

Overview of the nigerian financial sector and economy finance essay



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CHAPTER 2

Nigeria is one of the largest countries in Africa. It was a colony of the British Empire. In 1960, after the abolishment of the colonization, Nigeria became independent and a new country was established and ruled by Nigerians. This was viewed as an outstanding milestone in that Nigeria at that time was viewed as one of the African countries with apparent growth potentials and it was believed that it will rise up to defend all other Africa countries dignity. However, this dream could neither be materialized nor actualized. Nigeria is known as a federal country, which consists of thirty-six different states and a federal capital territory. This nature of Nigeria came about due to the fact that Nigeria is a multi-cultural society, consisting of different ethnic groups with their respective languages and cultural identity.

Nigeria is a culturally diverse country. Nigeria is a country blessed with vast mineral resources ranging from agricultural products which includes cash crops like coffee, pepper, cocoa, palm kernel, timber and rubber. Also mineral resources like tin, columbite, steel, bauxite, crude oil and natural gas are of vast availability. Amongst these; crude oil constitutes the largest revenue. Table 2. 1 below contains the data for the economic and business environment which explains Nigeria at glance.

Table 1: Overview of Nigerian Economic and Business Environment: The Economic Profile.

1

Land Area

923, 773 Square kilometers

2

Population

140, 000, 000

3

GDP

140 Billion (2007)

4

GDP Growth

10%

5

GDP/H

\$1, 200

6

% Petroleum to Total Revenue

95%

7

% Petroleum to Export Earnings

95%

8

Average Daily Output

2. 3b/d

9

Oil Reserves

40bb

10

Gas Reserves

150 Trillion Cubic Meter.

11

Average Interest Rates

22% per annum

12

Average Inflation

17%

13

Exchange Rates

N240/GBP

\$1 : N150

14

Major Trading Partners

UK, USA, Spain, Germany, France and China.

15

Cost Of Capital

8.7

16

Country Rating

BB by S&P, Moody and Fitch.

Source: Husaini Muhammad (2010), Pg. 4.

Given the economic profile above, one can discover all the indicators needed in seeing the strengths and weaknesses of the Nigerian financial sector and the economy at large. By looking at the land area, it can be seen that the huge population of 140 million people, which comprises of vast young population that are perceived to be productive labor force, both skilled and un-skilled since technical expertise is closely associated with the literacy level in a country which Nigeria has high level of illiteracy rate as indicated by most of the international organizations in their development reports such

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as the international monetary fund and the world bank. As can be seen from the report above, petroleum is one of the major exports which are in fact the main export that generates revenues for Nigeria.

Nigeria is the 12th largest producer of petroleum in the world and the 8th largest exporter, and has the 10th largest proven reserves. (The country joined OPEC in 1971). Petroleum plays a large role in the Nigerian economy, accounting for 40% of GDP and 80% of Government earnings. However, agitation for better resource control in the Niger Delta, its main oil producing region, has led to disruptions in oil production and currently prevents the country from exporting at 100% capacity (Wikipedia, 2010)

As the report shows, 95% of the revenue that is generated as a result of export is through petroleum and the rest of the 5% includes all other activities from different sectors such as the agriculture, services and so' on. The revenue generated from the sale of petroleum is huge amounting to 44 billion USD, which in principle can be enough for the development of Nigeria infrastructure and other sectors as well. Yet upon the huge revenues from the oil sector, the GDP Per capita is relatively low compared to most of the countries in the world that are by far poorer than Nigeria in every aspect. Nigeria has been classified by the World Bank group as a lower middle income country.

Also “ according to the Economist Intelligence Unit and the World Bank, Nigerian GDP at purchasing power parity has nearly doubled from \$170. 7 billion in 2005 to 292. 6 billion in 2007. The GDP per head has jumped from \$692 per person in 2006 to \$1, 754 per person in 2007” (Wikipedia, 2010).

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Almost Doubling of the GDP per head and GDP at purchasing power parity is a sign that Nigerian economy is doing well, because as we have known that these aggregate measures are the ones being used to access the growth potential and facts of a certain country, which therefore makes Nigeria a potential place for investment as a result of the certain improvements mentioned that took place. A clear sign shows that when GDP per capita increases and the purchasing power also increases, the welfare of the people is attached to that because the whole poverty index decreases as a result thereby increasing the living standards of Nigerians in general.

