

# Nigerian financial system overview



\n[[toc title="Table of Contents"](#)]\n

\n \t

1. [Strategy](#) \n \t
2. [Overview](#) \n \t
3. [Alternative Approaches to Strategy:](#) \n \t
4. [Similarities and Differences](#) \n \t
5. [Conclusion](#) \n

\n[/toc]\n \n

The Nigerian financial system is made up of two sub sectors; the formal and the informal sub sectors. The formal sub sector comprises of the regulatory bodies, money market, capital market, foreign exchange markets, insurance companies, brokerage firms, deposit money banks (DMBs), development finance and other financial institutions. As at the end of March 2010, there were 24 deposit money banks(DMBs), 5 discount houses(DHs), 941 microfinance banks(MFBs), 107 finance companies(FCs), 101 primary mortgage institutions(PMIs), 13 pension fund administrators(PFAs), 5 pension fund custodians(PFCs), 1 stock exchange, 1 commodity exchange, 1621 bureau-de-change operators(BDCs), 690 securities brokerage firms, 5 development finance institutions(DFIs) and 73 insurance companies.

The informal sub sector includes self-help groups, financial cooperatives and credit associations.

It is imperative to know that there is a weak relationship between the informal sub sector and the formal sub sector (financial stability report, 2010)

<https://assignbuster.com/nigerian-financial-system-overview/>

## Discount House Sub Sector

### Overview:

Discount Houses in Nigeria were first established in 1993. They were licensed to commence operations with just three discount houses as players. Their number later increased to five and their foundation can be linked to Great Britain, which is generally regarded as the origin of discount houses. These institutions evolved to provide a link between the banks and the Bank of England by serving as a channel for the interchange of banks' funds as well as providing access to the Bank of England as a lender of last resort (Chartered Institute of Bankers of Nigeria, ) and in like manner discount houses in Nigeria are to act as intermediaries between the Central Bank of Nigeria and other licensed banks in Nigeria in Open Market Operations transactions (Revised Guidelines for Discount Houses, 2004).

There are five discount houses in Nigeria wholly owned by consortiums of banks and other financial institutions as allowed in the Discount House guidelines 2004 by the Central Bank of Nigeria. However the maximum permissible equity holding for any single investor in a discount house is 40% (Revised Guidelines for Discount Houses, 2004). These Discount Houses are named as follows: Associated Discount House Limited (ADHL), Consolidated Discount Limited (CDL), Express Discount House Limited (EDL), First Securities Discount House Limited (FSDH) and Kakawa Discount House Limited (KDHL). They fall under a common umbrella referred to as Nigerian Discount Market Association. They are presently not listed in the Nigerian Stock Exchange.

The Discount House sub sector is highly regulated by the Central Bank of Nigeria and the Securities and Exchange Commission of Nigeria requiring of them their daily, weekly, quarterly, semi-annual and annual reports showing the state of their affairs.

Their daily operational activities include the injection and the withdrawal of funds by the Central bank of Nigeria from the money market through them (Ezirim and Enefaa, 2010) of which they must invest 60% of their deposit liabilities in government securities at any point in time (Revised Guidelines for Discount Houses, 2004).

By this a balance is maintained in the economy thereby guarding liquidity. Apart from this function, the discount houses also facilitate the issuance and sale of short term Government securities, provide discount/re-discount facilities for treasury bills, government securities and other eligible financial instruments, accept short-term investments on an intermediary basis from banks and wholesale investors and lastly provide short term financial accommodation to banks (Revised Guidelines for Discount Houses, 2004).

#### Services and Financing of the Discount Houses

Discount Houses offer a wide range of financial products to Banks, Non-Bank Financial Institutions and the general public. The main services include: (a) Securities trading which includes buying and selling of: Treasury Bills, Treasury Bonds, Government Bonds, and Commercial Bills; (b) Accepting short-term investments from banks and providing short-term accommodation to banks; (c) Short-term financial intermediation through the acceptance of funds and simultaneous investment of the funds in:

Commercial Papers, Bankers Acceptances, Government Securities; (d) Providing personalized wealth management to high net-worth individuals through a network of investment managers, financial consultants and other specialists; (e) Effective portfolio management on both discretionary and non-discretionary basis through the provision of medium to long term investment management services to: Pension funds, Private clients, Employee Schemes, Trustees of family settlements and charities; and (f) Providing Business Solutions in: Financial Arrangement and Management, Mergers and Acquisitions, Privatization, Business Assessment, Business Structuring, and Data Resource and Management (Revised Guidelines for Discount Houses, 2004)

The Sources of funds for discount houses in Nigeria include: (a) Equity - Paid-up Capital and Reserves. (b) Call money and short-term borrowings of not more than three years maturity. (c) Call money placed by banks with discount houses shall form part of the specified liquid assets of the respective banks for the purpose of the liquidity ratio requirement.

