.

II. To promote private investment and long run balanced growth of international trade and BOP equilibrium by means of guarantees or participation in international loans and investments.

III. To arrange loans made or guaranteed by it, so that more useful and urgent projects receive preference.

IV. To provide finance to projects from its own capital, funds raised by it and by participating with other members.

V. In addition, the Bank provides advice and expertise. It now puts more emphasis on institutional technical assistance and infrastructure assistance. Over the years, it has been able to generate and disseminate policy relevant knowledge. Today, it has been concentrating more on this asset rather than financial resources. This organization is now called the ‘knowledge bank’.

VI. The World Bank provides economic, monetary, and technical advice to the member countries for any of their projects.

VII. It encourages the development of of-industries in underdeveloped countries by introducing the various economic reforms.

3.6 Agencies of World Bank Group: & their Organizational Structures

The World Bank group is a collection of five international organizations in charge of providing funds and advice to nations for the purposes of economic growth and development as well as eradicating poverty. The five international organizations of the World Bank group are:

- (i) International Bank for Reconstruction and Development (IBRD)
- (ii) International Finance Corporation (IFC)
- (iii) International Development Association (IDA)
- (iv) Multilateral Investment Guarantee Agency (MIGA)
- (v) International Centre for Settlement of Investment Disputes (ICSID)

The World Bank's activities are centered on developing nations, in areas such as, human development (e.g. education, health), agriculture as well as rural development (e.g. irrigation, rural services), environmental protection (e.g. pollution reduction, establishing and enforcing regulations), infrastructure (e.g. roads, urban regeneration and electricity) and governance (e.g. anti-corruption, legal institutions development).

The International Bank for Reconstruction and Development (IBRD) and International Development Association (IDA) offers loans at special rates to member nations, as well as grants to the poorest nations. Loans or grants for particular projects are frequently connected to broader policy changes in the sector or the economy. For example, a loan to improve coastal environmental management might be connected to development of new environment institutions at national and local levels and the implementation of new regulations to restrict pollution. The activities of the International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA) include investment in the private sector and providing insurance respectively.

3.6.1 Organizational Structure of these Agencies

Along with four affiliated agencies established between 1956 and 1988, the International Bank for Reconstruction and Development (IBRD) is part of the World Bank Group. The Group's headquarters is in Washington, D.C. It is an international organization owned by member governments; though it makes

profits, these profits are used in assisting the continued efforts in alleviating poverty.

To be precise, the World Bank is part of the United Nations system, but its governance structure is different. Every institution in the World Bank Group is owned by its member governments, which subscribe to its basic share capital, with votes proportional to shareholding. Membership gives specific voting rights that are similar for all countries but there are also additional votes which rely on financial contributions to the organization.

Consequently, the World Bank is controlled specifically by developed countries, while clients have almost exclusively been developing countries. A number of critics made a case that a different governance structure would take greater account of developing countries' needs. As of November 1, 2006 the United States held 16.4% of total votes, Japan 7.9%, Germany 4.5% and the United Kingdom and France each held 4.3%. As key decisions require an 85% super-majority, the US can block any such major change.

3.6.2 World Bank Group Agencies:

The World Bank Group consists of:

- i. The International Bank of Reconstruction and Development (IBRD) was established in 1945. It provides debt financing on the basis of sovereign guarantees;
- ii. The International Financial Corporation (IFC) was established in 1956. It provides numerous forms of financing of without sovereign guarantees, mainly to the private sector;
- iii. The International Development Association (IDA), was established in 1960, it provides concessional financing (interest-free loans or grants), more often than not with sovereign guarantees;
- iv. The Multilateral Investment Guarantee Agency (MIGA) was established in 1988, it provides insurance against certain types of risks, including political risk, mainly to the private sector; and,

v. The International Centre for Settlement of Investment Disputes (ICSID), was established in 1966, it works with governments to reduce investment risk.

The term “World Bank” in general refers to the International Bank of Reconstruction and Development (IBRD) and International Development Association (IDA), whereas the World Bank Group is used to refer to the institutions jointly.

Governments can select which of these agencies they become a member to individually. The International Bank of Reconstruction and Development (IBRD) has 185 member governments and other institutions have between 140 and 176 members. The institutions of the World Bank Group are all managed by a Board of Governors meeting once a year. Every member country appoints a governor, usually its Minister of Finance.

On a daily basis the World Bank Group is managed by a Board of 24 Executive Directors to whom the governors have delegated specific powers. Each Director symbolizes either one country (for the largest countries), or a group of countries. Executive Directors are appointed by their respective governments or the constituencies. The agencies of the World Bank are each governed by their Articles of Agreement that serve as the legal and institutional foundation for all of their work. The Bank also serves as one of several implementing agencies for the UN Global Environment Facility (GEF).

