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91, Cadastral Zone, University Village Jabi, Abuja

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COURSE WRITERS: **DR ABDULLAHI S. ARAGA**
NATIONAL OPEN UNIVERSITY OF NIGERIA
MRS. TEMI OLAJIDE ARISE
NATIONAL OPEN UNIVERSITY OF NIGERIA

COURSE EDITOR: **DR. (MRS) ROSELINE O. OLUITAN**
(DEPARTMENT OF BANKING & FINANCE, LASU)

COURSE COORDINATOR: **MRS. OLAKUNBI LAWAL**
DEPARTMENT OF FINANCIAL STUDIES, NOUN

HEAD OF DEPT: **DR. (MRS.) OFE I. INUWA**
DEPARTMENT OF FINANCIAL STUDIES, NOUN

MODULE 1

Unit 1 Evolution of Banking Methods and Processes

Unit 2 Types of Banking

Unit 3 Banking Methods of Payment

Unit 4 Instruments of Payment in Banking

Unit 5 Clearing House

Unit 6 Electronic Banking

UNIT 1: EVOLUTION OF BANKING METHODS AND PROCESSES

CONTENTS

1.0 INTRODUCTION

The first question one may ask when reading this Unit is 'What is so special about banks?' this Unit aims to offer some insights into the evolution of banking and the growth of banks in Nigeria. A bank can be defined as a financial intermediary that offers loans and deposits, and payment services to the banking public. Nowadays banks also offer a wide range of additional services and these functions serve as the basis for distinguishing the types of banks which we shall discuss in the course of this lecture.The importance of banks in channelling funds from savers to borrowers will be discussed in this unit along with the history, concept and the role of banking within the economy.

2. 0 OBJECTIVES

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

- Explain the concept of banking
- Distinguish between banks and moneylenders
- Outline the role of banking

3.0 MAIN CONTENTS

3.1 HISTORY OF BANKING

The roots of banking can be traced to the earliest civilizations. The Egyptians and early societies of the Middle East developed the prototype upon which modern banking is based. It is argued that the English word **"Bank" was** derived from the Italian word **"Banco"** (long bench), A Banco was a table covered in green cloth where moneylenders completed their transactions in the marketplace. **"Bank"** may also trace its origins to the German word **"Banch"** meaning **"a pile",** the word Germans used to represent a kind of public debt. Regardless of how the word originated, banks have been important financial institutions linking the economies of the world. Historically, banks functioned to provide deposit, loan, and currency exchange services. With time, these banking services became increasingly important to a nation's economic advancement.

There is firm evidence that around 3,900 B.C., Egypt adopted a banking service utilizing cows as units of exchange. Deposited cows were assigned a value and exchanged for goods of equal value. Near Babylon, in modern-day Iraq, services to secure valuables and extend business loans were also emerging. At the Semitic red monastery of Uruk (thought to be the derivation of "**Iraq**"), one of the world's oldest cities, the priests leased land to farmers. The monastery also held a vast quantity of valuables donated by the faithful. The monastery earned extra income by lending these items to borrowers and charging rental fees. Later, they offered pawning services, paying farmers cash for their grain and cattle. As Uruk prospered, traders began depositing their valuables with the monasteries. They were issued clay tablets coloured with sienna as proof of deposit; with them, they could withdraw items at monastery branches. In addition to the monasteries, wealthy people offered banking services.

Once more, monasteries were the key players with priests, both male and female, acting as **"bankers".** They accepted deposits of cash and valuables against loans which were extended to people affected by disorders or wars. The **"bankers"** also provided currency exchange, loans, and bills of exchange equivalent to the amounts deposited. These bills were debts payable and were accepted for use in other cities. Under strict government supervision, banking grew, attracting investors from the private and public sectors throughout the realm. As the Roman Empire began to disintegrate, trade and banking declined.

3.2 THE CONCEPT OF BANKING AND DEFINITION

Today, the term, bank, means different things to different people in different economies. In order to reconcile the divergent views on the meaning and characteristics of banks, the banking laws in each economy provides operational definition and functional classification which governs banking practices in the economy. In practical terms, a bank means what the operating banking law in an economy defines as a bank (Ezeuduji, 2000:8). To many people, a bank refers to an institution which accepts deposits from the public and in turn creates credit through granting loans and advances. Credit creation function of banks is a major service that distinguishes it from other types of financial institutions because they cannot create credit even though they may accept deposits and grant loans and advances.

Economists on their part have defined a bank in various capacities, some emphasizing its various functions. However, a bank can be defined broadly as any financial institution thataccepts, collects, transfers, pays, exchanges, lends, invests, or safe-guards moneyfor its customers. This broader definition includes many other financial institutions that are not usually thought of as banks but which nevertheless provide one or more of these broadly defined banking services. In summary, a bank is simply an institution which accepts deposits from the public and in turn grant loans and advances resulting in credit creation.

SELF-ASSESSMENT EXERCISE 1

Explain the concept of banking.

3.3 ROLE OF BANKING WITHIN THE ECONOMY

Banks provide funds for business as well as personal needs of individuals. They play a significant role in the development of the economy of a nation. Let us discuss some of this medium of positive impact on the economy.

1. The deposit collection by banks from the customers encourages savings habit amongst the banking public and this the banks pool together to make funds available for productive use.
2. Banks act as intermediary between people having surplus money (surplus sector) and those that require funds for investment purposes (deficit sector) within the economy.
3. They facilitate business transactions through payment and collection of financial instruments which are used for settlement instead of cash.
4. They provide a vehicle for utilising the deposits mobilised through loans and advances to investors both for short term and long-term purposes.
5. They facilitate import and export transactions that allows fruition of the law of comparative advantage.
6. They act as agent for socio-economic development by providing credit to farmers, small-scale industries andself-employed people as well as to large businesses. This enhances the productive base of the economy and ultimately the per capita income.
7. They assist to improve the standard of living of the people in general through provision of loans for purchase of consumer durable goods, houses, automobiles, etc.

3.4 DISTINCTION BETWEEN BANKS AND MONEYLENDERS

You may be thinking that a bank is like a moneylender who provides funds to borrowers and charges interest on the loan. This is not so. A bank is quite different from a moneylender. A bank performs two main functions. Firstly, it accepts deposits, and on that basis it lends money. The moneylenders, on the other hand, advance money out of their own private wealth and usually do not accept deposits from others. The table below shows the distinction between a bank and moneylender.

	Basis	Banks	Moneylenders
1	Entity	Banks are government licensed institutions that are required to operate under the enabling act (BOFIA).	Moneylenders are individuals who are usually not licensed.
2	Activity	Banking activities include acceptance of deposit as well as lending of money.	Activities of moneylender does not usually include acceptance of deposits
3	Clients	Banks meet the needs of	Moneylenders meet the needs

		people in general and business community in particular.	of peasants within the economy.
4	Security	Banks accept tangible and personal security to hedge against risk in case of default.	Moneylenders generally accept gold, jewellery or land as security for giving loans.
5	Process of recovery of loans	The process of recovery is flexible.	The process of recovery is rigid and strict.
6	Supervision	Banks are supervised by the government through the appropriate agencies namely Central Bank of Nigeria, Nigeria Deposit Insurance Corporation (NDIC) etc	They are usually unsupervised hence adopt quack methods in their operational approach

SELF-ASSESSMENT QUESTION 2

Distinguish between banks and moneylenders.

3.5 GROWTH OF BANKS IN NIGERIA

In Nigeria, commercial banking pre - dates central banking and laid the foundation of the Nigerian financial system as far back as the late nineteenth century. The first commercial bank in Nigeria was the African Banking Corporation which opened its first branch in Lagos in 1892. The bank experienced some initial difficulties and eventually decided to transfer its interest to Elder Dempster and Co. in 1893. This led to the formation of a new bank known as the British Bank of West Africa (BBWA) in 1893 which is today known as the First Bank Nigeria PLC. Another bank known as the Barclays Bank DCO (Dominion, Colonial and Overseas) opened its first branch in Lagos in 1917. This bank is known today in Nigeria as the Union Bank Nigeria Plc. British and French Bank, now called United Bank for Africa Plc. was established in 1949 making it the third expatriate bank to dominate Nigeriancommercial banking.

The foreign banks came principally to render services in connection with international trade, so their operationsas at that time were mainly with the expatriate companies and with the government.

They ignored the development of local African entrepreneurship. These three banks controlled almost about 90% of the aggregate bank deposits as at then. From 1914 to the early part of 1930s, several abortive attempts were made to establish locally owned and managed banks to break the foreign monopoly. This was as a result of the weakness of those indigenous banks in such areas as capitalization and management; and given the total absence of regulation by any government agency, the indigenous banks could not survive the hostile and unfair competition posed by the foreign banks.

The discriminating attitude of the expatriate banks led to the establishment of the first indigenous bank in Nigeria - The industrial and commercial bank in 1929 but this bank was liquidated as a result of bad financial management, undercapitalization and aggressive competition from the expatriate banks in 1930. In 1931, another indigenous bank named - The Nigeria Merchantile Bank came into existence but equally did not survive until 1933 when National Bank of Nigeria was established. Several other banks were established that collapsed thereafter until 1945 whenAgbonmagbe Bank now Wema Bank came into existence. Some of the banks that were established but failed during this period include but not limited to -The Nigerian Penny Bank which was set up in the early 1940s and collapsed in 1946 as a result of mismanagement, The Nigerian Farmer and commercial Bank established in 1947 and Nigerian Continental Bank Plcequally in 1947. It was therefore not surprising that by 1954, a total of 21 out of 25 indigenous banks had failed and went into self – liquidation.

In a nutshell, historically, evolution of banks in Nigeria can be classified into four stages. The first stage can be described as the unguided laissez – faire phase (1930-59), during which several poorly capitalized and unsupervised indigenous banks failed before their tenth anniversary. The second stage was the controlled regime (1960-1985), during which the Central Bank of Nigeria (CBN) ensured that only "fit and proper" persons were granted banking license, subject to a minimum paid – up capital. The third stage was the post Structural Adjustment Programme (SAP) or decontrolled regime (1986-2004), during which the Neo – liberal philosophy of "free entry" was over stretched and political authorities on the bases of patronage dispensed banking licenses. The emerging fourth stage is the era of consolidation (2004-to a foreseeable future), with major emphasis on recapitalization and proactive regulation based on prudential principles.

In the area of Central Banking, the West African Currency Board (WACB) carried out banking operations in the former British colonies in West Africa before independence. The problems of the WACB led to the establishment of Central Banks in these colonies. In Ghana, it came into being in

1957, in Nigeria 1959, Sierra Leon in 1964, and in the Gambia in 1964. The Central Bank of Nigeria (CBN) was established by the Central Bank Act of 1958. It was to replace the West African Currency Board (WACB) of the colonial government as part of the preparation for independence in Nigeria.

4.0 CONCLUSION

In this unit, you have learnt the history of banking and how the roots of banking can be traced to the earliest civilizations and also, how the Egyptians and early societies of the Middle East developed the prototype upon which modern banking is based.

5.0 SUMMARY

This unit has examined the historical concept of banking in Nigeria and the various definitions of banks. We have also compared banking with the activities of money lenders and the effect that banks create on the growth of the economy.

6.0 TUTOR-MARKED ASSIGNMENT

7.0 REFERENCES/FURTHER READING

Oluitan, R. O. (2003) The Nigerian Financial System. Walex Printing, Lagos, Nigeria. 1st Edition.

UNIT 2 TYPES OF BANKING

CONTENTS

1.0 INTRODUCTION

This Unit outlines the main types of firms that undertake banking business and describes the activities of each of the types of banks considered in this unit. Banking occupies one of the most important positions in the modern economic world. It is necessary for trade and industry. Hence it is one of the important agencies for commerce. Although banking in one form or another has been in existence from very early times, modern banking activities is of recent origin. It is one of the results of the Industrial Revolution and the child of economic necessity. Its presence is very helpful to the economic activity and industrial progress of a country.

2.0 OBJECTIVES

At the end of this unit, you will learn about:

- The types of banks that operate mainly in Nigeria
- The main functions of these banks

3.0 MAIN CONTENT

3.1 CENTRAL BANK

The core functions of central banks in any country are: to manage monetary policy with the aim of achieving price stability, to prevent liquidity crises, monitor situations in the money market to prevent disorderliness and financial crises, and to ensure the smooth functioning of the payment system. Anybank which is entrusted with the functions of guiding and regulating the banking system of a country is known as the Central Bank. Such a bank does not deal with the general public. It acts essentially as Government's banker; maintain deposit accounts of all other banks and advances money to other banks, when needed.

The Central Bank provides guidance to other banks whenever they face any problem. It is therefore known as the bankers' bank. The Central Bank maintains record of Government revenue and expenditure. It also advises the Government on monetary and credit policies and decides on the interest rates for bank deposits and bank loans. In addition, foreign exchange rates are also determined by the central bank. Another important function of the Central Bank is the issuance of currency notes, regulating their circulation in the country by different methods. It is charged with the issuance of notes and currencies within the economy.

3.1.1 FUNCTIONS OF A CENTRAL BANK

A Central Bank can generally be defined as a financial institution responsible for overseeing the monetary system for a nation, or a group of nations, with the goal of fostering economic growth without inflation.

The functions of a Central bank can be classified into three categories namely:

A. Traditional Banking Functions

1. The central bank controls the issue of notes and coins (legal tender).
2. It has the power to control the amount of credit-money created by banks. In other words, it has the power to control, by either direct or indirect means, the money supply.
3. A central bank should also have some control over non-bank financial intermediaries that provide credit.
4. A central bank act as the government's banker.
5. The central bank should oversee the financial sector in order to prevent crises and act as a lender-of-last-resort.