The fact also shows that “ Nigeria is the most populous country in Africa, the eighth most populous country in the world, and the most populous country in the world in which the majority of the population is ‘ black’. It is listed among the “ Next Eleven” economies, and is a member of the Commonwealth of Nations. The economy of Nigeria is one of the fastest growing in the world, with the International Monetary Fund projecting a growth of 9% in 2008 and 8. 3% in 2009 . It is the second largest economy in Africa, and is a regional power that is also the hegemon in West Africa (Wikipedia, 2010)

This gives Nigerians privileged amongst their African counterparts. With the growth rate increasing from a lower figure to the level of 9%, even though it decreased by 0. 7% is not that much but taking in to consideration that it’s an aggregate measure, this makes it very important because all sectors are included and therefore, the whole economy is taken into consideration.

2. 2 The Formal Financial Sector

Formal financial sector consists of all regulated financial institutions such as banks and insurance companies. What determines a formal financial sector changes from country to country because of the differences in the level of their respective economic developments. The way the formal financial sector is shaped depends on how market environment is perceived in a given country. Nigerian financial sector consists of different sections. These sections include:

2. 2. 1 The Regulatory Authorities

The Nigerian Financial System comprises bank and non-bank financial institutions which are regulated by the Federal Ministry of Finance (FMF), Central Bank of Nigeria (CBN), Nigeria Deposit Insurance Corporation (NDIC), Securities and Exchange Commission (SEC), National Insurance Commission (NIC), Federal Mortgage Bank of Nigeria (FMBN), and the National Board for Community Banks (NBCB). These agencies are briefly discussed below:

The Federal Ministry of Finance (FMF): The Federal Ministry of Finance advises the Federal Government on its fiscal operation and co-operates with Central bank of Nigeria in monetary matter. Recent amendment to the laws of the Central Bank of Nigeria compels it to report through the Federal Ministry of Finance to the Presidency. This ministry serves as the centre where the whole economic activities are being viewed and also it acts as a linkage between the trades partnerships between Nigeria and the world. The minister who is dully in charge of all the financial as well as economic activities those are of interest to the Nigerian society. Also it serves as the

centre that informs different business initiatives that are of particular interest on Nigeria.

The Central Bank of Nigeria (CBN): This is the apex regulatory authority of the financial system. It was established by the Central Bank of Nigeria Act of 1958 and commenced operations on 1st July 1959. Among its primary functions, the Bank promotes monetary stability and a sound financial system, and acts as banker and financial advisor to the Federal Government, as well as banker of last resort to the banks. The Bank also encourages the growth and development of financial institutions. Enabling laws made in 1991, gave the Bank more flexibility in regulating and overseeing the banking sector and licensing finance companies which hitherto operated outside any regulatory framework. By the powers of the central bank of Nigeria, the whole economy and especially the financial sector is being regulated and overseen. This gives Nigerian financial sector, hence the banking sector a sound environment in which the banks and other financial sector actors performed well even during the recent economic down turn.

The Nigerian Deposit Insurance Corporation (NDIC): This compliments the regulatory and supervisory role of the central bank of Nigeria. It is however autonomous of the CBN and reports to Federal Ministry of Finance. The NDIC effectively took off in 1989 and was set up to provide deposit insurance and related services for banks in order to promote confidence in the banking industry. The NDIC is empowered to examine the books and affairs of insured banks and other deposit-taking financial institutions. Licensed banks are mandated to pay of 1% of their total deposit liabilities as insurance premium

to the NDIC. A depositor's claim is limited to maximum of N50, 000. 00 in the event of a bank failure.

The Federal Mortgage Bank of Nigeria (FMBN): The FMBN took over the assets and liabilities of the Nigerian Building Society. The FMBN provides banking and advisory services, and undertakes research activities pertaining to housing. Following the adoption of the National Housing Policy in 1990, The FMBN is empowered to license and regulate primary mortgage institutions in Nigeria and act as the apex regulatory body for the mortgage finance industry. The financing function of the Federal Mortgage Bank of Nigeria was carved out and transferred to the Federal Mortgage Finance, while the FMBN retains its regulatory role. The FMBN is under the control of the Central Bank. With this bank serving as the apex regulatory authority for the mortgage industry in Nigeria, investors have hugely invested in real estate and this has been in boom right from the adequate regulation of the mortgage sector in Nigeria.