4.0 CONCLUSION

The World Bank seeks to promote the economic development of the World’s poorest countries. It assists developing countries through long-term financing of development projects and programmes. By doing it plays a significant role in the economic development of third world countries. It acquires most of its financial resources by borrowing on the international bond market. It has the central purpose of promoting economic and social progress in developing countries by helping to raise productivity so that their citizens may live a better life.

5.0 SUMMARY

In this unit, you learnt the definition and purpose of the World Bank; its objectives as well as its functions. In addition, we also discussed the organizational structure and the roles of the agencies of the World Bank

6.0 TUTOR-MARKED ASSIGNMENT

1. List and explain the functions of the World Bank.
2. Discuss the organizational structure and the agencies of the World Bank.

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UNIT FIFTEEN - THE INTERNATIONAL MONETARY FUND (IMF) CONTENTS

1.0 Introduction

2.0 Objectives

3.0 Main Content

3.1 Meaning and Origin of the International Monetary Fund

3.2 Objectives of the International Monetary Fund (IMF)

3.3 Functions of the International Monetary Fund (IMF)

3.4 Organization and Management of the International Monetary Fund

3.5 Financial Structure of the International Monetary Fund

3.6 Instruments of IMF Lending and Loan Conditionality

3.6.1 Borrowing methods used by the International Monetary Fund

3.7 Achievements of the International Monetary Fund

3.8 Failures of the International Monetary Fund

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 References/Further Reading

1.0 INTRODUCTION

This unit shall focus on the International Monetary Fund. The International Monetary Fund will be discussed in terms of its meaning, origin, objectives, functions, organization, management, financial structure, borrowing methods, achievement as well as failures so that we can have a good knowledge and understanding on how the fund carries its day to day activities.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Discuss the meaning and origin of the IMF
- Discuss the objectives and functions of the IMF
- Explain the organizational and management structure of the IMF
- Explain the financial structure and borrowing methods of the IMF
- Discuss the achievements as well as failures of the IMF

3.0 MAIN CONTENT

3.1 Meaning and Origin of the International Monetary Fund

International Monetary Fund (IMF) is an United Nations (UN) specialized agency, founded at the Bretton Woods Conference in 1944 to acquire international monetary collaboration/cooperation/assistance, to stabilize currency exchange rates, as well as to make the access to international liquidity bigger (access to hard currencies).

The first half of the 20th century was symbolized by two world wars that brought about huge physical and economic obliteration in Europe and a Great Depression that caused economic destruction in both Europe and the United States. These occurrences encouraged a desire to establish a new international monetary system that would stabilize currency exchange rates devoid of backing currencies completely with gold; to decrease the rate as well as gravity of balance-of-payments deficits (which happen when more foreign currency leaves a nation than enters it); and to get rid of damaging mercantilist trade policies, for instance, competitive devaluations as well as foreign exchange restrictions all while considerably maintaining each country's capability to pursue independent economic policies. Multilateral discussions led to the United Nations Monetary and Financial Conference in Bretton Woods, New Hampshire, U.S., in July 1944. Delegates from 44 countries drafted the Articles of Agreement for an intended International Monetary Fund that would oversee the new international monetary system. The new Bretton Woods monetary regime was expected to encourage world trade, investment, as well as economic growth by preserving convertible currencies at stable exchange rates. Countries with temporary, moderate balance-of-payments deficits were anticipated to fund their deficits by borrowing foreign currencies from the IMF rather than by imposing exchange controls, devaluations, or deflationary economic policies that could extend their economic problems to other nations.

As soon as the ratification by 29 countries, the Articles of Agreement came into force on December 27, 1945. The IMF's board of governors came together the next year in Savannah, Georgia, U.S., to adopt bylaws and to elect the IMF's first executive directors. The governors made a decision to put the organization's permanent headquarters in Washington, D.C., where its 12 original executive directors first met in May 1946. The IMF's financial operations started the following year.

3.2 Objectives of the International Monetary Fund (IMF)

Article 1 of the Articles of Agreement explained in simple term six aims for which the International Monetary Fund was established. These are:

1. To encourage international monetary cooperation/collaboration/assistance through a permanent institution which provide the mechanism for consolation and collaboration on international monetary problems
2. To facilitate the extension and balanced growth of international trade, and to play a part in the encouragement as well as maintenance of high levels of employment and real income and to the development of the productive resources of all members as principal goal of economic policy.
3. To promote exchange stability, to maintain orderly exchange arrangements among members, and to keep away from competitive exchange depreciation.
4. To help in the setting up of a multilateral system of payments with regards to current transactions between members and in the removal of foreign exchange restrictions which hinder the growth of world trade.
5. To give confidence to members by making the general resources of the Fund temporarily obtainable to them under sufficient protection, thereby providing them with the chance to correct maladjustments in their balance of payments, devoid of resorting to measures destructive of national or international prosperity.
6. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balance of payments of members.