B. Monetary Functions

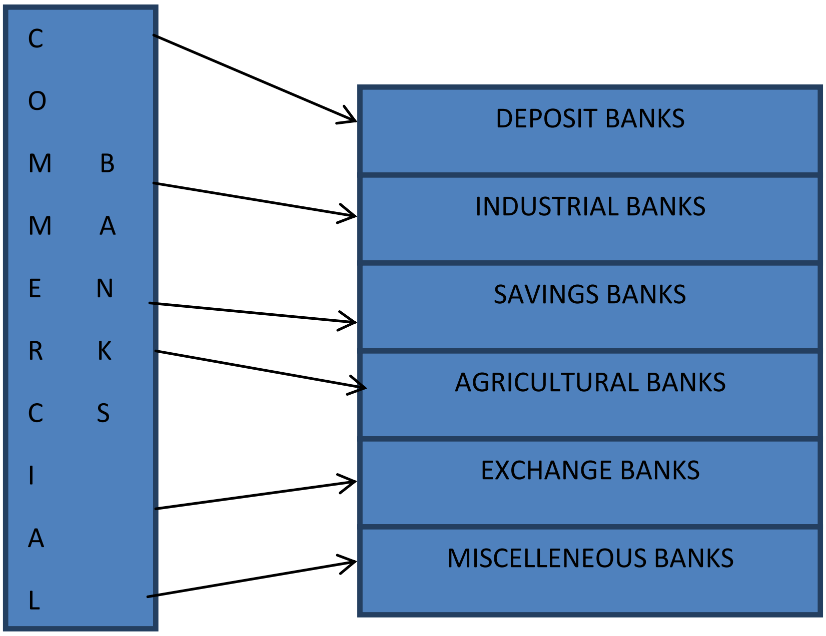
The Central Bank monitors the Monetary Policy through directives such as:

1. Open Market Operation
2. Stabilization Securities
3. Cash Reserve Requirement
4. Liquidity Ratio

5. Special Deposit
6. Moral Suasion etc

C. Development Functions

1. The Central Bank is the government agency for the management of the foreign reserves of the country.
2. The central bank also acts as the official agent to the government in dealing with all its gold and foreign exchange matters.
3. Manages the country's external debt
4. Enacts development policies that aids efficient banking services such as the rural banking scheme, Agricultural Credit Guarantee Scheme Fund etc
5. Monitors the banking institutions to fill observed gaps through establishment of specialised banking institutions such as Nigerian Industrial Development Bank; Nigerian Bank for Commerce and Industry etc.



3.2 COMMERCIAL BANKS

Commercial Banks are banking institutions that accept deposits and grant short-term loans and advances to their customers. In addition to giving short-term loans, they also give medium-term and long-term loan to business enterprises. Now-a-days some of the commercial banks are also providing housing loan on a long-term basis to individuals. Commercial banks are the major financial intermediary in any economy. They are the main providers of credit to the household and corporate sector and operate the payment mechanism. While commercial banking refers to institutions whose main business is deposit taking and lending it should always be remembered that the largest commercial banks also engage in investment banking, insurance and other financial service areas through operating windows established for that purpose.

FUNCTIONS OF COMMERCIAL BANKS

The functions of commercial banks are divided into two categories:

I. Primary functions.
II. Secondary functions.

I. **Primary functions:**

The primary functions of a Commercial Bank includes:

a) Accepting deposits

b) Granting loans and advances

a) Accepting deposits

The most important activity of a commercial bank is to mobilise deposits from the public. People who have surplus income andsavings find it convenient to deposit the amounts with banks. Depending upon the nature of deposits, funds deposited with the bank also earn interest. Thus, deposits with the bank grow along with the interest earned. If the rate of interest is higher, public are motivated to deposit more funds with the bank. There is also safety of funds deposited with the bank because the government ensures that deposit money banks' deposits are insured against risks that could affect the funds deposited.

b) Grant of loans and advances

The second important function of a commercial bank is to grant loans and advances. Such loans and advances are given to members of the public and to the business community at a higher rate of interest than allowed by banks on various deposit accounts. The rate of interest charged on loans and advances varies depending upon the purpose, period and the mode of repayment. The difference between the rate of interest allowed on deposits and the rate charged on the loans is the main source of a bank's income.

i. **Loans -** A loan is granted for a specific time period. Generally, commercial banks grant short-term loans. But medium and long term loans may also be granted. The borrower may withdraw the entire amount in lump sum or in instalments. However, interest is charged on the full amount of loan. Loans are generally granted against the security of certain assets. A loan may be repaid either in lump sum or in instalment.

ii. **Advances -** An advance is a credit facility provided by the bank to its customers. It differs from loan in the sense that loans may be granted for longer period, but advances are normally granted for a short period of time. Furthermore, the purpose of granting advances is to meet the day to day requirements of business or individuals and repayment is usually in lump sum. A typical example is Salary advance which is given to individuals with the hope of deduction against future salary payments of the customer. The rate of interest charged on advances varies from bank to bank. Interest is charged only on the amount withdrawn and not on the sanctioned amount.

II. Secondary functions

Besides the primary functions of accepting deposits and lending money, banks perform a number of other functions which are called secondary functions. These are as follows -

a) Issuance of letters of credit, traveller's cheques, circular notes etc.
b) Safe custody of valuable items, important documents, and securities by providing safe deposit vaults or lockers.
c) Providing customers with facilities of foreign exchange.
d) Transferring money from one place to another; and from one branch to another branch of the bank.
e) Provision of guarantee facilities on behalf of its customers either for making payments or for purchase of goods, machinery, vehicles etc.
f) Collecting and supplying of business information.
g) Issuance of demand drafts and payment orders.
h) Provision of reports on the credit worthiness of customers.

3.2.1 DEPOSIT MONEY BANKS

The most important type of deposit money banks is the commercial banks. They have connection with the commercial class of people. These banks accept deposits from the public and lend them to needy parties. Since a large percentage of their deposits are for short period only, these banks extend loans mainly for short period. Ordinarily these banks lend money for a period between 3 to 12 months. They do not like to lend money for long periods or to invest their funds in long term securities.

3.2.2INDUSTRIAL BANKS

Industries require a huge capital for a long period to buy machinery and equipment. Industrial banks help the industrialists to achieve their goals. They provide long term loans to industries.

Besides, they buy shares and debentures of companies which enable them to have fixed capital. Sometimes, they even underwrite the debentures and shares of big industrial concerns. A typical bank of this nature in Nigeria is the Nigerian Bank for Commerce and Industry. The important functions of industrial banks are:

1. They accept long term deposits.
2. They meet the credit requirements of industries by extending long term loans.
3. These banks advise the industrial firms regarding the sale and purchase of Shares and Debentures.

3.2.3 SAVINGS AND LOANS BANKS

These banks were specially established to encourage thrift among small savers and therefore, they are willing to accept small sums as deposits. They encourage savings of the poor and middle class people. In Nigeria, these banks perform in major cities but their activities are still relatively low when compared to the Deposit Money Banks.However, they are prominent with market women who engage in daily savings of their sales hence it is very common to see the Savings and Loans officials within the markets collecting deposits from the sellers.

3.2.4 AGRICULTURAL BANKS

Agricultural business has its peculiar problems hence the need to establish special banks that helps to finance their activities. These banks are organised on co-operative lines and therefore do not work on the principle of maximum profit for the shareholders. These banks meet the credit requirements of the farmers through term loans, viz., short, medium and long term loans. The major bank saddled with this activity in Nigeria is the Nigerian Agricultural &Co-operative Bank which was established in 1973 with the primary objective of:

- Granting of loans for agricultural production including horticulture, poultry farming and pig breeding and for storage, distribution and marketing connected with such production.
- Granting of direct loans to individual farmers, cooperative societies or other bodies whether corporate or unincorporated.

3.2.5DEVELOPMENT BANKS

These banks are established for the provision of medium and long term finance for the public and private sectors. They are charged with ensuring the promotion and development of projects.

They also provide advice and other forms of assistance necessary to ensure smooth take off and survival of the business enterprises within the country. A typical example in Nigeria is the Nigeria Industrial and Development Bank. Another special one is the Nigeria Export Import Bank.

3.2.6 MISCELLANEOUS BANKS

There are certain kinds of banks which have arisen in due course to meet the specialised needs of the people. In England and America, there are investment banks whose object is to control the distribution of capital into several uses. American Trade Unions have got labour banks, where the savings of the labourers are pooled together. In London, there is the London Discount House whose business is "to go about the city seeking for bills to discount." There are numerous types of different banks in the world, carrying on one or the other banking business.

4.0 CONCLUSION

There are many types of banks operating in any economy and the types available is a function of the needs of the populace. In Nigeria, we have different types that are meant to enhance local production and thrive businesses. Each type of bank has its catchment area of the general public and the banking habit of the populace so far has been on the increase.through several methods of payment which we shall discuss in the next unit.

5.0 SUMMARY

We have examined the types of banks in Nigeria and their functions. We have also looked at the people that they usually target which aids the level of success so far achieved by the banks considered herein.

6.0 TUTOR-MARKED ASSIGNMENT

7.0 REFERENCES/FURTHER READING

Oluitan, R. O. (2003) The Nigerian Financial System. Walex Printing, Lagos, Nigeria, 1st Edition.

UNIT 3 BANKING METHODS OF PAYMENT

CONTENTS

1.0 INTRODUCTION

Everyday people trade/exchange goods and services for money. With money being the major medium of exchange, payments systems were developed out of a need to facilitate growth of commerce and economic development. In this unit different types of payment systems are discussed.

To begin, let's define Payment Systems. They are systems that facilitate businesses and consumers to transfer funds to one another. While cash is an important payment instrument that people use daily to purchase goods and services, other payment instruments are also available and widely used.

2.0 OBJECTIVES

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

- Mention the various payment instruments.
- List the advantages and disadvantages of a credit card.
- Explain the large value payment system.

3.0 MAIN CONTENT

3.1 LARGE VALUE PAYMENT SYSTEM

This system typically processes high value critical payments. It is an essential payment system which ensures the smooth functioning of the economy and the financial system. If this system fails, it could trigger disruptions or transmit shocks within the economy. Currently, a popular method in Nigeria is the SWIFT transfer which is used by commercial banks to make large value payments on a daily basis both domestically and internationally. This enables banks to automate and standardize financial transactions, thereby reducing operational risk and eliminating inefficiencies.

3.2 RETAIL PAYMENT SYSTEM

This payment system is as important as the large value payment system and has a larger user group. A person with a payment card of any kind is part of the retail payment system. At the retail level most transactions involve cash, cheques or cards.

3.2.1 CASH

Cash refers to money in the form of banknotes and coins. Of all the different payment methods available, cash is still the most commonly used for everyday purchases. Using it couldn’t be simpler, it’s almost always used face-to-face and you can physically see the money being handed over (and get any change straight away too). Cash is the preferred method for small payments because it involves no credit and therefore no promises. With cash, you can usually purchase goods and services easily as it is widely accepted. Carrying too much cash is risky as it can lead to theft and other problems. However, people still carry cash for its convenience and flexibility. From the payee’s point of view, transactions are completed immediately and this cash can be re-used for other transactions.

ADVANTAGES OF USING CASH AS A FORM OF PAYMENT

1. Cash is the most common way of payment around the globe when compared to all other types of payment. It does not involve third-party action for its immediate conversion into other forms /value.
2. Cash requires no authorization for the person who carries it, thus it is convenient for those who desires small payment amounts to be used.
3. Cash payment does not require additional knowledge when a transaction occurs; whereas credit card payment may need the users to be taught beforehand in order to properly use it.
4. The use of cash does not involve any transaction fees for both ends, that is, the person who uses cash and the merchant does not have to worry about paying any fees when buying and selling goods and services.

DISADVANTAGES OF USING CASH AS A FORM OF PAYMENT

1. Cash payment is not suitable for larger purchases, such as car, or house, etc. As it becomes impossible when stacks of notes are used to make purchases.
2. Cash purchases are instant and have the tendency to be final and irreversible, unless seller agreed otherwise.
3. Cash can be easily purloined and anybody can claim its ownership, thus, it is insecure when compared to other forms of payment.
4. Cash can be forged; merchants without proper tool to confirm genuineness could find it difficult to detect.

WHAT WOULD I USE THIS FOR?

- Cash is used every day for all types of transactions such as in shops, restaurants, coffee shops and pubs. It is also the easiest way to transfer money between people as you can simply hand over banknotes or coins.
- Cash can also be used in vending machines to buy certain items – for example, parking tickets, train tickets, drinks, food, etc.

HOW DO I USE IT?

- **Cash machine:** Also known as an ATM.This is a self-service machine that allows cardholders with a PIN to withdraw cash from their account. Other banking services are also available on most machines. With the introduction of ATM in Nigeria, it has gainer wider acceptance though it is still fraught with teething problems.
- **Cash Advance:** An advance that draws directly against a credit cardholders' credit line, where the service is available. Interest is usually charged when cash is obtained in this way, and there can be other fees too. Check with your card issuer if you are not sure.
- **Cashback:** When purchasing goods with a debit card, some retailers (generally supermarkets), offer a cashback service. This enables a customer to add a cash value to the transaction and obtain the cash at the checkout, as an alternative to using a cash machine. The transaction value and the cash value will be debited directly from the cardholder's bank account. Cashback is only available on debit cards. (An alternative use of the expression 'cashback' refers to the feature offered on some credit card accounts of refunding a cash

sum to cardholders based on a percentage of their spending. This is similar to other reward schemes such as Air Miles or points for travelers.)

3.2.2 CHEQUE

A cheque is a paper voucher linked to a current account. When you open a bank account you may be given a cheque book which contains a number of cheque leaves. Each cheque will be printed with the issuing bank's name;address and a unique cheque number along with the sort code and customer's account number.A cheque is an order to transfer funds from the payer's bank to the account of the payee. Cheques are generally valid for six months after the date of issue. The use of cheques has traditionally dominated the world's non cash payments. Despite the development of other payment instruments, cheques remain an important form of payment. A cheque is effectively a future promise to pay the amount stated on it and needs to be presented to a bank in order to obtain the payment. Cheque clearance usually takes 2 - 4 working days in Nigeria.

ADVANTAGES OF A CHEQUE

1. Safer than cash e.g. a crossed cheque can only be deposited into the payee's account.
2. Preferable for large amounts and a large number of payments to avoid carrying large sums of cash.
3. Payments can be made at your convenience and posted to the payee.

DISADVANTAGES OF A CHEQUE

1. Can take up to 2 – 4 working days before funds are available to use.
2. There is no guarantee that the payer has sufficient funds hence the cheque may become dishonoured (bounce) by the bank.
3. There are extra costs if the payee wants an immediate clearance of funds. Cheques also have other administrative costs associated to it.

WHAT WOULD I USE THIS FOR?

- You can write a personal cheque to a business or an individual for any amount, but it's up to you to make sure you have enough money in your account to allow the payment to go through.
- Cheques are most commonly used to pay bills, tradesmen who come to the house or to pay a friend or another person's face-to-face.