The Financial Services Coordinating Committee (FSCC): This is a committee established to co-ordinate the activities of all regulatory institutions in the financial system. The Committee is chaired by the Federal Minister of Finance. This committee is one of the important nails of the Nigerian financial sector because it reports on basis the strengths and shortcomings of the financial sector and the economy at large. By having that report as needed, and by co-operating with the legislative body which is the parliament, which is responsible for passing the budget allocation and its ratification, the whole financial system is being scanned to meet the needs

of the present world and make the sector as competitive as possible with adequate regulations and supervisions.

Figure 1: A Typical Nigerian Financial System

Source: Husaini Muhammad (2010), Pg. 8.

2.3 The Informal Financial Sector

While the formal sector consists of the highly regulated portion of the economy that deals with the day-to-day operations of the economy, the informal sector as well play a very big and important role in the economy. It's true that the informal sector is un-regulated, and as a result, certain benefits that the economy get from different sectors is being missed, one cannot say that it's not an important sector of the economy. This is because of the fact that the informal sector in some countries is perceived to be an added option when it comes to job opportunities. Job opportunities are almost endless when it comes to the informal sector perspective because anytime a person wants to enter it can be possible as a result of its nature of not being regulated and taken into consideration. Millions of dollars are being traded in the informal sector. Let's take an example of the "black money market" in Nigeria. This market consists of people selling and buying currencies and exchanging currencies, which huge transactions takes place every day of the year. Why most of the time people prefer this sector and why that it disregards all the regulatory rules that are been exerted on those businesses called bureau de change which are dealing with the currency exchange. One can go directly and buy or sell any currency he/she wishes

and leave in peace without giving any identity in carrying out the transaction.

Traditionally, the informal sector in Nigeria comprises not only of the currency exchange market, it consists of different modes of transactions have been happening long periods of time. In the old days, inhabitants of different districts in Nigeria have their own ways of transacting currencies from one place to another, and these ways were all informal. Long before the arrival of the colonial powers, inhabitants in the country now called Nigeria were dealing with outside traders. This trade depends entirely of the closeness of the trade in terms of distance. For long time; the Arab caravan traders have penetrated the northern Nigeria since before the coming of the white colonial powers. This made them to know and get exposed to the world of gold as an object-serving like a currency for exchange of goods and services at that time. The southern part of Nigeria too had its on exposure with the white men, which it's believed that they stayed there for decades before they penetrated to the mainland Nigeria.

By looking at the recent situations compared to the old days that I have discussed above, the situation some few decades changed as a result of the changing nature of the world itself due to different developments that took place. Clearly it has been observed that different ways of savings and business techniques developed amongst different ethnic entities in Nigeria. A common way where poor people used to save to gather money in order to use for the future, as its believed that poor people always have the thought of saving for the future because they always feel insecure that they are poor,

with also cultural and religious beliefs that made the poor to save for their future welfare.

In Nigeria, there used to be special kind of people who usually are informal groups that go round taking money from people in their job places, these kinds of people serve like the village bank, where they accept the money as deposit and save it for the people. This kind of agreement between the inhabitants of the respected area and the people going round to collect their money is in form of trust between them. Although it defers between community to community, the whole idea is the same which is deposit taking and saving, but what remains interesting here is that in some cases, these people that agree to save form group amongst them, and one or two people among them collect the money after it has been accumulated, usually they gather the money for some months, ranging from 6-12 months. The people that collect the money usually use it to boost their businesses and have agreements such as paying higher than what they have taken after some few month, which they are required to return back the money to the deposit taker, which another person among them will get the same and this procedure turns round and round. This is only one of the interesting cases because it gives us an insight of what informally the financial sector had been conducted in Nigerian villages and towns.