All these objectives of the International Monetary Fund might be summarized as thus:

To promote international cooperation; to facilitate the expansion and balanced growth of international trade; to promote exchange stability; to help in the establishment of a multilateral system of payments; to make its general resources available to its members experiencing balance of payments difficulties under

adequate safeguards; and to shorten the duration and lessen the degree of disequilibrium in the international balance of payments of members.

SELF ASSESSMENT EXERCISE

Discuss the objectives of the International Monetary Fund

3.3 Functions of the International Monetary Fund (IMF)

The major function of the International Monetary Fund is to supervise the international monetary system. More than a few functions are gotten from this. These include: granting of credit to member countries in the midst of temporary balance of payments deficits, surveillance over the monetary and exchange rate policy of member countries, issuing policy recommendations. It is to be observed that all these functions of the International Monetary Fund might be combined into three.

These are: regulatory, financial, and consultative functions:

Regulatory Function:

The International Monetary Fund acts as the guardian of a code of rules set by its (AOA— Articles of Agreement).

Financial Function:

It acts as an agency of providing resources to meet short term and medium term Balance of Payments disequilibrium faced by the member countries.

Consultative Function:

It acts as a centre for international cooperation and a source of counsel and technical assistance to its members.

Another key function of the International Monetary Fund is to offer provisional financial assistance to its members so that the basic balance of payments disequilibrium can be corrected. Although granting of such credit is dependent on stern conditionality. The conditionality is a direct consequence of the International

Monetary Fund's surveillance function over the exchange rate policies or adjustment process of members.

The major conditionality clause is the introduction of structural reforms. Low income countries drew attraction of the International Monetary Fund in the early 1980s when most of them faced terrible balance of payments problems and grave debt repayment difficulties. Against this backdrop, the International Monetary Fund took up stabilization programme and 'structural adjustment programme. Stabilization programme is a demand management issue, while structural programme focuses on supply management. The International Monetary Fund maintains that member countries execute these programmes to deal with macroeconomic instability. Its main elements are:

- (i) Application of the principles of market economy;
- (ii) Opening up of the economy by removing all barriers of trade; and
- (iii) Prevention of deflation.

The International Monetary Fund offers financial assistance. It includes credits and loans to member countries with balance of payments difficulties to support policies of adjustment and reform. It makes its financial resources available to member countries through a range of financial facilities.

Also, it offers concessional assistance under its poverty reduction and growth facility and debt relief initiatives. It offers finance to fight money- laundering as well as terrorism in view of the attack on the World Trade Centre in the United States of America on 11th September 2001.

In addition, technical assistance is also given by the International Monetary Fund. Technical assistance is composed of expertise and support offered by the International Monetary Fund to its members in quite a few broad areas: the design and implementation of fiscal and monetary policy; institution-building, the handling and accounting of transactions with the International Monetary Fund; the gathering and retirement of statistical data and training of officials.

Maintenance of stable exchange rate is another significant function of the International Monetary Fund. It prohibits multiple exchange rates.

It is to be remembered that unlike the World Bank, the International Monetary Fund is not a development agency. Instead of providing development aid, it provides financial support to tide over balance of payments problems to its members.

3.4 Organization and Management of the International Monetary Fund

Similar to most international organizations, the International Monetary Fund is managed by a Board of Governors, an Executive Board and an international staff. Each member country assigns a representative (normally heads of central banks or ministers of finance) to the Board of Governors, the top link of the chain of command. It meets once a year and takes decision on important matters such as electing new members or changing quotas.

The Executive Board is entrusted to the management of everyday policy decisions. The Board comprises 24 executive directors who supervise the execution of policies set by the member governments through the Board of Governors. The International Monetary Fund is headed by the Managing Director who is elected by the Executive Board for a 5 year term of office.

Rights and obligations, i.e., the balance of Powers in the International Monetary Fund is determined by a system of quotas. Quotas are decided by a vote of the Board of Governors. Quotas or subscriptions roughly reflect the importance of members in the world economy. It is the quota on which payment obligation, credit facilities, and voting rights of members are determined.

3.5 Financial Structure of the International Monetary Fund

The capital or the resources of the International Monetary Fund come from two sources:

- (i) Subscription or quota of the member nations, and
- (ii) Borrowings.