HOW DO I USE IT

- When you write a cheque to someone else you fill in the name of the person or business you are paying and the amount in both words and numbers. The other person then pays the cheque into their account and the respective banks arrange for the money to be moved from one account to the other.
- If you pay someone a cheque it will only start to be processed when they pay it into their account, which might not be straight away. If you want to avoid going overdrawn you'll need to make sure that you have adequate funds in your account to cover any cheques you write (and until they are paid in).
- Not all businesses accept cheques so if you intend to pay with one it's always worth checking they are accepted in advance.

3.2.3 DEBIT CARD

This is a payment card where the transaction amount is deducted directly from the card holder's bank account upon authorization.A debit card is linked to your current account and is used to pay for goods and services anywhere in the world, online and abroad. The amount of the purchase is debited from your available balance on the same day. However it can take several days for the funds to be debited from your account. Debit cards also allow you to withdraw money at cash machines or get cashback in shops that offer that service. The cards could be branded VISA, MAESTRO or MASTERCARD.

ADVANTAGES OF A DEBIT CARD

1. Debit card payments will only be accepted if the card holder has sufficient funds in his/her account.
2. Debit card can be used for mail order or online purchases.
3. Less risk involved than holding cash. The risk of theft is mitigated by having pin codes.

DISADVANTAGES OF A DEBIT CARD

1. Takes time for money to be received and acknowledged.
2. Operates with a fee payable to the bank.

WHAT WOULD I USE THIS FOR?

- More than one million places around the world, including online and over the phone accept debit cards. Debit cards badged Visa or MasterCard can be used worldwide – though in some countries you'll still be asked to sign when you pay rather than giving a PIN.

- Debit cards are useful for everyday spending and are generally free to use, provided that you have enough money in your account to cover the purchase. On average,people use their debit cards regularly for everyday shopping, withdrawing cash and paying bills or other forms of business transactions.
- If you use your debit card in a cash machine (or ATM) there are other things you can do as well as getting cash. These include getting an account balance or mini-statement, changing your PIN, or in some cases topping up credit on your mobile phone.
- Some shops, like supermarkets, offer the option of "cash back" when you make a debit card purchase above a minimum value. This means the retailer will give you the amount of cash you ask for (up to a specified limit) and the money will be debited from your account straightaway. It is useful when you need cash but there isn't an ATM nearby.

HOW DO I USE IT?

- When you make a transaction using a debit card, the funds are taken from your account straightaway. You need to be sure there is sufficient money in your account to make the purchase – otherwise your card might be declined by the retailer or you could be charged for an unauthorized overdraft.
- When you use your debit card in person, you will be asked to enter your PIN to confirm the transaction. Once you have successfully entered your PIN into the keypad, information is sent electronically to your bank to arrange for the money to be taken to your account and paid to the business.
- Chip and signature cards are available as an alternative to chip and PIN for people who aren't able to use a PIN – you should contact your bank to request for one if needed. Card terminals in shops are designed to automatically prompt shop staff to ask for a signature when one is needed and both the business and customer benefit from the same protections from liability for fraud losses offered by chip and PIN.
- Debit cards are also commonly used to buy things online or over the phone. To buy something in this way, you need to provide the 16-digit card number and the name on the card. You will also be asked for the expiry date, an issue number (if there is one) and the three-digit security code on the back of your card. Businesses accepting payments in this way have to meet standards to ensure your information is stored safely, but you should always make sure the company you are dealing with is trustworthy, as this information can

be valuable to fraudsters. You should NEVER give your PIN to anyone either online or over the phone.

- There's usually no charge for paying by debit card but your bank may charge you for using your card overseas, and some internet retailers levy a charge too. Some ATMs also charge for cash withdrawals, but you will always be told upfront on the screen before withdrawing cash if you are to be charged, so you have the choice to stop the transaction.

3.2.4 CREDIT CARD

A credit card is used to buy goods or services on credit. When you use a credit card to buy things, you are borrowing money from the credit card company who will have advised you of your credit limit – the maximum amount you can borrow. You'll have to repay the money and pay any interestdue. If you pay your bill off in full each month you won't pay any interest.Credit cards are issued through commercial banks and/or other issuers.

ADVANTAGES OF A CREDIT CARD

1. Guaranteed payment up to an approved limit.
2. Can be used for mail order and online purchases.

DISADVANTAGES OF A CREDIT CARD

1. A fee is paid to the bank for this service.
2. High interest rates make credit cards an expensive mode of borrowing.
3. Risk of theft if the card is stolen or if internet payment sites are not secure. The culprit can use the available credits if not immediately stopped.

WHAT WOULD I USE THIS FOR?

- Credit cards are now almost universally accepted to pay for goods and services both at home and abroad and to shop online. You should think carefully before withdrawing cash on a credit card as you will be charged a fee and will you will pay interest from the date of the withdrawal.
- Credit cards can be an effective way of budgeting if used properly – but interest charges can mount up if bills are not paid in full. Credit cards can be handy in emergencies, allowing you "instant access" to a borrowing facility up to your pre-agreed credit limit. If you pay off the bill in full each month, you won't pay any interest so credit cards can be a very useful way to borrow over the short term.

- Credits cards are increasingly used for regular shopping but many people use them mainly for larger cost items such as holidays or household goods, helping them to spread the cost of these items over a longer period of time.
- Credit cards provide unique consumer protection. Should the goods you buy fail to arrive, they are faulty or the company you are buying from goes bust you may be able to claim your money back from your credit card company.
- Some credit cards will give you cash back or air miles for using your card. Others will make a donation to a charity every time you use it.

HOW DO I USE IT?

- Credit cards are issued by banks, building societies and retailers but most are branded either MasterCard or Visa. Other credit card brands include American Express.
- If you use a credit card in a shop you will have to enter a PIN (or sign in some countries) and if you use it online you'll need the three-digit security number on the back of the card. You can also use your credit card to withdraw cash from ATMs although this can be expensive. Credit cards are generally accepted worldwide.
- Credit card users receive a monthly bill detailing what they have spent on the card and any interest charged. You can pay off as much of the bill as you want each month but you must pay the stated minimum payment or you will incur a fee.

3.2.5 DIRECT DEBIT

A Direct Debit is a regular payment debited from your account that you have previously authorized. The transaction is 'pulled' from your account by the company who's provided you with a service, but only because you know in advance the amount you will be debited and the date the payment will happen. Direct Debits are typically used to make regular payments for life, car and home insurance, tax, utility bills and subscriptions. Amounts can vary but you will always know in advance what the amount will be.

ADVANTAGES OF A DIRECT DEBIT CARD

1. For businesses, it is a form of guaranteed payment.
2. Customers don't have to remember payment dates.
3. Customers don't have to write cheques and post them.
4. Businesses can change amount and payment dates.

DISADVANTAGES OF A DIRECT DEBIT CARD

1. Monies are paid even if there is no money in the customer's account. Therefore the customer can incur a bank overdraft at a very high interest rate.
2. Customers may fail to check price increases and budget accordingly.

WHAT WOULD I USE THIS FOR?

- Direct Debits are typically used to make payments for regular financial commitments, for example insurance payments, or utility and mobile phone bills. Businesses like Direct Debits as they have more certainty about when they get their money and it makes their administration more efficient. As a result customers willing to pay by Direct Debit can often find cheaper deals.
- You can also set up a Direct Debit to pay your credit card each month; either the full balance, a set amount or the minimum amount required by your credit card company. In addition you can use a Direct Debit to pay less frequent bills, for example an annual insurance policy.
- You can sign up to a Direct Debit agreement over the phone or online, not just on paper. In those cases, the company you have agreed to pay must provide you with evidence of your agreement for your records.

HOW DO I USE IT?

- You will need to have a bank account capable of making Direct Debit payments; most accounts have this option.
- The company you are paying will need to have an arrangement with their own bank that allows them to collect payments by Direct Debit and ensures they have been rigorously checked.
- You will need to supply the company you are paying with your account details, including name of bank, sort code and account number. They will either take this information over the phone or online, or by using an instruction that you sign and return to them. This will set out the terms of what you are agreeing including the date and frequency of payment (monthly, quarterly, annually etc.)
- The company will then send this information to your bank either electronically or by paper and your bank will then set up the Direct Debit for you.

4.0 CONCLUSION

Payment system is an important aspect of economic development that allows individuals and businesses to engage in transactions with ease. Whichever option is chosen, each has it's merits and demerits and the type of transaction actually determines the preferred payment option.

5.0 SUMMARY

In this unit, we have discussed about methods of payment and the options available. We have also looked at the merits and demerits of each option and how the services could be activated. We have also discussed the processes involved in making use of the options effectively including methods to prevent unnecessary exposure to risk.

6.0 TUTOR-MARKED ASSIGNMENT

7.0 REFERENCES/FURTHER READING

UNIT 4 INSTRUMENT OF PAYMENT IN BANKING

CONTENTS

1.0 INTRODUCTION

Besides payment of customers' cash instrument over the counter, there are a number of methods and instrument used in carrying out customers' payment instrument. In this unit, we shall discuss these systems under bankers draft, standing order, trader's credit, salary payment and dividend/interest warrants. This is to enable you have a clear understanding of their meanings.

2.0 OBJECTIVES

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

- Define and explain the term banker's draft, standing order etc.
- Explain the procedures of issuing bankers draft, standing order etc.

- List the advantages of banker's draft,standing order etc.

3.0 MAIN CONTENT

3.1 BANKERS' DRAFT

A banker's draft may be defined as a payment instrument drawn by a branch of the same bank as drawer on another branch of the same bank as drawee. A bankers draft is not a cheque because the same bank is drawer and drawee; whereas a cheque can be defined as a bill of exchange payable on demand. A bill of exchange however is an unconditional order in writing, addressed by one person (party) to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a future determinable time, a sum certain in money to the order of a specified person or to bearer thereof.

ADVANTAGES OF BANKERS DRAFT

i. It reduces the risk of carrying cash by the customer since a draft is as good as cash.
ii. It provides almost 100% certainty of payment to the third party (payee)since it is drawn by a bank.
iii. The bank ensures adequate security in form of coding, decoding and franking particularly for large amounts.

PROCESS OF ISSUING BANKERS DRAFT

A customer who requires a bankers draft must complete a draft request form. Information to be given in the form includes:

i. Date of request
ii. Name of customer and account number
iii. Value of draft
iv. Payee of draft
v. Place of payment i.e. branch on which draft is to be drawn.
vi. Signature of customer requiring issuance of the draft. It is important to state that the person who signs the draft request form must be an authorised signatory to the account or must be duly authorised in writing by a signatory to the account.

After the completion of the draft request form, which must be backed with customer's cheque covering the value of the draft plus bank charges, the bank staff proceeds to verify signatures on the draft request form and to pay the cheque issued.

3.2STANDING ORDER

A standing order is an instruction given to a bank or building society to authorize deduction for payment of a stated amount, usually on a regular basis. Such payments are transferred to the recipient by the collecting branch. On the day specified, your account will be debited and the money transferred to the person or business receiving the money. Standing orders are typically used to make rent payments, insurance, monthly charity donations or if you want to make a regular payment into a savings account. A standing order amount remains the same, unless you amend your instruction.

ADVANTAGES OF A STANDING ORDER

i. They provide cheap transmission services.
ii. They are convenient means of payment as the customer is spared the need to write cheques and keep tract of outstanding payments.
iii. The onus of making payment at the correct time rests with the bank.
iv. The customer is provided with good record of payment.

DISADVANTAGES OF A STANDING ORDER

i. You have to make sure that there is enough money in your account for the bank to effect the payment otherwise it will be refused.
ii. You have to be careful to remember when the money will be taken out by the bank.
iii. You may also get charged by your bank if you don't have enough money for the standing order.

SELF-ASSESSMENT EXERCISE 1

Outline the advantages and disadvantages of a standing order.

3.3 TRADER'SCREDITS

This system is used by multinational companies such as oil companies and conglomerates to make payment to their numerous creditors. A list of creditors is forwarded to the banks showing their names, banks where accounts are domiciled, their account numbers and amounts to be paid. A single cheque is drawn to cover the total amount involved. On receipt, the document is authenticated, cheque paid and credit transfers carried out accordingly. The paying bank customers' accounts are credited immediately while payment instruments are prepared and forwarded to other branches of the same bank or other banks with list of beneficiaries attached.

ADVANTAGES OF TRADER'S CREDITS

i. Reduced capital requirements, this means that if a new business setting up has trade credit, they will obviously require less money in capital to start up the business.
ii. Trade credit will improve the cash flows and therefore provide smoother operation for the business.
iii. Businesses can look to grow without having to worry of the need to make immediate payments which may set them back.
iv. Businesses can buy now and pay later which means that even if they don't have the money at first, they can purchase items, sell them as a business and then make the payments at the end of the month when the products have been sold and a profit has been made.

DISADVANTAGES OF TRADER'S CREDITS

i. If repayments are not made by certain deadlines, the business will receive a poor credit history which will be a big blow to any business as they will not be trusted in the future if they require any loans, trade credit, credit cards or leasing.
ii. Only companies with a good credit history will get trade credit and these can often be hard to build up, especially for new businesses.

3.4SALARY PAYMENT

Similar to trader's credit is the system used by employers to pay their staff salaries. Rather than issue cheques to individual staff, the corporate customer or institution forwards a list of its staff with details of banks used, account numbers and net salary payable and covers total amount with a single cheque. In some cases, the customer's major bank receives salaries and in turn forwards credit transfers to other banks together with their respective customer's lists. In other cases, the employer forwards separate lists to different banks where the staff operate account and covering them with cheques drawn on their major bank. The cheques are sent for clearing and staff accounts subsequently credited.

ADVANTAGES OF SALARY PAYMENT

i. Saving- The biggest benefit of salary packaging is the potential tax saving. You may be able to incorporate items you would normally buy from your take-home pay into your salary.
ii. Flexibility- You can structure your salary to best meet your needs.
iii. Budgeting- You don't have to sacrifice the whole amount at once. Your sacrifice is spread over a period as specified in your Company's salary packaging policy.

DISADVANTAGES OF SALARY PAYMENT

i. Less take-home pay- Salary sacrifice may save you money overall but your take-home pay will probably reduce. You need to plan for this when you are deciding how much of your salary to package.

3.5DIVIDEND AND INTEREST WARRANTS

Holden (1982) defines dividend warrant as an unconditional order in writing, addresses by or on behalf of a company to its bankers, ordering them to pay on demand a sum of money to a member of the company or his agent, in respect of a dividend due to the member arising out of his holding of shares or stock in the company. Similarly interest warrant is defined as 'an unconditional order in writing addressed by a borrower to its bankers, ordering them to pay on demand a sum of money to a lender or his agent, in respect of interest due to the lender.