These kinds of activities discussed above were those that gave rise to the need for the rural or remote area inhabitants to organize groups which are little bit stronger than the ones before. These groups were mainly in the form of Non-Governmental Organization NGO's that represent the interest of the inhabitants. Solidarity and trust were the main mechanism behind the driven <https://assignbuster.com/overview-of-the-nigerian-financial-sector-and-economy-finance-essay/>

force of these organizations. Moving from Southern to Northern Nigeria, these organizations became popular as every community wants to have a proper lead and a controlling leader that will prevent their business interests. Taking an example of the eastern part of Nigeria where is inhabited predominantly by the Igbo speaking tribe. Igbo people are known to have elders in their communities long before the western influence came to Nigeria. Apart from the elders, a king also is available. The elders are the king-makers, so they have the controlling power. These elders organize community groups which purposely protect the businesses of the poor people from being bullied by the richer ones. so this is a typical example that can be seen as protection of the minority businesses against any monopolistic pressure from other bigger businesses around, hence one can conclude that this constitute the earlier version of micro-finance of a village think.

These kinds of savings that the remote inhabitants engaged have been named differently among the ethnic groups in Nigeria. Generally there are three major ethnic groups in Nigeria which comprises of the Yoruba, Hausa and Igbo. These groups provide savings and credit services to their members. The informal microfinance arrangements operate under different names: ' esusu' among the Yorubas of Western Nigeria, ' etoto' for the Igbos in the East and ' adashi' in the North for the Hausas (CBN, 2000). This became one of the main driven forces behind the establishments of the modern day micro-finance banks in Nigeria. The informal associations that operate traditional microfinance in various forms are found in all the rural communities in Nigeria (Otu, 2003). They also operate in the urban centers.

However, the size of activities covered under the scheme has not been determined.

2. 4 The Nigerian Banking System and Environment

The Nigerian banking sector has been in existence right from the colonial era. The fact that Nigeria was a top producer of most of the needed cash crops by the colonial masters, it became an important need for the country to have a proper financial system that will be used in conducting the businesses efficiently.

In 1892 Nigeria's first bank, the African Banking Corporation, was established. No banking legislation existed until 1952, at which point Nigeria had three foreign banks (the Bank of British West Africa, Barclays Bank, and the British and French Bank) and two indigenous banks (the National Bank of Nigeria and the African Continental Bank) with a collective total of forty branches. A 1952 ordinance set standards, required reserve funds, established bank examinations, and provided for assistance to indigenous banks. Yet for decades after 1952, the growth of demand deposits was slowed by the Nigerian propensity to prefer cash and to distrust checks for debt settlements. (CIA, 1991).

Since then, the Central Bank Of Nigeria has been the regulatory authority that oversees the whole banking system of nigeria in order to guarantee the soundness in the financial system. Since from its inception, many banks were given licences which could not perform well and some of them failed as a result of bad risk management or mis aappropriations of public funds. In the early years back some banks were reported to have weak capital base and

some of them could not meet their daily liquidity needs, this rose the idea of tightening the regulatory standards of the establishing laws of the Central Bank Of Nigeria which led to the amendments of the CBN act in 1999 which restructure the banking system and tight risk management policies were implemented (CBN, Amendments Of CBNAct, 1999).

As a result of adequate regulatory system by the CBN, in 2004 also another development took place. This development was aimed at a comprehensive change of the whole Nigerian banking industry, particularly the deposit money banks which are otherwise knows as conventional or traditional banks. These major key points and solutions were proposed by the CBN Governor and are indicated in Appendix A.

With these amendments taken into force in 2005, which made the banks to have adequate capital base to at least begin to be able to regain their reputations in the eyes of world. Before the reforms, Nigerian banking sector stopped attracting international investors due to the higher country risk and inadequate regulatory rules on the banking sector. Many businesses were attracted as a result of the reforms which increased the soundness of the banking and hence the financial sector in Nigeria. As a result, some banks had to merge with others because they cannot meet the capital requirement of 25 Billion Naira set by the CBN. This reduced the total number of the banks from 89 to 24 in 2005 as a result of the reforms (CBN, Banking Supervision Annual Report, 2008). Below is a table showing some of the banks that merged and acquired other banks as reported by the CBN bank supervision annual report in 2008.

Table 2: Resolution Of Private Sector Deposits for Acquiring and assumed Banks.