Every member country is obliged to subscribe an amount equivalent to its quota. It is the quota on which payment obligations, credit facilities, and voting right of members are determined. Immediately a country joins the International Monetary

Fund, it is assigned a quota which is expressed in Special Drawing Rights (SDRs). At the time of creation of the International Monetary Fund, the quota of each member was made up of 25 p.c. in gold or 10 p.c. of its net official holdings of gold and US dollars (whichever was less). Now this has been revised.

The capital subscriptions or quota is now made up of 25 p.c. of its quota in SDRs or widely accepted currencies (such as the US dollar, euro, the yen or the pound sterling) instead of gold and 75 p.c. in country's own currency. The size of the Fund equals the sum of the subscriptions of members. Total quotas at the end-August 2008 were SDR 217.4 billion (about \$341 billion).

The International Monetary Fund is authorized to borrow in special conditions if its own resources show to be inadequate. It sells gold to member countries to replenish currency holdings. It is entitled to borrow even from international capital market. Though the Articles of Agreement allow the Fund to borrow from the private capital market, till today no such use has been made by the International Monetary Fund.

3.6 Instruments of IMF Lending and Loan Conditionality:

The International Monetary Fund Articles of Agreement clearly state that the resources of the Fund are to be used to give temporary assistance to members in financing BOP deficit on current account. Of course, the financial assistance provided by the Fund is loan. The following technique is employed: If a country calls on the Fund it buys foreign currencies from the IMF in return for the equivalent in the domestic currency.

This, in legal and technical terms, is called a 'drawing' on the Fund. The technique, thus, suggests that the IMF does not lend, but sells the required currency to the members on certain terms. This unique financial structure of the Fund clearly suggests that the Fund's resources cannot be lent for long time. It is meant to cover short run gaps in BOP.

The IMF's unique financial structure does not allow any member to enjoy financial assistance over a long time period. The total amount that a country is entitled to draw is determined by the amount of its quota. A member is entitled to draw an

amount not exceeding 25 p.c. of its quota. The first 25 p.c. called the ‘gold tranche’ (‘tranche’ a French Word meaning slice) or ‘reserve tranche’ can easily be drawn by countries with BOP problems.

This 25 p.c. of the quota is the members’ owned reserves and therefore no conditions are attached to such drawings. This may be called ‘ordinary, drawing rights; even the Fund cannot deny its use. However, no interest for the first credit tranche is required to be paid though such drawings are subject to repayment within 3-5 years period.

The ‘credit tranche’ of 100 p.c. each equalling 25 p.c. of a member’s quota are also available subject to the IMF approval and hence, ‘conditional’. Originally, it was possible to borrow equal to 125 p.c. of one’s quota. At present, borrowing limit has been raised to 450 p.c. of one’s quota which must be redeemed within five years.

3.6.1 Borrowing methods used by the International Monetary Fund

The borrowing methods used by the fund includes

(i) Stand-by Arrangements

This method of borrowing has become the most normal form of assistance by the Fund. Under this form of borrowing, a member state obtains the assurance of the Fund that, usually over 12-18 months, requests for drawings of foreign exchange (i.e., to meet short- term BOP problems) up to a certain amount will be allowed if the country concerned wishes.

However, the stand-by arrangements can be extended up to 3 years while repayments are required to be made within 3-5 years of each drawing. The term “stand-by” here means that, subject to conditionality, a member has a right to draw the money made available, if needed. In most cases, the member does, in fact, draw.

(ii) Extended Fund Facility (EFF)

Stand-by arrangements to stabilize a member’s BOP run usually for a period of 12-18 months. Developing countries suffer from chronic BOP problems which could

not be remedied in the short run. Such protracted BOP difficulties experienced by the LDCs were the result of structural imbalances in production and trade. It then necessitated an adjustment programme and redemption scheme of longer duration.

In the 1970s, the Fund recognized this idea and built up the EFF in 1974. The EFF is designed to provide assistance to members to meet their BOP deficits for longer period (3-4 years) and in amounts larger in relation to their quotas. Repayment provisions of EFF cover a period of 4-10 years. However, conditions for granting loans are very stringent. Drawings on this account since 2000 stand at over 50 billion dollar in SDRs.

(iii) Compensatory Financing Facility (CFF)

Apart from the ordinary drawing rights, there are some ‘special finances’ windows to assist the developing countries to tide over BOP difficulties. CFF, introduced in 1963, is one such special drawing provision. Its name was changed to Compensatory and Contingency Financing Facility (CCFF) in 1980, but the ‘contingency’ was dropped in 2000. Under it, members were allowed to draw up to 25 p.c. of its quota when CFF was introduced. It can now draw up to 45 p.c. Since the mid- 1990s, this has been the least-used facility.