Dividend and interest warrants are made in favour of and forwarded by mail to individual shareholders and creditors who in turn lodge these instruments in their bank accounts. In some cases, dividend and interest mandates are executed authorizing the company or creditor to make dividend or interest payment direct to the shareholders' bank.

ADVANTAGES OF DIVIDEND

i. They provide a way for investors to place a large amount of capital that can then be used as a source of income, since it regularly brings in money.
ii. Dividends allow investors to profit from their investment in the company without selling their stock. This means you can look forward to regular returns.
iii. An investor can continue to receive dividend payments from the company as long as the investor continues to hold stock. This can lead to significant dividend payments for a long-term investment, even though you're seeing results over a short-term time frame.

DISADVANTAGES OF DIVIDEND

i. Dividends are not universally available - The Board of Directors is responsible for deciding whether or not a dividend is to be paid out to its investors. However, even if a company makes a significant profit, it is under no obligation to pay a dividend.

ii. Tax repercussions - Dividends are often criticized as being subject to double-taxation, as the company is taxed on its income and the individual shareholder is also subject to paying taxes on the dividendpay-out.

SELF-ASSESSMENT EXERCISE 2

Explain the term Traders Credit.

4.0 CONCLUSION

The importance of instruments of payments in banking has been discussed. We have looked at the types available and how it operates within the banking industry. In the following unit, we shall be looking at modern methods of payment and services available in the banking sector..

5.0 SUMMARY

In this unit, you have learnt the various instruments of payment in banking, their advantages and disadvantages.

6.0 TUTOR-MARKED ASSIGNMENT

7.0 REFERENCES/FURTHER READING

UNIT 5 ELECTRONIC BANKING SYSTEM

CONTENTS

1.0 INTRODUCTION

Banking operation continues to witness improvement in a bit to satisfy the banking public. One of such is the use of electronic devices to perform certain activities that makes the service easier and faster over time. The advent of globalization which made the entire world a global village has equally been of tremendous assistance in this regard. In this unit, we shall examine the various options available for electronic banking services and the methods adopted to do them.

2.0 OBJECTIVES

In this unit, we shall learn about the following:

- The types of electronic devices that can be used for banking services
- The services that are available
- The procedures involved to perform these services

3.0 MAIN CONTENT

3.1ELECTRONIC BANKING USING PERSONAL COMPUTERS

Along with significant growth in the usage of mobile phones in banking practice, personal computers have also come to the fore, which to an extent facilitates and modernize banking service provision. In an information society this communication instrument plays an irreplaceable role and is indispensable for the present day banking sphere. The area of electronic banking realized through personal computers can be divided into home banking, internet banking and mail banking.

3.1.1 INTERNET BANKING

Internet banking can be utilised from the home or the office, as well as an internet café, although the latter isnot recommended for security reasons. In order tohandle your account, a user needs an internet browser (such as Explorer, Firefox, Google chrome etc.). A client cannot avoid visiting the bank though, because he must first ask for an identification code. After opening the bank's web site the client simply selects internet banking and subject to proper identification, can perform passive or active operations. Safety for concrete applications is assured by client authentication, verification of data and data protection by encryption.

Client identification is done using passwords or codes. The client chooses some of these and the bank assigns others. It is recommended to choose a password made up of various types of characters, which can be a combination of numbers, lower case and capital letters, and special symbols. Banks usually protect large volume transactionswith additional security means, such as an encryption (authentication) calculator, or a token, which generates nonrecurring random passwords, which a client types on confirming an order.The token itself is protected by certain security features. Further action will only be permitted or enabled after the client types a four-digit PIN code, whereby the user can change the PIN at any time. In the event of three failed attempts to type the correct PIN, the token blocks itself. After 60 seconds of inactivity a token automatically switches itself off and once switched back on, it again requests the PIN.

3.1.2HOME BANKING

Home banking is a service that enables a bank client to handle his accounts from a computer from a place selected in advance, at home or in the office. The main features of home banking systems are the high level of security, comfort, simplicity of use, openness of the system, wide communication possibilities, networking, definition of users and their rights, automated data transmission and the option to define a combined signature specimen.

A home banking system usually consists of two parts: a bank computer program and a program in the client's computer. The bank program works as the communication server. It receives calls from clients, verifies their identity, receives data from them, authenticates digital signatures, generates digital receipts and sends data to clients. A home banking computer system is a multi-user application, meaning that several of the client's employees can work with it, in particular:

a) Administrator – can define new employees, change rights.

b) Sender – ensures communication with the bank and transmission of prepared data.

c) Accountant – can type payment orders and equally present orders for collection.

b) Viewer – can browse through statements and announcements received.

3.1.3 WAP (WIRELESS APPLICATION PROTOCOL)

WAP is often compared to web pages, although this is a simplification. Unlike pages appearing on a computer monitor, WAP presents its output on a small mobile phone display, therefore concentrating on text information. It is a form of gateway to various services prepared by a mobile network operator or another firm. One condition for using the service is that the client must have a mobile phone supporting WAP technology. Security is again provided by an electronic key. WAP banking is not very popular amongst the banking public however, some banks continue to offer it despite the relatively low number of users.

3.2ELECTRONIC BANKING USING A TELEPHONE CONNECTION

Telephone banking and the first banking services using classic telephone lines for communication date back to thesixties and seventies of the last century. These services grew very rapidly and at the close of the 20th century, mobile phones also started to be used for banking services with the development of information and communication technologies. In this period banks quickly responded to the dawning of a new era in using mobile telephones world-wide and began communicating with their clients through SMS messages. Subsequently, GSM banking became a natural component of electronic banking. Each financial institution offers this under a different name, but the essential product remains the same.

3.21 TELEPHONE BANKING

Telephone banking is the provision of banking services using a classic telephone line. A bank client can obtain the necessary information bydialling a telephone number specified in advance. Before the requested banking service information is provided, theclient’s identity is determined using contractually agreed terms. Using this banking service enables bank clients to obtain information concerning active and passive banking products, but a client can also actively use the bank payment system and request, for example, a payment order or a collection order, open or cancel a term deposit or a current account. In this case a fax connected to the telephone serves as an output communication channel. The client advisor or so-called telephone banker is a bank employee capable of providing any information about products and services and, following verification that he is speaking with an authorized person, can also perform any passive or active operation. He can provide advice to the client and offer other banking products available including new additions to the list of products and services by the bank.

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3.2.2 AUTOMATED TELEPHONE SYSTEM

The technical means necessary to use this system are the same used for communication with a client advisor. A telephone is required, which must have tone dialling or be equipped with an accessory adaptor (tone dialler). An automated telephone system works on the basis of a menu through which clients can move around using buttons on the telephone. The service menu tree is usually designed to be simple so that a choice does not take too long.

More extensive information is sent to the client by fax either to a telephone number agreed in advance or to a number requested by the client during their conversation. Cost efficiency is a major advantage of this service. Some banks offer this service to clients’ free-of-charge because costs are negligible and comfort attached is significant.One disadvantage is that problems can sometimes arise when the client cannot choose a menu item that corresponds with his wishes or the computer responds to an instruction in a way that differs from what the client wanted. However, most users are versed with the use of electronic devices hence can avoid these errors to a large extent.

3.2.3 SMS BANKING

SMS banking uses short text messages sent through the client’s mobile phone. SMS text messages can be used for both passive and active operations similarly with the classic telephone banking. A client can automatically receive information about his account balance: an SMS is sent to the client immediately after a certain operation is performed, or on request: a client sends the bank a correctly formatted message which processes it and answers the client's request by SMS.

Information sent on request mostly concerns current interest rates or currency exchange rates. Providing these is simple for the bank because this is publicly accessible information that needs no protection. A client however can request information about the balance in his account, which is not public information and must be protected when it is provided. Passwords are used for this purpose or technologies based on the principle of an electronic key.

4.0 CONCLUSION

The use of electronic devices for banking services and products has gained wide acceptability amongst the banking public. The level of comfort attached is one of the factors that prompted wide acceptability amongst others. The products available equally are numerous and help customers to seamlessly perform banking operations in the comfort of their homes or offices. The equipment and products available continue to increase and will definitely continue to increase in the foreseeable future.

5.0 SUMMARY

In this unit, we have learnt about the types of electronic devices that banks and customers use for their services and the procedure adopted to perform the tasks including the security measures that needs to be put in place.

6.0 TUTOR-MARKED ASSIGNMENT

7.0 REFERENCE/FURTHER READING

MODULE 2

UNIT 1 OVERVIEW OF THE NIGERIAN FINANCIAL SYSTEM

CONTENTS

1.0 INTRODUCTION

2.0 OBJECTIVES

3.0 MAIN CONTENET

3.1NIGERIAN FINANCIAL SYSTEM

The Nigeria Financial System consists of bodies, institutions and persons engaged in financial intermediation and in the provision of financial services. They include the Central Bank of Nigeria, the apex institution with supervisory role, commercial banks, merchant and development banks, the Nigerian stock exchange, insurance companies and other non-bank financial institutions. Collectively the financial institutions exert far-reaching influence on the economic health of the nation. They determine the rate of economic growth and development and impact greatly on the economic well-being of Nigerians both at the macro and micro levels. The banking system creates the institutional environment and framework for mobilization and channeling of financial resources into productive areas of the economy.

It is on account of the domineering influence of the financial institutions on the overall development of the economy that government exerts control directly by legislation and indirectly through other policy instruments.

The need for control became apparent following massive failure of early financial institutions in the country. The expatriate banks were established to serve the commercial and administrative interest of the colonial masters and most of the early indigenous bank established before 1952 collapsed on account of capital and human resource inadequacies in an unregulated banking environment. The Federal Government of Nigeria provides the legal and structural framework for the overall control of the financial institutions.

3.2FUNCTIONS OF THE FINANCIAL SYSTEM

The primary function of any financial system is to facilitate the allocation and deployment of economic resources, both spatially and temporally, in an uncertain environment. Bodie&Merton (1998) further distinguished five core functions performed by the financial system:

1. Transferring resources across time and space.

A well-developed financial system provides a way to transfer economic resources through time and across geographic regions and industries. Loans help move resources from the future to today, and savings products help do the opposite, but the underlying function for these two seemingly different products is the same. Student loans, borrowing to buy a house and saving for retirement are all actions that shift resources from one point in time to another. The financial system also provides mechanisms to shift resources from one place to another. So, when a person sends money to a family member in a different location, the basic function the movement of resources to him to the recipient.

2. Managing Risk (write this out pls)

3. Clearing and settling payments.

The financial system provides a payments system for the exchange of goods and services. Suppose you live in a country whose government sets a limit on the foreign currency that is accessible. In your country you will be able to pay for your goods and services with the local currency. But if you wish to travel, you will need to use other means of payment. One way of making payments is by barter, which entails exchange of goods without making payments, but with a lot of inconveniences. An important function of the financial system is to provide an efficient way for people and businesses to make payments for the goods and services they wish to buy. Depository financial intermediaries serve this function with wire transfers, checking accounts, and credit/cash cards.

3. Pooling resources and subdividing shares.

The financial system provides a mechanism for the pooling of funds to undertake large-scale indivisible enterprise or for the subdividing of shares in enterprises to facilitate diversification. Suppose you wish to invest in a business that costs $100,000, but you only have $10,000 to invest. Since you cannot possibly divide the business to buy a part of it, you will not be able to make this investment. A financial system corrects this problem by bringing together a bunch of investors and distributing shares to them, thereby dividing the $100,000 investment into smaller economic pieces. Any money the business earns from the race will then be distributed among the shareholders.

4. Providing information.

The financial system provides price information that helps coordinate decentralized decision-making in various sectors of the economy. The clear function of financial markets is to allow individuals and businesses to trade financial assets. An additional function of the capital market is to provide information that assists in decision-making. For example interest rates and security prices are information that households use in making their consumption-saving decisions.

5. Dealing with incentive problems

The financial system provides a way to deal with the asymmetric-information and incentive problems when one party to a financial transaction has information that the other party does not. An efficient financial system reduces these incentive problems. Incentive problems take a variety of forms – moral hazard, adverse selection and principal-agent problems. The financial institutions develop mechanisms to help overcome these problems. For example, they develop ways to take and manage collaterals to address the moral hazard and adverse selection problems.

4.0 CONCLUSION

5.0 SUMMARY

6.0 TUTOR-MARKED ASSIGNMENT

7.0 REFERENCE/FURTHER READING

Bodie, Z. & Merton, R. C. (1998) Finance. Prentice Hall Business Publishing, USA. Preliminary ed.

UNIT 2 EXTERNAL CONTROL OF BANKS

CONTENTS

1.0 INTRODUCTION

2.0 OBJECTIVES

3.0 MAIN CONTENT

3.1THE NIGERIAN DEPOSIT INSURANCE CORPORATION (NDIC)

The NDIC is a regulatory body established by the Federal Government to complement the efforts of the Central Bank in the supervision and regulation of the banking sector. Its major responsibility is to ensure the security of funds deposited in bank accounts by the investing public. It carries out periodic examination of commercial and other licensed banks that accept deposits from the public to ensure that banks comply with statutory requirement with regards to capital adequacy, liquidity, and reserve ratios. It provides insurance cover for customers' deposit in bank accounts.(THIS WRITE UP IS TOO SCANTY PLS)

3.2THE BANKERS COMMITTEE

The Bankers Committee is the apex organization of the banking profession from operational point of view. It is the supreme body in matters affecting banking operations. It has the responsibility of formulating policies and finding solutions to common banking problems arising in Nigeria. The committee is composed of:

i. The Governor of the Central Bank, who acts as the chairman of the Committee and presides over all its meeting.
ii. The Chief Executives of all other banks operating in Nigeria. Policies formulated by the Bankers Committee are binding on the commercial and other banks covered by umbrella organization. It also provides guidelines for the operations of the Clearing House Committee.

3.3THE CLEARING HOUSE COMMITTEE

The Clearing House Committee is composed of:

i. A representative of the Central Bank of Nigeria as chairman.
ii. Five other members drawn from among member banks. The body is charged with the responsibility of controlling the clearing houses, making amendments to the clearing house rules, subject to subsequent ratification by the bankers committee. The committee may also introduce changes in the regulations affecting the day-to-day running of the clearing houses and approves applications for membership in the scheme.

The Nigerian Bankers Clearing House is established in all towns (state capitals and others) where there is Central Bank branch or cash office. The clearing house committee sees to the implementation of all Nigeria bankers clearing house rules. The rules have to do with eligible instruments for clearing purpose, demarcation of clearing areas, duration of clearing periods and procedure for giving value. The clearing rules are changed from time to time to reflect changes in the financial and business environment.