Source: Central Bank of Nigeria, Bank Supervision Annual Report, (2008). Pg. 24.

However, by looking at the table 2 above, it's understandable for the Nigerian banks to merge because they had less capital base to continue with their operations and be able to meet-up and compete with the rest of the world. The merging of the banks gave them strength in terms of capital and also variables like number of branches and employees and hence human capital and technical expertise increased. Even though that some of the banks had to close down totally, that did not affect the financial system negatively in terms of performance measures accessed of the banks, instead efficiency is fostered and more reliability is seen in the banking sector as the whole aggregate balance sheet structure of the banking system showed below:

Table 3: Aggregate Balance Sheet Structure of the Nigerian Banking System

Source: Central Bank of Nigeria Bank Supervision Annual Reports (2010), Pg. 68.

Clearly changes have been seen between the pre-mergers/recapitalization and post-mergers/recapitalization of the banks. The pre-merger period which was the year 2004, the annual growth of the entire banks in the system was 12. 24 percent and in 2008 which is the recent post-merger period, the annual growth rate stood at 60. 43 percent, even though in 2007, a negative

growth of 12.78 percent was realized. Certainly, this was an outstanding performance that indicated the working of the mergers between the previous 89 banks in the system. This clearly shows that the merging of the banks to 24 banks in number had brought to the banking system of Nigeria a sound sense that is perceived as a component that will aid in regaining the long-eroded trust of the industry in the eyes of the world. Therefore, this was and still is a tremendous milestone in the history of the Nigerian banking system.

Table 4 below shows the list of the current 24 banks that came to being as a result of the mergers between the previous 89 banks. Note that some of the banks maintained their positions and name due to the fact that they met up with the requirements setup by the CBN.

Table 4: List of the Current Banks in Nigeria.

Institution Name

Type Of Institution

Date Re-registered

Date Licensed

1

Access Bank Nigeria Plc.

Universal Bank

1/17/1990

1/17/1990

2

Afribank Nigeria Plc.

Universal Bank

1/3/2006

1/3/2006

3

Citibank Nigeria Limited

Universal Bank

10/11/2004

10/8/2004

4

Diamond Bank Nigeria Plc.

Universal Bank

12/31/1990

12/31/1990

5

Ecobank Nigeria Plc.

Universal Bank

4/24/1989

4/24/1989

6

Equitorial Trust Bank Plc.

Universal Bank

1/2/2006

1/2/2006

7

Fidelity Bank Plc.

Universal Bank

1/2/2006

1/2/2006

8

First Bank of Nigeria Plc.

Universal Bank

1/29/1979

1/29/1894

9

First City Monument Bank Plc.

Universal Bank

11/11/1983

11/11/1983

10

First Inland Bank Plc.

Universal Bank

1/2/2006

1/2/2006

11

Guaranty Trust Bank Plc.

Universal Bank

1/17/1990

1/17/1990

12

Intercontinental Bank Plc.

Universal Bank

10/2/1989

10/2/1989

13

Oceanic Bank International Nigeria Plc.

Universal Bank

1/31/2006

3/20/2000

14

Platinum Habib Bank Plc.

Universal Bank

5/2/2001

5/2/2001

15

Skye Bank Plc.

Universal Bank

1/3/2006

1/3/2006

16

Spring Bank Plc.

Universal Bank

1/3/2006

1/3/2006

17

Stanbic - IBTC Bank Plc.

Universal Bank

1/2/2006

1/2/2006

18

Standard Chartered Bank Nigeria Plc.

Universal Bank

12/1/2004

6/9/1999

19

Sterling Bank Plc.

Universal Bank

1/25/1999

11/25/1960

20

Union Bank of Nigeria Plc.

Universal Bank

1/2/2006

1/2/2006

21

United Bank For Africa Plc.

Universal Bank

1/2/2006

1/2/2006

22

Unity Bank Plc.

Universal Bank

1/2/2006

1/2/2006

23

Wema Bank Plc.

Universal Bank

1/18/1965

1/17/1945

24

Zenith Bank Plc.

Universal Bank

9/13/2004

6/20/1990

Source: Central Bank of Nigeria, (2010).