A discount house that is short of funds may: (i) obtain from the Central Bank of Nigeria (CBN) an overnight advance against acceptable collateral.

However such an advance shall not exceed 20 percent of the total assets of the discount house and shall not in any event be granted if the discount house has exceeded the borrowing limit as prescribed by Central Bank of Nigeria (CBN); (ii) sell short-term bills and/or other securities to the Central Bank of Nigeria (CBN). The Central Bank of Nigeria (CBN) shall provide rediscounting facilities for treasury and other eligible securities; and (iii)

enter into Repurchase transactions with the Central Bank of Nigeria (CBN) using eligible securities (Revised Guidelines for Discount Houses, 2008)

The Discount House Sub-Sector Environment:

The discount house sector is greatly influenced and controlled by environmental forces; global and domestic.

The global economic environment shows that the global economic crisis appeared to have eased off in the latter part of 2009 but general optimism is being replaced with pessimism of a double dip recession, as fears grow that governments and policy makers around the world might be forced (due to pressure or mistakes) to remove monetary and fiscal props, too soon. So even though developed economies are gradually beginning to come out of the general recession, the situation is still delicate (First Securities Discount House, 2009).

In emerging market economies, growth has been robust but inflationary pressures are strong and on the rise. The negative impact of the political crises in the oil-producing Middle East and North Africa (MENA) region on oil prices and the disruptions and destructions associated with the earthquake and tsunami in Japan have added to uncertainty about the sustainability of global economic recovery and growth% ( Central Bank of Nigeria communiqué No 75, 2011). This has great implications on the discount houses with Nigeria being a developing and emerging economy and the effect of the global crises is strongly felt with a probability of increases in the international interest rate.

The domestic economic environment is being characterised by a fluctuating inflation rate which has significant impact on interest and lending rates. It has been a herculean task trying to bring down the inflation rate to a single digit as proposed and rather the rate rose from 11.1% as at March, 2011 to 12.8% in April, 2011 (Nigeria Bureau of Statistics, 2011). This inflationary rise still has a tendency to heighten further as a result of the general increase in global and food prices.

The operating economic environment is full of challenges as there are array of issues. In March 2011, the Monetary Policy Committee of the Central Bank increased MPR from 6.5% to 7.5% maintaining interest rate corridor of +/- 2% around the MPR. By this, the Standing Lending Facility Rate (rate at which CBN lends to Banks and Discount Houses as bank of last resort) became 9.5% and has remained so. On the other hand, the Standing Deposit Rate (rate at which Banks and Discount Houses place excess funds with the Central Bank of Nigeria) remained at 4%.

Also the Gross Domestic Product (GDP) was projected to grow by 7.43 per cent in the first quarter of 2011 making the outlook for 2011 to be generally good, given the expected improvement in the oil economy and the growing emphasis on the development of non-oil sector and key infrastructure (Central Bank of Nigeria communiqué No 75, 2011).

Finally on the political scene, the year 2011 being an election year for Nigeria, there are a lot uncertainties associated with the electoral process and the election results and this could affect the discount house sub sector and the Nigerian economy as a whole and it is projected that the effect of

these uncertainties will result in higher exchange rate risks with lower reserves and high spending-currency devaluation possible and that Inflation will remain over 10% with implications for demand, input costs and projects(Resource and Trust Company Limited, 2011).

### Competitiveness In The Discount House Sub- Sector

The discount house sub sector is just a small sector in a large financial sector with just a few players who are almost of equal standing; hence, there is strong competition among the services providers which have led to innovation, efficiency and the upgrade of competitive advantage by the players. The provision of specialised personalised services allowable within the scope of the discount house guidelines. Example is the personal pension plan developed by Consolidated Discount Limited which was created as a way of preparing clients to be less vulnerable to loss of earning capacity after retirement (Consolidated Discount Limited, 2009).

Also Associated Discount House Limited in conjunction with the Debt Management Office (DMO) of Nigeria organized an awareness seminar on 12 February, 2009 to enkindle the interest of retail investors both local, international and in the diasporas in Federal Government of Nigeria Bonds (Associated Discount House Limited, 2009).

### Opportunities In The Discount House Sub- Sector

Without gainsaying, there are opportunities in Discount Houses businesses (if not many) which gives them an edge over banks and other specialised banks.