3.4 THE CHARTERED INSTITUTE OF BANKERS OF NIGERIA

The Chartered Institute of Bankers is another super structure, a professional body established by the bankers committee in November 1963 as a local branch of the London institute of Bankers. It has since acquired independent state from the chartered institute of bankers London.

The main objectives of the institute are as follows:

i. To maintain discipline in the banking profession through a disciplinary committee.
ii. To promote banking education with a view to helping staff employed in the banking industry to acquire modern banking techniques and prepare them for higher responsibilities in their various institutions.
iii. To give advice to the government whenever such is requested and collaborated with it in formulating policies for the banking sector.
iv. To facilitate the consideration and discussion of matters of interest to bankers and public.

The Chartered Institute of Bankers of Nigeria serves a useful role of providing common forum for professional interaction of Nigerian bankers. Through its disciplinary committee the institute is expected to sustain in members high standards of professional ethics and compliance with the requisite code of conduct.(THIS IS TOO SCANTY, PLS VISIT THE CIBN WEBSITE FOR MORE DETAILS)

4.0 CONCLUSION

5.0 SUMMARY

6.0 TUTOR-MARKED ASSIGNMENT

7.0 REFERENCES/FURTHER READING

UNIT 3 INTERNAL CONTROL MECHANISM

CONTENTS

1.0 INTRODUCTION

2.0 OBJECTIVE

3.0 MAIN CONTENT

3.1 HEAD OFFICE CONTROL SYSTEM

Banking internal control is maintained through inspection division and by means of periodic returns. The chief security officer of any commercial bank is the chief inspector who heads the inspection division. The division takes responsibility for installation and supervision of all security and operational controls. The major functions of inspection division include:

i. Establishment and management of coding and security system covering payment instruments, inter branch transfers and other sensitive operations.

ii. Unusual events and abnormal matters are promptly reported to inspection division for information and necessary action.

iii. Compilation or updating of bank instruction manual. This is the code of rulesand instructions guiding various operations of the bank.

iv. Monitoring of banking operations through annual inspection and periodic spot checks to ensure that operational rules are observed. Annual inspection reports provide vital information system to the board and top management as well as external regulatory bodies such as the Central Bank of Nigeria.

v. Supervision and control of major installations and changes in operational system and methods. The installation and change of strong room keys for example cannot be effected without involvement of inspection division. Similarly inspection division must supervise a change from manual or mechanical to computerized system at every point and in every branch.

vi. Get prepared for regulatory bodies' such as CBN or NDIC inspection. When these agencies visit the banks, they ensure that the bank complies with laid down procedures and regulations. Violations are usually very costly and in some cases could determine the existence of the bank. Internal control serves to ensure internal compliance to prevent unwarranted penalty and actions by the government.

vii. Be abreast of the rudiments of actions with other banks. In Nigeria, there is an association called the body of Chief Inspector of banks who meet to exchange notes on activities within their domain. Any new thing is taken back to verify how it relates to their bank for immediate attention. A peculiar example is bank fraud and the body makes it mandatory for every bank to report such cases so that every other bank can take necessary precautions. Internal control serves as the platform for ensuring this within the bank.

3.2 CONTROL BY MEANS OF RETURNS

The Board of Director and management of commercial banks obtain direct information and are able to control operations in branches and head office departments by means of periodic returns. Returns which could be weekly, monthly, bi-monthly, quarterly, semi-annually and annually cover all essential operational areas from treasury figures, operating results like statements of assets and liabilities (balance sheet), income and general expenses (profit and loss account) to loan and advances to customers. The returns not only help the board and management of banks to keep close watch over banking operations, they also enable banks render both statutory and other returns (reports) to the Central bank.

3.3CONTROL AT BRANCH LEVEL

The branch manager takes responsibility for the management and control of his branch. He ensures adequate security through controlled movements within the premise and to sensitive areas such as the machine or computer room. Besides physical control of working environment, the manager exerts operational control using the branch diary system. Diary cards are opened for major aspects of branch operations and the manager or his delegate confirms work done by periodic checks and entry on the diary cards. To ensure that individual staff discharges their functions within approved limits and in accordance with bank operational rules the following control measures are usually installed:

1. **Call over of vouchers: -** vouchers that are posted to accounts, whether personal or impersonal are called over at the end of operational day to ensure accuracy of positing. Calling over is particularly indispensable in manual or mechanical operations where operational errors can easily be made.
2. **Balancing of Account: -** All books of account must be periodically balanced. This is a very important control measure. The general ledgers (in manual and mechanical operations) must be prepared and balanced on daily basis. Weekly, monthly and quarterly balancing of accounts must equally be concluded before returns are made to head office. Even in computerized branches where ledger cards are no longer in use the audit trail must show a balanced position. The manager for purpose of effective monitoring and control must personally see abnormality and other sensitive computer reports.
3. **Use of Passwords: -** In computerized branches every computer operator is given a password by the branch manager who makes changes as may be necessary for the purpose of effective control and security.

4. **Spot Checks: -** The manager conducts periodic spot checks on cashiers till, foreign exchange float and clerical staff drawers. Such surprise checks keep staff on alert and reduce to minimum unprofessional and unethical practices.
5. **Control of General Expenses and Overdrafts: -** The branch manager personally approves general expenses whatever the amount. He equally has close surveillance on overdrawn accounts to ensure that approved limits are respected.

4.0 CONCLUSION

5.0 SUMMARY

6.0 TUTOR-MARKED ASSIGNMENT

7.0 REFERENCES/FURTHER READING

UNIT 4 CHEQUE CLEARING SYSTEM

CONTENTS

1.0 INTRODUCTION

2.0 OBJECTIVES

3.0 MAIN CONTENT

3.1 MANAGEMENT OF CLEARING HOUSE

The Nigerian Bankers Clearing House (NBCH) is managed by a committee which consists of the representatives of commercial banks and the CBN. The CBN assigns the chairman of the committee, the clearing house superintendent and the assistant clearing house superintendent. Each member bank appoints a representative to the committee whose position would not fall under the rank of an assistant general manager. Clearing sessions are presided over by the clearing superintendent and the assistants whose decisions are binding on all clearing representatives at any session. Such decisions are however subject to appeal to the senior manager of banking office in the states or the assistant director, clearing office at the CBN head office at the end of the day's session. A member-bank can be suspended from participation in any clearing session for any of the following reasons:

i. If it fails to maintain adequate collateral on daily basis.
ii. If despite a written notice, it fails to provide a qualified or competent representative at the clearing sessions.
iii. If after a written warning the member still contravenes the NBCH rules.
iv. If it is so suspended by the management of CBN for any other reason in the interest of the system.

3.2 DEMARCATION OF CLEARING AREAS

The All Nigerian Bankers' Clearing House rules introduced with effect from 2nd January 1995 demarcated the Nigeria clearing area as follows:

i. Local Clearing Area: -This covers transactions between banks located within a clearing zone as established by the CBN. The area covered is defined by the committee in each state. As earlier stated, each CBN office has a clearing zone located in all states of the Federation though some states have more than one clearing house.
ii. Intra-state Clearing Area: - This covers all clearing transactions between banks located within a state where such banks are not in close proximity with the NBCH in the state as to be covered under local clearing area. (Reframe pls, it is not clear and give an example)

iii. Inter-state Clearing Area: - This covers all clearing transactions between banks located in different states anywhere in Nigeria.

By the All Nigeria Bankers Clearing House Rules that came into effect on 2nd January 1995, clearing instruments presented at the counter of any member bank shall be deemed paid after the date of presentation as follows:

i. Local clearing: - Four clearing sessions that is five working days
ii. Intra-state clearing area: - Eight clearing sessions that is nine working days.
iii. Interstate clearing: - Fourteen clearing sessions that is fifteen working days.

(THIS IS NOT TRUE PLS, UPDATE YOUR INFORMATION PLS)

The Central Bank of Nigeria in consultation with the bankers' committee from time to time make changes in the clearing house rules as may be considered necessary to ensure speedy clearing of instruments. Currently, local clearing period remains four clearing sessions the intrastate and interstate clearing areas have been merged and all up country instruments are now cleared within eight clearing sessions.(NOT TRUE PLS)

3.3OPERATIONAL PROCEDURE

We need to differentiate inward and outward clearing and the procedure for inter branch and interbank clearing.

Clearing generally involves the receipt of house cheques from other branches of the same bank and from other banks for payment, as well as the forwarding or presentation to other branches of the same bank or other banks, their cheques for collection and payment. The fate of all inward clearing instruments, that is, house cheques received from other banks and branches must be determined promptly and must be either paid or returned unpaid withinthe specified period. In the event of non-payment of an instrument, it should be clearly stated on the face of such instrument and must not be at variance with actual fact.

With respect to outward clearing instruments, the procedure is as follows: At the end of the day's banking operations, the clearing officer, supervisor or clerk, sorts the cheques and other instruments paid in by customers. Other banks' cheques are separated from cheques drawn on other branches of the same bank. Cheques drawn on other branches, listed separately in cheque sent for collection schedule and forwarded by internal mailing system directly to respective branches. Each bank has its own documentation requirements and design but the principle is the same.

Other banks instruments are similarly sorted according to drawee banks and these are the instruments that are cleared through the CBN supervised Nigerian Bankers Clearing Houses (NCBH). Clearing sessions at NCBH usually begin around 9.30am. Before reporting to the clearing centre, the bank-clearing representative enters the sorted cheques on presentation forms, bank by bank, and prepares debit notes in respect of cheques returned unpaid. Settlement forms are also prepared and net position for each bank is established as cheques are exchanged during the clearing session.

4.0 CONCLUSION

5.0 SUMMARY

6.0 TUTOR-MARKED ASSIGNMENT

7.0 REFERENCES/FURTHER READING

MODULE 3

Unit 1 Theories of Banking

Unit 2 Principles of Money and Banking

Unit 3 Principles of Bank Lending and Portfolio Management

Unit 4 System of Banking and Essentials of a Sound Banking System

Unit 5 Resources Management and Regulations in the Nigerian Banking Sector

UNIT 1: THEORIES OF BANKING

CONTENTS

1.0. INTRODUCTION

In this unit you are going to learn about the various theories of banking. These theories which are propounded by scholars who, bearing in mind the banks unique type of business, sought to provide solutions on how the business can survive. These theories include the Real Bills Doctrine, the shiftability theory, the anticipated income theory, and the liability management theory.

2.0. OBJECTIVES

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

- State and explain some theories of banking
- Differentiate between the theories of banking
- Identify and explain the weaknesses of these banking theories.

3.0. MAIN CONTENT

3.1. THE REAL BILLS DOCTRINE

The Real Bills Doctrine or the commercial loan theory states that a commercial bank should advance only short-term self-liquidating loans to business firms. In other words, this theory holds that banks should lend only on “short-term, self-liquidating commercial papers. This is for the simple reason that a bank has liabilities payable on demand, and it cannot meet these obligations if its assets are tied up for a long period of time. Rather, a bank needs a continual and substantial flow of cash moving through it in order to maintain its own liquidity, and this cash flow can be achieved only if the bank limits its lending activities to short-term maturities. Self-liquidating loans are those which are meant to finance the production, and movement of goods through the successive stages of production, storage, transportation and distribution. When such goods are ultimately sold, the loans are considered to liquidate themselves automatically. The theory states that when commercial banks make only short-term self-liquidating productive loans, the central bank, in turn should only lend to the banks on the security of such short-term loans. This principle would ensure the proper degree of liquidity of each bank and the proper money supply for the whole economy. This in essence aim at the stabilization of the banking system. The weakness of this theory stems from the failure to realize that the loans are made, given the value of the goods and not the good itself; and also the value of goods itself is subject to variations, given the state of the economy.

3.2. THE SHIFTABILITY THEORY

The Central thesis of this theory holds that the liquidity of a bank depends on its ability to shift its assets to someone else without any material or capital loss when the need for liquidity arises. This theory asserts that if the commercial banks maintain a substantial amount of assets that can be shifted on to the other banks for cash without material loss in case of necessity, then there is no need to rely on maturities. According to this view, for an asset to be perfectly shiftable, it must be immediately transferable without capital loss when the need for liquidity arises. This is particularly applicable to short-term market investments, such as treasury bills and bills of exchange which can be immediately sold whenever it is necessary to raise funds by banks. For example, it is quite acceptable for a bank to hold short-term open market investments in its portfolio of assets, and if a large number of depositors decide to withdraw their money, the bank need only sell these investments, take the money thus required and pay off its depositors. Therefore, the theory tried to broaden the list of assets demand that is legitimate for bank ownership, and hence redirected the attention of banks and the banking authorities from loans to investments as a source of bank liquidity. This implies that the fundamental source of liquidity is the banks secondary resources.

The flaw of this theory is that it may not necessarily be effective for the entire industry in the event of runs or at best be done at very high cost that eventually leaves the industry in no better state. One bank could obtain the needed liquidity by shifting its assets but not so possible when all members of the bank behave the same way (Fallacy of composition). Hence, the problem of liquidity of the whole banking system is simply not solvable by commercial banks alone. This is where a central bank that is prepared to act quickly and decisively is an absolute necessity.

SELF-ASSESSMENT EXERCISE1

What do you understand by the Real Bill Doctrine?

3.3. THE ANTICIPATED INCOME THEORY

According to this theory, regardless of the nature and character of a borrower's business, the bank plans the liquidation of the loan from the anticipated income of the borrower. This theory opines that a bank should make long-term and non-business loans since even a "real bill" is repaid out of the future earnings of the borrower; i.e out of anticipated income. At the time of granting a loan, the banks take into consideration not only the security, but the anticipated earnings of the borrower. Thus a loan by the bank gets repaid out of the future income of the borrower in installments, instead of in lump sum at the maturity of the loan.

SELF-ASSESSMENT EXERCISE2

Differentiate between the Real Bill Doctrine and the Anticipated Income Theory.

3.4. THE LIABILITY MANAGEMENT THEORY

According to this theory, there is no need for banks to grant self-liquidating loans and keep liquid assets because they can borrow reserve money in the money market in case of need. A bank can acquire reserves by creating additional liabilities against itself from different sources. These sources include the issuing of time certificates of deposits, borrowing from other commercial banks, borrowing from the central bank, raising of capital funds by issuing shares, and by ploughing back of profits. Arguing that a bank can use its liabilities for liquidity purposes, the theory opines that it can manage its liabilities so that they actually become a source of liquidity by going out to buy money when it needs it (for paying its demand deposits and meeting loan requests). That is, liability management suggests that the bank borrow the funds it needs by means of various bank-related money market instruments.