(iv) Structural Adjustment Facility (SAF) and the Enhanced SAF (ESAF)

In 1986 a new facility—the SAF—was introduced for the benefit of low income countries. It was increasingly realised that the so-called stringent and inflexible credit arrangements were too inadequate to cope with the growing debt problems of the poorest members of the Fund. In view of this, SAF was introduced which stood quite apart from the monetary character of the Fund.

Under it, credit facilities for economic reform programmes are available at a low interest rate of 0.5 p. c compared to 6 p.c. for most Fund facilities. Loans are for 10 years with a grace period of five and a half years. LDCs facing protracted BOP problems can get assistance under SAF provided they agree to undertake medium-term structural adjustment programmes to foster economic growth and improve BOP conditions. An extended version of SAF—ESAF—was introduced in 1987.

The ESAF has been replaced by a new facility, called Poverty Reduction and Growth Facility in 1999.

What emerges from the structural adjustment facility is that the IMF's loan is now available to member countries in support of policy programmes. It now insists on the supply side policy 'as a condition' for assistance, in addition to loans meant for short-term BOP difficulties.

(v) Poverty Reduction and Growth Facility (PRGF)

The PRGF that replaced the ESAF in November 1999 provides concessional lending to help the poorest member countries with the aim of making poverty reduction and economic growth —the central objectives of policy programmes. Under this facility, low-income member countries are eligible to borrow up to 140 p.c. of its quota for a 3-year period. Rate of interest that is charged is only 0.5 p. c and repayment period covers 5 1/2-10 years, after disbursement of such facility. However, financial assistance under this facility is, of course, 'conditional'.

(vi) Supplemental Reserve Facility (SRF)

This instrument provides additional short-term financing to member countries facing exceptional BOP difficulties because of a sudden and disruptive loss of market confidence reflected in capital outflows of countries concerned. Consequent upon the eruption of East Asian financial crisis, the SRF was introduced in 1997.

Till date (March, 2012), the top three largest borrowing nations are Greece, Portugal and Ireland from the IMF.

3.7 Achievements of the International Monetary Fund

From this balance sheet of the working of the IMF, we are now in a position to evaluate its performance over the last 65 years or so. First, we state the achievements of the Fund.

The IMF acts both as a financing and an adjustment-oriented international institution for the benefit of its members. It has been providing financial assistance to the deficit countries to meet their temporary disequilibrium in BOP.

The Fund aims at promoting exchange rate stability. In its early phase, the Fund made arrangements of avoidance of competitive exchange depreciation.

It has made an attempt to solve the problem of international liquidity. To create international liquidity, Special Drawing Rights (SDRs)—an artificial currency—were created in 1969 as foreign exchange reserves to benefit the developing countries in particular. SDR allocations are made to member countries to finance the BOP deficits.

It is an institution through which consultation in monetary affairs takes place in an on-going way. It acts as a forum for discussions of the economic, fiscal and financial policies of member countries, keeping the BOP problems in mind. Previously, the poorest developing countries did not receive adequate treatment from the Fund. But from 1980s onwards—when the debt crisis broke out in poor countries—the Fund decided to divert its financial resources to these countries.

In 1980s, centrally planned economies were not hitherto members of the Fund. With the collapse of the Soviet Union in 1989, ex-communist countries became members of the Fund and the Fund is providing assistance to these countries so as to instill the principles of market economy. It has decided to finance resources to combat terrorism and money-laundering.

Finally, the IMF has assisted its members in the formulation of appropriate monetary, fiscal, and trade policies.

3.8 Failures of the International Monetary Fund

Despite these achievements, its failures are glaring. In other words, its success is, on the whole, limited. There are some serious charges against this institution that cannot escape attention. These are:

The Fund provides short-term finance to its members to tackle BOP disequilibrium. For this purpose, it adopted an adjustable peg system in the first

phase of its life. But it failed to establish a stable exchange rate. Its role in controlling the competitive exchange depreciation policies adopted by the members was subject to serious scrutiny, although it was created to avoid devaluation as a BOP measure as much as possible.

Truly speaking, the IMF is incapable of taking independent policy decisions. It complies with the 'order' of the superpowers. Further, it has minimal influence over the policy decisions of the major industrial powers. In these cases, its mandate to exercise 'firm surveillance' over some influential members or superpowers is virtually meaningless—it has no influence over the US deficits or European interest rates.

Secondly, the Fund imposes conditions on the poor countries while sanctioning loans. Now, it is ignoring its central concern—exchange rate management and the BOP problems. It is now championing the issue of 'market principle'. It suggests poor developing countries to cut expenditure-borrowing-subsidy, raise prices of state enterprises, privatisation of state-owned enterprises, etc. If such measures—most popularly known as structural adjustment programmes—are adopted only then the IMF credit would follow. It is said that the third world debt crisis is due to the Fund policies and working.