As earlier inferred, discount houses are allowed to offer certain unique financial services which puts them almost in the same stand as banks and even much more but they cannot be referred to as banks and one of the reasons is because there is minimum paid up capital imposed on the regular banks which amounts to N25, 000, 000, 000. 00(Twenty five billion naira) only at any point in time. For the discount houses sub sector, the minimum paid up capital shall be N1, 000, 000, 000. 00(One billion naira) only or as may be prescribed by Central Bank of Nigeria from time to time (Revised Guidelines for Discount Houses, 2008). There is a revised Guideline for year 2008 which also relaxes the ownership of Discount Houses to now include non-financial institutions and individuals. This revision provides the opportunity for Discount Houses to grow their capital base to enable them to explore new areas of business and boost their profitability (Kakawa Discount House, 2009).

Discount Houses have sizable support from the Central Bank of Nigeria being the lender of last resort facility.

Discount Houses are able to offer highly attractive pricing on Treasury Bills and other risk-free government debt instruments because of the significant concessions available to them from the Central Bank of Nigeria

Discount Houses are tightly regulated therefore danger signals (if any) are easily detectable.

Being specialist institutions, Discount Houses are proactive in managing money market trends to the advantage of their clients.

Unlike other deposit taking institutions, the financial assets acquired by Discount Houses are of the finest quality with little or no credit risk (Express Discount House Limited).

#### Threats To The Discount House Sub- Sector

Naturally the discount house sub sector is faced with its own threats and challenges as from inception, discount houses operated in an environment that could termed as unusual or abnormal. There was a distress situation in the banking sector which was at its peak and most banks patronized discount houses in order to ensure the safety of their funds, but with the return of orderliness and calm, discount houses patronage by banks reduced. Rather, the interbank and foreign exchange markets seem to have provided more attractive trading options for the banks, to the detriment of the discount houses.

Licensing of additional discount houses to make the total number of discount houses 5 proved to be a challenge as it had an adverse effect on the total turnover of the discount house sub sector, following the initial boom from the year of operations of 1993 where total asset stood at N9, 600, 000, 000. 00(Nine billion, six hundred million naira) only which dropped significantly to N3, 400, 000, 000. 00(Three billion, four hundred million naira) only in 1995 following the entrance of a new entrant into the market. With these happenings, licensing of new discount houses might still impact on the sub-sector further negatively.

Their narrow scope of operations has also proven to be a major challenge for the Discount House sub sector being a specialised bank is inhibiting a lot of opportunities for expansion (Chartered Institute of Bankers of Nigeria, 2010).

Finally, from the inception, discount houses had the exclusive right to conduct Open Market Operations transactions (OMO). Open Market Operations (OMO) is an indirect monetary policy technique that is used to control the level of money supply. It involves the sale/purchases of money market instruments in the open market; these instruments being Nigerian treasury bills (Ezirim and Enefaa, 2010). With the Central Bank of Nigeria opening up the window to banks as well, the discount house sub sector lost the sole right of Open market Operations.

## Conclusion

In spite of all the challenges and threats faced by the Discount House sub sector, the Discount Houses are still are very vital part of Nigeria as an emerging economy and just the existing players in the market are not enough to keep a balanced financial sector and the economy as a whole.

In the light of the fact that the Central Bank of Nigeria as the major regulator keeps on revisiting and revising the guidelines of the Discount House sub sector, there is hope yet still for growth, expansion, innovation and maximum output which should encourage new players to participate.

## Part 2

## Strategy

### Overview

Strategy is a plan or blueprint of what an organisation intends to achieve and how to go about it. Artto, Kujala, Dietrich and Martinsuo (2008) define strategy as a firm's goal to attain a desired position in its competitive external environment. This is in line with Kenneth Andrew (1987) school of thought that views strategy from the corporate angle where he views corporate strategy as the nature of decisions a company takes which reveals its short and long term goals, how it plans to go about achieving these goals and how its outcome will affect all stakeholders and community at large. There is a popular belief that an organization that fails to plan or strategise, plans to fail and Goold (1996) goes on further to share his own view when he says that matured businesses can easily become staid and resistant to change. Usually this behaviour leads them to a decline and the only way it can regain its position is through strategy or change in strategy. This resolve usually involve the pursuit, accomplishment, and maintenance of competitive advantage in its industry (Varadarajan and Clark cited in Morgana and Strong, 2003).

Whittington (2001: 10) summarises it all when he says strategy is all about 'thinking better and thinking differently' and claims that a good strategy means doing something different from every other person. But there are pitfalls to strategy as Mintzberg (1994) puts forward the question; 'is a climate conducive

to strategic planning necessarily one conducive to effective strategic thinking and acting? He claims that there are underlying issues which affects <https://assignbuster.com/nigerian-financial-system-overview/>

the ability of plans to make head way and emphasizes that these issues are neither technical nor analytical but rather human (Abel and Hammond cited in Mintzberg, 1994). But Smith and Reese (1999) argue that as long as there is a fit or alignment between operational elements and business then there should be no pitfalls where he defines fit as 'the degree to which operational elements match the business strategy'.