4.0. CONCLUSION

The unit discusses four theories of banking which explains how the banks try to survive in an economy as a business entity.

5.0. SUMMARY

In this unit, we have studied about;

- the Real bill doctrine
- the Shiftability theory
- the Anticipated income theory
- the Liability management theory

6.0. TUTOR-MARKED ASSIGNMENT

What do you understand by Shiftability Theory? What are its flaws?

7.0. REFERENCES/FURTHER READINGS

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Unit 2 PRINCIPLES OF MONEY AND BANKING

Content

4.0. Conclusion

5.0. Summary

6.0. Tutor-Marked Assignment

7.0. References/ Further Readings

1.0. INTRODUCTION

Understanding these principles of money and banking does not only helps you understand how the financial system works today in Nigeria, but also gives you an insight into why things go wrong, and what the consequences might be for future events in the economy. The simple principles of money and banking you shall learn in this unit include the principle of time (time has value), the principle of risk compensation, the principle of decision making on the basis of adequate information, the principle of efficient resource allocation by markets, and the principle of stability.

2.0. OBJECTIVES

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

- Describe the importance of timing of payments in banking transactions
- Explain why risks in banking transaction needs compensation
- Describe the implication of a decision taken on the basis of adequate information
- Describe how markets are an efficient way of resources allocation
- Explain the Principle of Stability in banking transaction.

3.0. MAIN CONTENT

3.1.THE PRINCIPLE OF TIME; (TIME HAS VALUE)

The timing of payments is an important part of any transaction. Lenders will demand compensation for parting with their money and getting it back slowly overtime. Borrowers are willing to give this compensation in return for getting the funds today. This is the basis for an interest rate. Furthermore, how long payments are stretched out, and how frequently they occur will be important in determining the value of any financial investment. Value is based on both the SIZE and the TIMING of promised payments.

3.2. THE PRINCIPLE OF RISK COMPENSATION

Risk is pretty much unavoidable, and no one likes it. Putting these two realities together means that people are willing to pay to avoid risk and those who assume certain risks will demand compensation. This is the whole basis of the insurance industry. Therefore, the value of a financial instrument is based on the SIZE, TIMING, and CERTAINTY of payments associated with the instruments.

SELF-ASSESSMENT EXERCISE 1

Explain the assertion that the principle of Risk is the basis of the Insurance Industry.

3.3. THE PRINCIPLE OF DECISION-MAKING ON THE BASIS OF ADEQUATE INFORMATION

At the core of microeconomics is the assumption of rational decision - making. Rational decisions are partly based on using all available information to make a decision. Some decisions are more important than others, e.g. buying a carvs buying your lunch. Some information are harder to gather than other types. Problems can arise especially when one party to a transaction has more / better information than the other party. This asymmetric information problem is a big motivation for financial intermediation by banks, insurance companies and other institutions. One role of financial institutions is to gather and disseminate information so that financial markets can run smoothly.

SELF-ASSESSMENT EXERCISE2

Discuss the principle of time (Time has value) in banking Business.

3.4. THE PRINCIPLE OF EFFICIENT RESOURCES ALLOCATION BY MARKETS.

In economics, we learn about the fundamental problem of scarcity and that most of the time markets are an efficient way to allocate scarce resources. A market sets a price that rations scare resources to those willing and able to pay. In the financial sector, markets will determine what investment projects get funded and what capital stock is built.

3.5. THE PRINCIPLE OF STABILITY

This principle is closely related to the core principle of risks compensation. People prefer the known to the unknown, all things being equal. Therefore when financial institutions offer instruments with stable payments or insurance against variability, and central banks work to create a stable financial system, individuals tend to be better off. That is, stability improves welfare.

4.0. CONCLUSION

This unit throws light on the time value of money, principles of risk compensation and the principle of decision making. It also sheds light on the principles of efficient resources allocation and stability.

5.0. SUMMARY

In this unit, we have learned about;

- the principle of time in banking business,
- the principle of risk management,
- the principle of decision-taking on the basis of adequate information,
- the principle of efficient resources allocation by markets,
- the principle of stability banking business.

6.0. TUTOR-MARKED ASSIGNMENT

Identify and discuss the principles of money and banking you know.

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UNIT 3 PRINCIPLES OF BANK LENDING AND PORTFOLIO MANAGEMENT

CONTENT

5.0.Summary

6.0.Tutor-Marked Assignment

7.0.References/ Further Readings

1.0. INTRODUCTION

In this unit, you shall learn about two major issues. These are the principles of bank lending; and portfolio management. In the principles of bank lending, you shall get to know the guiding principles for banks in terms of advancing loans to customers. The portfolio management on the other hand has to do with the day-to-day management of the total resources (wealth) of the bank.

2.0. OBJECTIVES

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

- describe the principles which banks follow in terms of lending in the economy.
- list and explain each of the principles of bank lending in an economy.
- define and explain the concept of Portfolio management
- state and explain the objectives of portfolio management

3.0. MAIN CONTENT

3.1. PRINCIPLES OF BANK LENDING

Banks follows some principles in terms of lending in the economy. These principles include the following:

a. Liquidity principle

Liquidity is an important principle of bank lending. Banks lend for short periods only because they lend public money which can be withdrawn at any time by depositors. They, therefore, advance loans on the security of such assets which are easily marketable and convertible into cash at a short notice. A bank prefers securities which possess sufficient liquidity. It is essential because if the bank needs cash to meet the urgent requirements of its customers, it should be in a position to sell some of the securities at a very short notice without disturbing their market prices so much. There are certain securities such as government bonds which are easily saleable without affecting their market prices. The shares and debentures of large industrial concerns also fall in this category. Therefore, banks invest in government securities, shares and debentures of reputable companies.

b. Principle of profitability

This is the cardinal principle for making investment by banks. It must earn sufficient profits. Banks therefore, invest in such securities which assure a fair and stable return on the funds invested. The earning capacity of securities and shares depends upon interest rate and the dividend rate and the tax benefits they carry. Banks normally invest in securities that yields more returns than those that yield less returns, all things being equal.

c. Principle of safety of bank funds

The safety of funds lent is another principle of bank lending. Safety means that the borrower should be able to repay the loan and invest in time at regular intervals without default. The repayment of the loan depends upon the nature of security, the character of the borrower, his capacity to repay and his financial standing. Like other investments, bank investments involve risks. But the degree of risk varies with the type of security. Securities of Federal Government are said to be safer than those of the state and local governments. This is because the resources of the Federal Governments are higher than that of the state and local government. The banks always take into consideration the debt repaying ability of the governments while investing in their securities. Political stability, peace and security are prerequisites for this. It is safer to invest in the securities of a government having larger tax revenue and high borrowing capacity than in government securities with less tax revenue. Above all, the safety of bank funds depends upon the technical feasibility and economic viability of the project for which the loan is advanced.

d. Principle of diversity

Commercial banks always follow the principle of diversity in choosing its investment portfolio. Banks invest their surplus funds in a particular type of security but in different industries. They choose the shares and debentures of different types of industries situated in different regions of the country. Diversification aims at minimizing risks of the investment portfolio of banks. The principle of diversity also applies to the advancing of +-loans to varied types of firms, industries, businesses and trades. These principles seek to emphasize the fact that "keeping all eggs in one basket is disastrous". Banks need to spread their risks by giving loans to various traders and industries in different sectors of the economy and different parts of the country.

e. Principle of stability

Another important principle of banks' investment policy is investment in those stocks and securities which possess a high degree of stability in their prices. The bank cannot afford any loss on its securities. It should, therefore, invest its funds in the share of reputable companies where the possibility of decline in their prices is remote. That is why banks normally invest more in debentures and bonds which are more stable than the shares of companies.

SELF-ASSESSMENT EXERCISE 1

Identify and explain the Principles of bank lending

3.2. BANK PORTFOLIO MANAGEMENT

The main aim of commercial banks is to seek profit like any other institution. Their capacity to earn profit depends upon their investments policy. Their investment policy, in turn, depends on the manner in which they manage their investment portfolio. Thus commercial banks investment policy emerges from a straight forward application of the theory of portfolio management to the particular circumstances of commercial banks.

3.2.THE CONCEPT OF PORTFOLIO MANAGEMENT

Portfolio refers to the securities held by an investor or the commercial paper held by a bank or other financial institutions. It could be a group of investments, asset of individual equities, bonds and other marketable assets that the investor owns. Portfolio management involves the principles and procedures by which such assets are managed. Bank portfolio management therefore, refers to the prudent management of a bank's assets and liabilities in order to seek some optimum combination of income or profit, liability and safety. In banking, the parts of a bank's asset portfolio include investments, liquidity, reserves, and loans, and their management involves the total balance sheet.

3.2.1. OBJECTIVES OF PORTFOLIO MANAGEMENT

There are three major objectives of portfolio management which banks follow. These include liquidity, safety and income or profit. These three objectives are opposed to each other. For examples, if the banks seek high profit, they may have to sacrifice some safety and liquidity. If they seek more safety and liquidity on the other hand, they may have to give up some income or profit. The main objectives of bank portfolio management are discussed below.

a.Liquidity

A commercial bank needs a high degree of liquidity in its assets which form one of the cardinal objectives of its portfolio management. The liquidity of an asset refers to the ease and certainty with which it can be turned into cash. The liabilities of a bank are payable on demand or at a short notice. Therefore, it must hold a sufficiently large proportion of its assets in the form of cash and liquid assets for the purpose of profitability. If the bank keeps liquidity as the upper most, its profit will be low. On the other hand, if it ignores liquidity and aims at earning more, it will be disastrous for it. Thus, in managing its investments portfolio, a bank must strike a balance between the objectives of liquidity and profitability. The balance must be achieved with a relatively high degree of safety. This is because banks are subject to a number of restrictions that limit the size of earning assets that they can acquire.

b. Safety

Another objective of portfolio management by commercial banks is safety of their funds / assets. A commercial bank always operates under conditions of uncertainty and risks. It is uncertain about the amount and cost of funds it can acquire and about its income in the future. Moreover, it faces two types of risks. The first is the market risk which results from the decline in the prices of debt obligations when the market rate of interest rises. The second is the risk by default where the bank fears that the debtors are not likely to repay the principal and pay the interest in time. The risk is largely concentrated in customer loans, where banks have a special function to perform, and bank loans to business and bank mortgage loans are among the high-grade loans of these types. In the light of these risks, commercial banks have to maintain the safety of its assets.

c. Profitability

One of the principal objectives of portfolio management by a bank is to earn more profit. It is essential for the purpose of paying interest to depositors, wages to the staff, dividend to shareholders and meeting other expenses. It cannot afford to hold a large amount of funds in cash for that will mean foregoing income. But the conflict between profitability and liquidity is not very sharp. Liquidity and safety are primary considerations while profitability is subsidiary, for the very existence of a bank depends on the first two.

SELF-ASSESSMENT EXERCISE 2

Define and explain the concept of Portfolio Management

4.0. CONCLUSION

The unit discusses the principle of bank lending and the management of the portfolio of the bank which are very cardinal to the successful management of a bank and its profitability in the economy. In specific terms the unit recognizes liquidity, profitability, safety, diversity and stability among the banking lending principles while liquidity, safety and profitability are considered crucial objectives of portfolio management.

5.0. SUMMARY

In this unit, we have learned about the principles of bank lending and the portfolio management of a bank. While the principles of bank lending guide the lending activities of the bank, the portfolio management helps the bank in managing the resources (portfolios) of the bank.

6.0. TUTOR-MARKED ASSIGNMENT

Enumerate and discuss the objectives of Portfolio Management

7.0. REFERENCES/FURTHER READINGS

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UNIT 4SYSTEMS OF BANKING AND ESSENTIALS OF A SOUND BANKING SYSTEM CONTENTS

3.1.3. Group banking

3.1.4. Chain banking

3.1.5. Correspondent banking

3.1.6. Universal banking

3.1.7. Electronic banking

3.2. Essentials of a Sound Banking System

3.2.1. High degree of Liquidity

3.2.2. Safety of Bank's money

3.2.3. Profitability

3.2.4. Stability of the system

3.2.5. Efficient Reserve management

3.2.6. Expansion

3.2.7. Sufficient Elasticity

4.0. Conclusion

5.0. Summary

6.0. Tutor-marked Assignment

7.0. References/ Further Readings.

1.0. INTRODUCTION

The countries of the world practice different banking systems. The type of banking system practice by any country depends on the banking rules and regulations, the size of the economy and the level of development of the banking and the financial system of the economy among other factors. The most common banking systems in most developed and developing countries of the world includes the Unit banking, Branch banking and Corresponding banking. Others include Universal banking, Group banking, and Chain banking among others. You shall also learn about the essentials of a sound baking system in this Unit.

2.0. OBJECTIVES

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

• identify and explain each banking system

• mention and explain the advantages and disadvantages unit banking

• enumerate and explain the advantages and disadvantages of branch banking

• list and discuss the essentials of a sound banking system

3.0. MAIN CONTENT

3.1. SYSTEMS OF BANKING

In this unit, we are going to look at the following systems of banking, unit banking, branch, group, chain banking and correspondent banking.

3.1.1. UNIT BANKING

Unit banks are independent, one-office- banks. Their operations are confined to a single office. The unit banks operate in small towns, cities and rural areas in Nigeria. Examples of Unit banks in Nigeria are the community banks and other banks that exists only in particular communities that established them without any branch anywhere. The existence of unit banking in the USA is due to legal restrictions which prevent the growth of monopoly in banking. Some unit banks have grown to large sizes but they operate under severe restrictions which limit or prohibit the establishment of branches particularly in the U.S.A.

Advantages of Unit Banking

Unit banks, being independent and one-office-banks, possess certain advantages which include:-

i) The provision of prompt and efficient services to customers

ii) Personal relations with the people (Since its organizers and staff are local people) which help in mobilizing large resources for the bank.

iii) Meeting the financial needs of the people promptly and efficiently because of the usual on-the-sport decision making by the banking management.

iv) Enjoying the advantages of branch banking as they are connected with a big bank through correspondent banking system.