Thirdly, the Fund has failed to eliminate foreign exchange restrictions imposed by its members that hamper the growth of trade.

In view of these, the developing countries are blaming the IMF for their economic malaise. It is said that the IMF has outlived its mission and the time has come for it to go into oblivion. Sixty- five years is long enough!

4.0 CONCLUSION

Being a central institution of international monetary system, the IMF works for global prosperity by promoting a balanced expansion of world trade. The IMF not only operates as a BOP adjustment institution but also a BOP financing institution. The IMF system provides for exchange rate stability in the short run but allows for exchange rate adjustment if a country faces 'fundamental' disequilibrium in its BOP accounts.

5.0 SUMMARY

In this unit, you learnt the meaning, origin, objectives, functions, organizational structure, management structure, financial structure and borrowing methods of the IMF. Furthermore, the achievements as well as failures of the IMF were also discussed so that we can assess how it has performed since inception

6.0 TUTOR-MARKED ASSIGNMENT

1. Discuss the borrowing methods of the IMF.
2. Discuss the achievements and failures of the IMF.

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UNIT SIXTEEN - THE AFRICAN DEVELOPMENT BANK (ADB) CONTENTS

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1.0 INTRODUCTION

This unit shall focus on the African Development Bank. The African Development Bank will be discussed in terms of its meaning, history, objectives, goals, functions, group entities as well as membership. Furthermore, we looked at the ADB's core operational focus since 2006 so that we can have a good understanding on how it carries out its everyday activities regarding its members.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Discuss the meaning and history of the ADB
- Discuss the objectives and goals of the ADB
- Explain the function and group entities of the ADB
- Explain the core operational focus of the ADB since 2006

- List the members of the ADB

3.0 MAIN CONTENT

3.1 Meaning of the African Development Bank (ADB)?

African Development Bank (ADB) is a financial institution comprising 54 African and 26 non-African countries that promote economic and social progress in Africa through loans, equity investments, and technical assistance. Structurally, the ADB Group includes the African Development Bank, the African Development Fund, and the Nigeria Trust Fund. Established in 1964 and headquartered in Tunisia, the Bank has provided a cumulative \$55 billion in loans and grants in the region.

3.2 A Brief History of the African Development Bank (ADB)

Following the end of the colonial period in Africa, a growing desire for more unity within the continent led to the establishment of two draft charters, one for the establishment of the Organization of African Unity (established in 1963, later replaced by the African Union), and for a regional development bank.

A draft accord was submitted to top African officials then to the Conference of Finance Ministers on the Establishment of an African Development Bank. This conference was convened by the United Nations Economic Commission for Africa (UNECA) in Khartoum, Sudan, from 31st July to 4th August. It was here that the agreement establishing the African Development Bank (ADB) was cosigned by twenty-three African governments on 4th August 1963. The agreement came into force on 10th September 1964.

The inaugural meeting of the Board of Governors of the Bank was held from 4th to 7th November 1964 in Lagos, Nigeria. The Bank's headquarters opened in Abidjan, Côte d'Ivoire, in March 1965 and the bank's operations commenced on 1st July 1966. From February 2003 onwards, the bank operated from its temporary relocation agency in Tunis, Tunisia, owing to the prevailing political conflict in Côte d'Ivoire at the time. The Bank was able to return to its original headquarters in Abidjan in late 2013 once the political crisis was over. By June 2015, over 1,500

staff had returned to the Bank's Abidjan headquarters out of the more than 1,900 total staff complement at the Bank.

Although, originally, only African countries were able to join the bank, since 1982 it has allowed the entry of non-African countries as well.

Since its founding, ADB has financed 2,885 operations, for a total of \$47.5 billion. In 2003, it received an AAA rating from the major financial rating agencies and had a capital of \$32.043 billion. In November 2019, the bank's capital was reported as \$208 billion.

3.3 Objectives of African Development Bank (ADB)

The strategy of the ADB will focus on two objectives to improve the quality of Africa's growth: inclusive growth, and the transition to green growth.

- **Inclusive growth**

The first and overarching objective is to achieve growth that is more inclusive, leading not just to equality of treatment and opportunity but to deep reductions in poverty and a correspondingly large increase in jobs.

Unlocking the continent's great potential and increasing its chances of reaping a demographic dividend. Inclusive growth will bring prosperity by expanding the economic base across the barriers of age, gender and geography.