## **Alternative Approaches to Strategy:**

### **Similarities and Differences**

There are various approaches to strategy but Whittington (2000) classifies strategy into four approaches: the Classical, Evolutionary, Processualist and Systemic. He further analyses each approach as follows:

The classical approach sees strategy as a process of rational deliberation, calculation and analysis, intended to achieve long-term benefit and that good planning is what it takes to master internal and external environments.

The Evolutionary approach analyses strategy from the point of view that rational long term planning is often irrelevant and that successful strategies only emerge as the process of natural selection.

The Processualist approach sees long term planning as basically pointless, but they are not overly pessimistic about the fate of businesses that do not somehow optimize environmental opportunities as they see inability or failure to think up and carry out the perfect strategic plan is hardly going to deliver any serious competitive disadvantage.

Finally the Systemic approach to strategy proposes that the objectives and practices of strategy depend on the particular social system in which strategy-making takes place in other words organizations strategic planning is basically influenced and controlled by the social system in which it operates. Meaning the demographic setting of the organization's environment needs to be taken into consideration when strategizing.

In analyzing the similarities and differences of these approaches, their style or processes and their end result is paramount.

In comparing the classical and evolutionary approaches to strategy, Whittington (2001: 2) posits " profit maximization as the natural outcome of strategy-making". This he made in reference from the point of view of their end result which is profit or return on capital. These approaches associate profitability with strategy and believe the higher the level of strategy employed, the higher and better the profit generated. This view is shared by (Friedman and Baumol cited in Vining and Meredith, 2000) where they argue that the only appropriate goal or strategy in any organisation is to maximize profit and that any other goal is considered inappropriate.

As much the classical and evolutionary approaches are similar in terms of profit maximization being their goal; they differ in style and processes. The classical approach adopts a style of rational planning (Whittington, 2000: 11) whereas the evolutionary approach lacks confidence in rational planning where they argue that no matter the level or intensity of strategy, the outcome is usually driven by market dictates and how well a manager is able

to perform and that 'investing in long term strategies can be counter productive' (Whittington, 2000: 19).

In this instance, the evolutionary approach can be compared with the Processualist approach to strategy in that they also do not believe in rational planning. This view is shared by Peppard 1995, who argues that in a claim to gaining competitive advantage, management develop strategies with seemingly superiority above others which is just a way of them being seen to be doing something and not necessarily hope to achieve anything by their strategies. By this claim, peppard tries to show that rational planning is just an act which is not necessarily relevant to the overall performance of the organisation but it is something that is done for the corporate image. His view is supported by Cyert and March ( cited in Whittington 2000: 22) who argue that firms can plan in such a way that major strategy sessions could be cut off and yet still deliver just enough to keep everyone satisfied.

Although the processualist approach is similar to the evolutionary approach in terms of processes and style, that where all their similarity ends because in terms of outcome.

The Processualist approach can be compared with the systemic approach of strategy whose school of thought sees not only profit maximization but other outcomes as a an end result of strategy (Whittington 2000: 21 - 27). Werther Jr and Chandler (2005) argue that firms are continuously appraised in terms of both the financial and social benefits that result from their corporate actions or strategies. The systemic approach proposes that 'firms differ according to the social and economic systems in which they are embedded'

(Whittington, 2000: 27) thereby viewing strategy as being guided and controlled by the environmental forces in which they operate. In the same spirit, the processualist advice against 'striving after unattainable ideal of rational fluid action, but to accept and work with the world as it is' (Whittington, 2000: 21).

Finally, the systemic approach can be compared with the classical approach in that they both believe in rational planning and do 'retain faith in the capacity of organizations to plan forward and to act effectively within their environment'(Whittington 2000: 26). This view is shared by Casadesus-Masanell and Ricart, (2010) when they opined that 'strategy is a high-order choice that has profound implications on competitive outcomes..... and strategy should contain provisions against a range of environmental contingencies, whether they take place or not' and Stallwood (1996) maintains that strategy is necessary but insists that whatever strategy is used must be appropriate and simple enough for it to become adopted by an organization without necessarily having to change after its initial usage.

## **Conclusion**

Strategy can be seen as a 'means of avoiding [perhaps] costly and damaging warfare' (University of Leicester, 2009: 90) and it is quite clear that all the approaches of strategy have their own benefits even though they are similar and also dissimilar in their own unique ways. Therefore which ever method adopted should be seen to add to an organization's performance and must be duly analysed and deliberated on ensuring it is in alignment with the organization's goals and objectives before adoption.