Disadvantages of Unit Banking

Some of the disadvantages of unit banking include;

i) Failure to spread risks as the unit banking operations are localized in a particular area, the failure of customers to repay loan in time may bring disaster to the bank.

ii) Limited resources at its deposal which always leads to bank failure during financial and economic crisis.

iii) Non-diversified banking services to its customers because of its inability to establish branches and higher cost of operations.

iv) Absence of economies of large scale operations. The unit banking system cannot have advantages of large scale banking because it cannot recruit more efficient and highly paid staff, and cannot enjoy the economies of large scale and intensive specialization and division of labour.

3.1.2. BRANCH BANKING

Under this banking system, a big bank has a number of branches in different parts of the country and even outside the country. The branch banking is the most prevalent banking system in most countries of the world. In Nigeria, all the commercial banks quoted in the stock exchange market have at least a branch in almost all the 36 states of the federation including the Federal Capital Territory Abuja.

Advantages of Branch Banking

The branch banking system has many advantages which make this system superior to the unit banking system. Some of the advantages of this system include;

i) Advantage of spreading risks geographically and industrially. If branches in particular area suffers losses due to recession in industries located there, the losses can be offset by profits from prosperous areas.

ii) Enjoys the advantage of large scale organization because a large bank is able to recruit efficient and trained staff and pay better than unit banks. It also enjoys the advantage of specialization and division of labour.

iii) Under this system, the bank enjoys the advantage of diversification of banking operations. Big banks can provide banking facilities to trade, industry, businessmen and the lower income group at cheaper rates and more efficiently than unit banks because they possess larger financial resources.

iv) The Central Bank of the country can control the banks more effectively under the branch banking system than under the Unit banking system. It is easier to control the credit policies of a few banks than those of numerous unit banks.

Disadvantages of Branch Banking

The branch banking system has also some disadvantages which include the following;

i) Delay in decision taking under the branch banking system: There are bureaucratic procedures in decision making and the management of all the branches is under the control of the head office. This leads to delay in taking prompt decision by the branch managers. They have to refer all cases above certain limit for advance to the head office.

ii) Inability to meet the need of local business communities: The branch managers are not able to meet the borrowing needs of the local business community as efficiently and sympathetically as the unit banks. This is because the branch bank managers stays in one locality and have to operate under rules set by the head office. He may not know the needs of the customers at different branches and also may be concentrating more on bigger industries at the detriment of small scale businesses in the rural areas.

iii) Fear of loss: When branch banking spreads on a large scale, some of the branches may run under losses due to bad debts and low mobilization of deposits. Such situation may lead to huge losses to the bank which could lead to its failure.

iv) In adequate supervision: As the big bank has a number of branches spread throughout the country, it is difficult to manage and supervise them effectively and efficiently. The control become relax, the banking services suffer and the clients are equally affected.

v) Unhealthy competition: Branch banking leads to competition among different banks in establishing branches at various places. This tendency leads to unnecessary increase in expenses.

SELF- ASSESSMENT EXERCISE1

Define Unit Banking and discuss its advantages and disadvantages.

3.1.3. GROUP BANKING

Group banking is part of the banking system in Nigeria. It is a type of multiple office banking consisting of two or more banks under the control of a holding company, which itself may or may not be a bank. The parent company controls and manages the operating banks under the group but each bank continues to keep its separate entity or name. The parent company pools the resources of the group and helps the group banks to make large loans and advances. An example of group banking in Nigeria is the Union Group which is made up of Union Bank of Nigeria Plc (Banking), UBN Merchant Bank (Merchant Banking), Union Assurance Co. Ltd (Insurance), Union Trustees (Trusteeship), and Union Homes Savings and Loans (Mortgage).

3.1.4 CHAIN BANKING

Chain banking is a system where some individuals or group of individuals control one or more banks, as against control by a holding company under group banking. Chain banking results when an individual, family or some other close association of persons controls the operations of two or more banks. It occurs when a syndicate or other small group of individuals with common interest own more than two banks. Chain banks are controlled through directors, and a recognized organization hierarchy beyond that of individual banks. A principal "key" bank frequently coordinates the management of the entire group and also serves as the depository for required reserves of state chartered holding company banks.

3.1.5. CORRESPONDENT BANKING

It is a bank which acts as agent for another bank in a place where the latter has no office, or for some reasons, is unable to conduct certain operations for itself. All banks with overseas business require correspondent banks abroad, and the arrangements are usually reciprocal with each party maintaining balances with the other. Correspondent banking is a familiar banking feature in the U.S.A and Nigerian financial systems. The U.S.A is geographically a big country where there are thousands of banks which operates in restricted areas. The various types of banks are able to operate efficiently through a correspondent relationship with one another. The country banks have deposits with city banks and city banks have deposit in the state banks in the same and other cities. The centre of correspondent banking is the New York city, followed by Chicago and other regional centres in big American cities. Many banks have deposits in more than one centre and correspondent banks in one centre have correspondent relations with banks in other centres.

When a small bank maintains its deposits with a big correspondent bank having a network of branches, the later provides such services to the former as extending large credit facilities, facilitating foreign exchange transactions, cheque clearing and collection, purchase and sale of securities etc. It also provides a wide range of other services to small banks which include reports on the state of the economy, advice on portfolio management, etc. In Nigeria, this kind of relationship between banks may exist between big commercial banks and Peoples Banks on one hand and between commercial banks and Community Banks on the other hand. The peoples Banks and the Community banks are not commonly found everywhere, so they resort to the use of some commercial banks as their corresponding banks.

SELF-ASSESSMENT EXERCISE2

Describe Branch Banking and explain its advantages and disadvantages.

3.1.6. UNIVERSAL BANKING

Globally, Universal Banking (UB) is increasingly becoming the major route to doing banking as there appears to be a shift in the practiceof providing customers with only isolated banking services to that of providing them with a supermarket where all financial services are available. Universal banking refers to the combination of deposit-taking, the making of advances and conducting stock exchange business all under the same roof. Banks involved accept deposits of all sizes for the most varied terms, grant short, medium and long-term credit to the business sector and private customers, and at the same time carry on securities business on a more or less wide scale; handle payment transactions; finance imports and exports, and deal in foreign exchange, notes and coins.

The Central Bank of Nigeria in its draft guideline for the adoption of universal banking practice in August 2, 2000, defines universal banking as "the business of receiving deposits on current, savings or other accounts paying or collecting cheque drawn or paid in by customers, provision of finance, consultancy and advisory services relative to corporate and investment matters, making or managing investments on behalf of any person and the provision of insurance, marketing services and capital market business or such other services as the Governor of the CBN may by regulation designate as banking business". Banks under the universal banking programme can choose to undertake one or a combination of the following; clearing house activities, underwriting/issuing house business and insurance services.

Universal banking simply connotes collapsing the various regulatory divides that separate commercial and merchant banking activities. In other word, it is all about creating a level playing field for both commercial and merchant banks.

Historically, commercial banking, in line with its retail orientation, involves general commerce and by implication, a credit policy that favours short-term finance. On the other hand, merchant banking or investment banking is about wholesale banking involving provision of long-term finance to fund users. On this basis of specialization, banks concentrate on one of the following -wholesale banking, retail banking, private banking, savings and loan mortgage among others. However, under universal banking, authority is given to banks to decide on their portfolios of business, select appropriate delivery channels and infrastructure within an applicable regulatory framework. The distinction between money, capital market and insurance business is removed. The most important issue in this system is the fact that the statutory / regulatory dichotomy between commercial and merchant banking activities is dismantled and the difference between banks in terms of functions and activities will only exist as a matter of choice rather than by reason of regulatory barriers.

The concept of universal banking came into operation in Nigeria in November, 2000. The universal banking system introduced in Nigeria was meant to result into huge finance conglomerates where any or all of the following services may be offered. Retail (Commercial) banking, Cheque clearing, Funds management, Investment (Merchant) banking services. Financial advisory services including; Financial consulting; Unit trusts; Mutual funds; Mortgage finance, Securities trading including derivation, Under writing business, Insurance (life and general), Trusteeship accounts, Pension funds, and Credit cards.

3.1.7. ELECTRONIC BANKING

Electronic banking which is more commonly called the Electronic Funds Transfer System (EFTS) refers to the application of computer technology to banking especially the payments (Deposit transfer) aspects of banking. The major distinction are the pieces of hardware used in performing the function such as Automated letter Machine (ATM), the Point of Sale (POS) system, and the Automated Clearing House (ACH).

An ATM can perform most of the routine banking functions that are now done by bank tellers. Deposits can be made, funds withdrawn, funds transferred between savings and current account etc. The customer operates the ATM by using a plastic card plus a Personal Identification Number (PIN) know only to himself.

The POS involves a computer terminal in retail stores that will transfer funds instantly from the bank deposit of the customer to the bank deposit of the store in which he is making purchase. In the process, the computer will verify that the customer has sufficient funds to cover the purchase, and will inform the customer of the new bank balance. The customer can also arrange for overdrafts at the bank, so that “instant loan” (Up to a pre-set limit) can be made.

On the other hand, the ACH is largely designed to transfer funds among banks electronically, although customers may also become involved. For example, a company may, with the authorization of its employees' record its monthly pay roll on electronic tape. The company then takes this tape to its bank and that bank then uses the tape to deposit (in other banks) salaries directly to the credit of the employees. The ACH can also be used for preauthorized payments of a recurring nature, e.g. instance premiums. The major merit of electronic banking lies in its ability to reduce costs given the number of cheques written in the economy each year.

3.2. ESSENTIALS OF A SOUND BANKING SYSTEM

The essentials of a sound banking system are regarded, as its liquidity and profitability. The secret behind any successful banking business is to distribute resources between the various forms of assets in such a way as to get a sound balance between liquidity and profitability.This process the bank to have cash (at hand or quickly realizable) to meet every claim, and at the same time enough income for the bank to pay its wages and earn profits for its shareholders. In addition, some of the essential issues that modern banks also consider for a sound banking system include the following:

3.2.1. HIGH DEGREE OF LIQUIDITY

One of the essentials of a sound banking system is to have a high degree of liquidity. The bank holds a small proportion of its assets in cash. Therefore, its other assets must possess the criterion of liquidity so that they may be turned to cash easily. This is only possible if the bank possess such securities which can be easily liquidated. The CBN has made it mandatory for commercial banks to keep a certain proportion of their assets in cash to ensure liquidity.

3.2.2. SAFETY OF BANK'S MONEY

Safety of banks' money is another essential feature of a sound banking system. Since the banks keep the deposit of the people, it must ensure the safety of their money. Therefore, the banks are expected to make safe loans and investments and avoid unnecessary risks. If the debtors of the banks do not repay the loans on time and the banks lose their investments, the banks in the system will become insolvent. As a result, depositors in the system lose money and suffer hardship. Thus, the banks must ensure the safety of deposits in the system

3.2.3. PROFITABILITY

A sound banking system should be able to earn sufficient profits for the shareholders. Profits are essential for individuals and the entire system to be viable. Individual banks should be able to pay corporation tax like any other company, pay interest to its depositors, dividend to shareholders, salaries to the staff and meet other expenses. Therefore, unless the banks earn, they may not operate soundly in the system. For this purpose, it must adopt judicious loan and investment policies.

3.2.4. STABILITY OF THE SYSTEM

A sound banking system must be stable. It should operate rationally. There should neither be undue contraction nor expansion of credit. If the banks restrict the creation of credit when trade and industry need it most, it will affect the interests of the business community negatively. On the other hand, if it expands credit when the economic conditions do not permit such, it will lead to boom and inflation. The CBN help in achieving stability with the banking operations of the commercial banks by a judicious credit control policy.

3.2.5. EFFICIENT RESERVE MANAGEMENT

A sound banking system should be able to possess efficient reserve management ability. A bank keeps some amount of money in reserve for meeting the demand of its customers in case of emergency. Though the money kept in reserve is idle money, yet the bank cannot afford the risk of keeping a small amount in reserve. There are however, some statutory limits laid down by the Central Bank in maintaining minimum reserves with itself and with the Central Bank. However, how much reserve money should a bank maintain is governed by its own wisdom, experience and the size of the bank. The bank should manage its reserve policy effectively and efficiently without keeping too much or too little cash. It has to balance both profitability and safety.

3.2.6. EXPANSION

A sound banking system must be spread throughout the country. It should not be concentrated only in big towns and cities but also in rural localities. It is only by widespread expansion of the banking system that the deposits can be mobilized and credit facilities can be made available to trade, industry, agriculture, etc. This is especially in developing countries where the banking system must provide these facilities through its expansion in all areas.

3.2.7. SUFFICIENT ELASTICITY

The elasticity of banking operations should have sufficient elasticity, in its lending operations. It should be in a position to expand and contract the supply of loanable funds with ease in accordance with the directives of the Central Bank of Nigeria.

4.0. CONCLUSION

The countries of the world practice different banking systems and the soundness of the banking sector of the countries varies from country to country. This unit highlights systems of banking varying from Unit banking, Branch banking etc to Electronic banking. It also discusses essentials of a sound banking system.

5.0. SUMMARY

In this unit, you have learned about,

- Systems of banking
- Advantages and disadvantages of unit banking
- Advantages and disadvantages of branch banking
- Essentials of a sound banking system

6.0. TUTOR-MARKED ASSIGNMENT

Discuss the essentials of sound banking system.

7.0. REFERENCES/ FURTHER READINGS.

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UNIT 5 BANK RESOURCES MANAGEMENT AND BANK REGULATIONS IN NIGERIA.

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1.0. INTRODUCTION

In a sense, the dual purpose of banking is to provide the needed banking services, and to earn an appropriate return on the capital investment. These needed banking services reflect recognition of a bank's obligations to its customers and depositors, its shareholders, its staff, and the community and hence must play its part in making the needed aid and justifiable credit available.

In addition, its obligation must look beyond local considerations, and conscientiously shape its institutional policies and practices to conform to the national pattern of monetary policy. The mission of a bank is the task of accomplishing such objectives with due regard for the conditions and constraints that must be observed, and in accordance with accepted criteria of successful accomplishment.

In fulfilling these tasks, the bank consciously manages its human resources, cash, credit, working capital and inventories judiciously and efficiently on daily basis. In this unit, you will learn about how banks manage these available resources and also expose you to the concept of bank regulation and bank fraud in Nigeria.

2.0. OBJECTIVES

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

- Discuss how banks manage human, working capital, cash, credit and inventory resources.
- Define and explain the concept of Bank Regulation
- State and explain the objectives of Bank Regulations in Nigeria
- Identify some Banking Laws and Regulations in Nigeria
- Discuss the benefits and problems of Bank Regulations in Nigeria.
- Define and explain the concept of Bank Fraud
- Identify and explain the types of Bank Fraud

3.0. MAIN CONTENT

3.1. BANK RESOURCES MANAGEMENT

Here, we are going to be looking at the type of inputs that are pooled together to achieve pre-determined results within the banking sector. We will be looking at human resource management, working capital management, cash, credit and inventory management.