The ADB will invest in infrastructure that unlocks the potential of the private sector, championing gender equality and community participation. It will help improve skills for competitiveness, ensuring that those skills better match the opportunities and requirements of local job markets.

- **Green growth**

The second objective is to ensure that inclusive growth is sustainable, by helping Africa gradually transition to green growth that will protect livelihoods, improve water, energy and food security, promote the sustainable use of natural resources and spur innovation, job creation and economic development.

The ADB will support green growth by finding paths to development that ease pressure on natural assets, while better managing environmental, social and economic risks.

Priorities in reaching green growth include building resilience to climate shocks, providing sustainable infrastructure, creating ecosystem services and making efficient and sustainable use of natural resources (particularly water, which is central to growth but most affected by climate change).

3.4 Goals of the African Development Bank

The goals of the African Development Bank include the following:

- End poverty in all its forms everywhere
- End hunger, achieve food security and improved nutrition and promote sustainable agriculture
- Ensure healthy lives and promote well-being for all at all ages
- Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
- Achieve gender equality and empower all women and girls
- Ensure availability and sustainable management of water and sanitation for all
- Ensure access to affordable, reliable, sustainable and modern energy for all
- Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
- Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation
- Reduce inequality within and among countries
- Make cities and human settlements inclusive, safe, resilient and sustainable
- Ensure sustainable consumption and production patterns
- Take urgent action to combat climate change and its impacts
- Conserve and sustainably use the oceans, seas and marine resources for sustainable development

- Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss
- Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels
- Strengthen the means of implementation and revitalize the global partnership for sustainable development

SELF ASSESSMENT EXERCISE

List the goals of the African Development Bank?

3.5 Functions of the African Development Bank (ADB)

The ADB was established to contribute to the economic development and social progress of its members – individually and jointly. To achieve this purpose, it has these functions:

- a. To use the resource at its disposal for the financing of investment projects and programmes relating to the economic and social development of its members, giving special priority to:
 - Projects or programmes which by their nature or scope concern several members; and
 - Projects or programmes designed to make the economies of its members increasingly complementary and to bring about an orderly expansion of their foreign trade
- b. To undertake, or participate in the selection, study and preparation of projects, enterprises and activities contributing to such development
- c. To mobilize and increase in Africa and outside Africa, resources for financing of such investment projects and programmes

- d. Generally, to promote investment in Africa of public and private capital in projects or programmes designed to contribute to the economic development or social programmes of its members
- e. To provide such technical assistance as may be needed in Africa for the study, preparation, financing and execution of development projects or programmes
- f. To undertake such other activities and provide such other services as may advance its purpose (Unachukwu, 1981; Ajayi, 1981)

In seeing to the attainment of these desirable functions, ADB co-operates with national, regional and sub-regional development institutions in and outside Africa—including borrowing from them.

3.6 Overview of Core Operational Focus since 2006

Over the years, the African Development Bank's operational vision has changed in keeping with the prevailing development conditions of the majority of the borrowing member countries. It has shifted from a purely sector approach to a country-focus and client-responsive approach to enhance stakeholder commitment, ownership and a bottom-up participatory approach that is likely to be more sustainable in the long-term. Since 2006, there has been a greater focus on investment and knowledge generation to build a knowledge-based development approach on the continent in the four sectors in line with its new priority actions—infrastructure, governance, regional integration and private sector development.

3.6.1 Infrastructure

- Critical for economic growth, private sector development and investment, increased competitiveness
- Catalyst for the development of other sectors and the achievement of key MDGs
- Power supply, water and sanitation, transport and communication accounted for over UA 16.6 billion (US\$25.6 billion) or nearly 38.5% of cumulative African Development Bank Group commitments at the end of 2008

- Infrastructure financing options of the African Development Bank Group include normal ADB/ADF/resources, NEPAD (IPPF), Infrastructure Consortium for Africa, Rural Water Supply and Sanitation Initiative (RWSSI Trust Fund), African Water Facility, MDWPP, Post-Conflict Countries Facility, EPSA (JBIC), FAPA, ACFA

3.6.2 Governance

- Supports efforts to improve the systems of governance by strengthening institutional capacities and by helping countries adopt and implement policy reforms
- Provides support to the African Peer Review Mechanism through technical and financial assistance
- Focuses on strengthening transparency, accountability and due processes in public resources management

3.6.3 Regional Integration

- Increase competitiveness and productivity and allow for greater regional economies of scale
- Actively promote regional economic communities through cooperation, trade expansion and capacity building
- NEPAD Infrastructure Project Preparation Facility in energy, transportation and ICTs
- Connect Africa Initiative to bridge major gaps in ICT infrastructure across the continent
- At the end of December 2008, the African Development Bank had committed over UA 2. 3 billion or US\$3.5 to multinational projects and programme

3.6.4 Private Sector Development

- Cognizant of the essential role that the private sector plays in stimulating economic growth and reducing poverty, the African Development Bank is mainstreaming private sector development activities into all aspects of its operations, as outlined in the Private Sector Development (PSD) Strategy
- The PSD Strategy, which is in line with the Bank's new strategic orientations and priorities, is built on three pillars: (i) country ownership of the private sector development process; (ii) partnership with development partners and other economic operators; and (iii) selectivity of intervention sectors, as defined in the Bank's country strategy papers

Increased support of private enterprises including SMEs

- Strengthen financial systems and intermediaries
- Build competitive infrastructure
- Promote trade and integration
- Improve investment climate
- Private sector approval in 2008 stood at UA 855.5millionor US\$1.3billion
- In 2008, as many as 30 private sector activities were financed, including 8 project loans, 9 lines of credit, 10 private equity participation and 3 private guarantees.

3.7 Group Entities of the African Development Bank

The African Development Bank has two other entities: the African Development Fund (ADF) and the Nigeria Trust Fund (NTF).

- **African Development Fund (ADF)**

Established in 1972, the African Development Fund started operations in 1974. The African Development Fund United Nations Convention to Combat Desertification (UNCCD) 2004], no longer available (2006) It provides development finance on concessional terms to low-income regional member countries which are unable to borrow on the non-concessional terms of the ADB. In harmony with its lending

strategy, poverty reduction is the main aim of ADF activities. Twenty-four non-African countries along with the ADB constitute its current membership. The largest ADF shareholder is the United Kingdom, with approximately 14% of the total working shares followed by United States with approximately 6.5 percent of the total voting shares, followed by Japan with approximately 5.4 percent. The Federal Reserve Bank of New York was designated as the depositor bank for the fund according to telegraphs sent from the U.S. Embassy in Abidjan in 1976.

The ADF's general operations are decided by a Board of Directors, six of which are appointed by the non-African member states and six designated by the ADB from among the bank's regional Executive Directors.

The ADF's sources are mainly contributions and periodic replacements by non-African member states. The fund is usually replenished every three years, unless member states decide otherwise. The total donations, at the end of 1996, amounted to \$12.58 billion. The ADF lends at no interest rate, with an annual service charge of 0.75%, a commitment fee of 0.5%, and a 50-year repayment period including a 10-year grace period. The tenth United Kingdom replenishment of the ADF was in 2006.

- **Nigeria Trust Fund (NTF)**

The Nigeria Trust Fund (NTF) was established in 1976 by the Nigerian government with an initial capital of \$80 million. The NTF is aimed at assisting in the development efforts of the poorest ADB members.

The NTF uses its resources to provide financing for projects of national or regional importance which further the economic and social development of the low-income regional member countries whose economic and social conditions require financing on non-conventional terms. In 1996, the NTF had a total resource base of \$432 million. It lends at a 4% interest rate with a 25-year repayment period, including a five-year grace period.

3.8 Membership of the African Development Bank

All countries in the African Union including Mauritania but excluding the SADR are eligible for NTF benefits. Morocco is also eligible though not a part of the African Union.

Non-African member countries are:

- Argentina
- Austria
- Belgium
- Brazil
- Canada
- China
- Denmark
- Finland
- France
- Germany
- India
- Italy
- Japan
- Kuwait
- Latvia - over 42.71 billion \$ since 1991.
- Netherlands
- Norway
- Portugal
- Saudi Arabia
- South Korea
- Spain
- Sweden
- Switzerland
- Turkey
- United Kingdom
- United States

4.0 CONCLUSION

The African Development Bank encourages economic growth, development as well as social progress of its regional member countries in Africa and the bank

devotes just about 3 billion dollars per annum to African countries. Its moderately small lending and tendency to follow in the path of more famous public organizations like the World Bank, IMF means that the African Development Bank has been receiving insignificant interest from civil society organizations as well as academia. The ADB give emphasis to the role of women along with education reforms, and lent its assistance to vital initiatives such as debt alleviation for heavily indebted poor nations and the New Partnership for Africa's Development (NEPAD).

5.0 SUMMARY

In this unit, you learnt the meaning, history, objectives, goals, functions, group entities as well as membership of the African Development Bank. In addition, you learnt about the ADB's core operational focus since 2006 and its assistance to vital initiatives such as debt alleviation for heavily indebted poor nations and the New Partnership for Africa's Development (NEPAD).

6.0 TUTOR-MARKED ASSIGNMENT

1. Discuss the functions of the African Development Bank.
2. Discuss the core operational focus of the African Development Bank since 2006.

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