3.1.1. HUMAN RESOURCE MANAGEMENT

Personnel Management is an important component of Human Resources Management (HRM). In practice, the two are frequently interchanged emphasizing the fact that the people employed in a bank or company are resources which are at least as important as financial material resources and must be given careful expert attention. Personal Management is the responsibility of all those who manage people, as well as being a description of the work of those who are employed as specialist (Nmadu, 1991:1). It is the part of management which is concerned with people at work and with their relationships within a bank or an enterprise. Through human resources management, banks seeks to bring together and develop into effective organization the men and women who make up an enterprise, enabling each to make his own best contribution to its success both as an individual and as a member of a working group. It seeks to provide fair terms and conditions of employment, and satisfying work for those employed. In managing human resources in the bank, it requires that employees be treated as important resources to be invested in prudently, to be used productively, and from them a return can be expected that should be monitored wisely.

Human Resources Management plans, develops and administers policies and programmes to make expeditious use of the banks' human resources. The major role that human resource management plays in the management of banks includes planning, staffing, development and maintenance. In the aspect of planning, human resource management in banks involves the planning of organizational goals and objectives, job analysis and human resources. In the area of staffing, it recruits and select staff. Besides, development in this respect, involves activities like orientation, training and development, performance appraisal, career planning etc. Finally, the activities that are involved in maintenance include compensation, benefits, safety and health, labour relations etc.

3.1.2. WORKING CAPITAL MANAGEMENT

Working Capital can be defined as the excess of current assets over current liabilities. It is the same as Net Current Assets. It represents the investments of a company's medium and long-term funds in assets which are expected to be realized within the year's trading. It is not a permanent investment, but as the name implies is continually in use, being turned over many times in a year. It is used to finance production, to invest in stock and to provide credit for customers. The more of a business finance invested in working capital, the less is available for investing in long-term assets such as buildings, plant and machinery.

In the management of working capital, at least three questions need to be considered. First, what size of investment should be allocated to the different forms of current assets? Second, what proportions of these current assets should be financed respectively by short-term and long- term funds? Third, what proportion of the total assets should be in the form of current assets, and what proportion in fixed asset? The successful control of working capital or cash depends on detailed budgets, which must be as accurate as possible. These are needed for planning balance sheets and profits and loss accounts, and consequently it is common practice for the conventional budgetary system to include estimates of the component parts of working capital. All that is needed for the management of working capital as a whole is that the parts should be put together. The size of the cash balance that a company might need depends on the nearness or availability of other sources of funds at short notice and the control of debtors and creditors – a crucial factor for short-term financial planning.

3.1.3. CASH MANAGEMENT

There are no simple rules to govern decisions concerning the amount of cash a firm should have on hand or short call at a bank. Part of the difficulty is that such decisions involve management’s subjective attitude to the risks ahead. The more cash that is on hand, the more easily the company can meet its bills when they are due for payment. By carrying a quantity of cash or processing securities at short call, the company is buying peace of mind. On the other hand, the more cash the company can invest or put to work within the business, the greater will be the profits it earns. However, if it does not retain a sufficient amount of liquidity, the company can lose the opportunities to take advantage of discounts and perhaps, because of late payments, lose suppliers. Management must therefore balance liquidity with profitability.
There are three basic reasons why a company would wish to hold some of its assets in the form of cash or cash equivalent. These reasons according to economic theory are;

- Transaction motive,
- Precaution motive, and
- Speculative motive.

One explanation often given for holding cash is that any profitable opportunities that arise can be met immediately. This motive may be strong in the case of a company that exists primarily for speculative purposes. To hold cash or near cash has a cost, which is the earnings that could have been obtained through using the funds elsewhere. The company has to ensure that the gains from the possible speculative opportunities are greater than the earnings from normal investment opportunities. Determining the amount of cash a firm needs at a point in time is not an easy matter. As already explained, if a bank has too little cash, it can run into liquidity difficulties, if it has too much cash, it will be missing opportunities to earn profits. The problem is to determine the appropriate amount of cash to hold at any point in time. The key statements by which management can be kept informed about the cash position of the company are the cash budget and the cash -flow statement. It is necessary to have these informative statements as quick as possible and as up to date as possible, so that action can be taken on the figures. The cash budget involves estimating what the inflow and outflow of cash will be at fixed intervals over the next planning period.

3.1.4 CREDIT MANAGEMENT

Credit Management is an important part of Financial Management. The credit issuing policy of a company should include several questions that aids prudent credit decision making. For instance, to whom should credit be extended to? How much credit should be allowed (at individual level and in total), how long should the credit be for? And what is to be done about defaulting debtors? The objective of the company is assumed to be to choose the credit policy that, taken into conjunction with its other policy decisions, maximizes the expected profits of the company. It may well be that the credit policy cannot be formulated without reference to constraints. The liquidity position of the company presents an obvious constraint, and production capacity, management capacity, and risk may define others. The problem is thus a programming problem in form, but it is, even in principle, so involved that a complete vigorous and general formalization would not be useful from the operational point of view. Some of the data that would be required for such model illustrates this difficulty.

The company needs to know the probability of sale to each potential customer as a function of the credit terms offered to him and the expected timing of the payments received from the customers. The choice of which customers to advance credit to, is really a question of the level of risk of non-payment that is considered acceptable. With every credit or sale, there is some risks that the customers will not be able to pay, but with most large banks or companies, the risk may be small. However, with small illiquid banks or companies, the risks of non-payment might be so high.

3.1.5. INVENTORY MANAGEMENT

An inventory policy is a set of decision rules which determine the size and timing of replenishment orders and what to do in a stock out situation. The policy issue here is that an order for replenishment is placed when inventory fell to or below the re-order level and the size of replenishment is fixed. The re-order level policy calls for continuous monitoring of inventory level. The periodic review policy retains the concept of a re-order level but stock on hand is not constantly known, there are periodic stock takings. If at the time of stocktaking inventory is at or below the re-order level a replenishment order, of fixed size, is placed. Otherwise there is no re-ordering. An efficient inventory policy is always an important requirement for the successful management of banking, manufacturing and distributing enterprise. Usually a fraction of the total assets of these companies are in the form of stock, so that improvement in stock control policy can bring major benefits for companies. Any idle resource may be thought of as an inventory. Rather more vividly, stocks have been described as “money in disguise”. Indeed the stock may be of money itself, as in the case of holdings of cash.

In terms of physical goods, it is conventional to distinguish three types of inventory.

- Pre-production inventory
- In- process inventory
- Finished goods inventory

Pre- production inventory is a raw material or other inputs secured from outside the firm. In-process inventory is work-in-progress (Possibly at several stages in the production process) and finished goods are the products of the enterprise awaiting sale. The purpose of inventory is to allow each stage of the production and distribution system to operate economically by insulating it from different or varying rates of activity at other stages. The most obvious illustration of this is the role that finished goods inventory plays as a cushion between production and sales. Even if the rate of sales is predictable and steady, it may be uneconomical to produce continually at just that rate while if demand is erratic, it would be nonsense to keep changing the rate of production. The entire production process usually needs insulating from irregularities in the arrival of suppliers. This is the main function of pre- production or raw material inventory. In times of inflation, there may be a speculative role too.

SELF-ASSESSMENT EXCERCISE1

Discuss how Human Resources, Working Capital, Cash and Credit are managed by banks

3.2. BANK REGULATIONS IN NIGERIA

Bank Regulation refers to the supervision and control of the banking sector by government in the interest of economic efficiency, fairness, health and safety of the banking system in the country. Regulation may be imposed simply by enacting laws and leaving their supervision to the normal process of the law, by setting up special regulatory agencies or by encouraging self-regulation by recognizing, and in some cases delegating powers to bodies or agencies. Regulation in the banking sector is ultimately aimed at the "safety and soundness" of the banking institutions, the protection of depositors' money, the shareholders' investments and the effective implementation of government monetary and other policies in the economy.

In Nigeria, there is evidence that over the years, the banking laws and regulations tended to make operations of commercial and merchant banks uniform. For example, while in 1979, the amendment to the repealed 1969 Decree made wholesale banking and medium-term lending as the main functions of Merchant Banks; the Banks and other Financial Institutions Decree of 1991 was silent on the role of Merchant Banks in wholesale banking and medium to long-term lending. Furthermore, the prescribed proportion of loans to medium and long-term enterprises was reduced from 50% in 1979 to 20% in 1991 and was abolished in 1996.

Similarly, the prescribed minimum deposit accepted by Merchant Banks was reduced from N50,000 in 1992 to N10,000 since 1994. These legal and regulatory changes continued in the banking sector until the adoption of universal banking in 1999 and subsequently bank consolidation in 2004. The changes in the laws and regulations were responses to the pressures mounted by the banking institutions to be allowed to expand the scope of their activities. Since the establishment of the CBN in 1958, the other major regulatory measure that had been taken was the establishment of the NDIC in 1988.

3.2.1. OBJECTIVES OF REGULATION OF THE NIGERIAN BANKING SYSTEM

The objectives of bank regulation and the emphases, varies from one country to another. In Nigeria, some of the objectives of regulating the banking sector include the following:

i. To achieve public policy objectives of financial stability, high economic growth, price stability, full employment levels of output, and a balance of payments equilibrium position.
ii. To ensure that adequate services are provided at reasonable costs to the public and that the services reach the people at reasonable low costs.
iii. To provide safety for depositors.
iv. To protect investors from fraud and deceit.
v. To limit the risk taken by banking financial institutions.
vi. To preserve the liquidity and ensure the solvency of the banks.
vii. To build confidence in the public and hence promote savings mobilization and investment.
viii. To promote a highly competitive financial market.
ix. To prevent unhealthy proliferation of banking institutions.
x. To prevent bank failure and help to build confidence in the public.
xi. To ensure that resources are allocated into their most efficient and profitable uses.
xii. To improve the flexibility of financial institutions to respond to the challenging needs of individuals and businesses.
xiii. To preserve a sound and resilient financial system.
xiv. To maintain a base for effective monetary policy.
xv. To promote a stable and growing standard of living.

3.2.3. SOME LAWS AND REGULATIONS IN NIGERIA

Some of the regulations/ legislations affecting the Nigerian Banking System are enumerated below. You should note that by this enumeration, these bank laws and legislations in Nigeria are not exhaustive.

1. The Banking Ordinance of 1952; which provided for the licensing of banks and prescribed a mandatory minimum capital requirement of N25,000 for the banks to operate in the country.

2. The Central Bank of Nigeria, Act 1958; this provided for the establishment of the CBN as an apex financial institution to regulate and control the commercial banks and other banks or financial institutions.

3. Banking Decree of (Acts), 1969; this provided for the regulation and control of the monetary and financial system. It made provision for granting of licenses to banks before they can carry on banking business in the country and also imposed restriction on certain activities of licensed banks. It also empowered the CBN, among other things, to prescribe the licensed banks' minimum holding of cash reserves, specified liquid assets, specified deposits and stabilization securities.

4. Banking (Amendment) Act, 1970; this provided sundry amendments to the CBN Act of 1958, including approval required before the award of certain banking activities and the determination of the salaries and allowances of the employees of the CBN.

5. Banking (Amendment) Act, 1972; this further amended the CBN Act of enable the CBN to grant advances to commercial banks which incur deficits in their clearing operations. Some other Nigerian banking laws and regulations are listed below to include:

a. Money Laundering Act (PROHIBITION) Act No.7, 2003.
b. Banks and other financial institutions Decree 25, 1991 Act CAP. B3 L. F. N.
c. Nigerian Bank for commerce and industry Act CAP. 296 L.F. N 1990 Act CAP. N92, L. F. N 2004.
d. Peoples Bank of Nigeria Decree No. 22 1990 Act CAP. P7 L.F.N 2004.
e. Revocation of Banking license S. I 1 2003.
f. Nigerian Education Bank Decree No. 50 1993 Act CAP. N104 L.F.N 2004.
g. Urban Development Bank of Nigeria Act. U16 L. F. N 2004.
h. Community Banks Decree No.46 1992 Act CAP. C18 L. F. N 2004.
i. Nigerian Export Import Bank Decree No. 38 1991 Act CAP. No.106 L. F. N 2004.
j. Federal Savings Bank Act CAP. 142, L. N. F 1990 Act CAP F20 L. F. N 2004.

3.2.3. BENEFITS OF BANK REGULATIONS IN NIGERIA

Banking regulation is expected to yield some benefits not only to the banking industry, but to the entire economy. Some of the benefits of bank regulation in Nigeria include the following:

i) It prevents bank runs and avoidance of the resulting losses to depositors and to banking institutions.
ii) Reduction of fraud, gross mismanagement, and excessive risk-taking by some managers of banks.
iii) Reduction of some possible aspects of centralized power and self-dealing should this occur were banks unconstrained as to location and products offered to the public. – NOT CLEAR PLS
iv) Greater and efficient allocation of resources than in the absence of laws and regulations.
v) Enhances confidence in the banking system.

3.2.5. PROBLEMS OF BANK REGULATION IN NIGERIA

i. Consumers tend to be major losers since they bear the cost of reduced competition in the form of higher prices and or poor services.
ii. The regulated institutions bear costs also from two sources; first, the cost of complying with the regulations such as supervision and examination, and secondly, the cost of being prevented from organizing their activities efficiently and offering products that customers want.
iii. It entails movement away from free competition and toward greater costs or suboptimal portfolio.
iv. It limits innovations in the banking system and banks also attempt measures to evade the supervisory/ regulatory structures.

SELF-ASSESSMENT EXERCISE2

Define and explain the concept of Bank Regulation.

3.3. THE CONCEPT OF BANK FRAUD

Fraud, generally, refers to an act or course of deception deliberately practiced to gain unlawful or unfair advantage; such deception directed to the detriment of another. It therefore suggests unfair dealing and could be against the customer by the bank officers, or against the bank by its officers, or by the customers against the bank, etc. What constitutes fraud in banking practice has to do with some elements of deception, misrepresentation and the intent to obtain some unjustifiable advantage. Such act is generally perceived as professionally unethical, legally unjust, and morally wrong.

3.3.2. TYPES OF BANK FRAUDS

a) **Forged cheques:** This is perpetrated in a number of ways depending on the type of cheque. Any type of cheque, be it personal cheque, government cheque or travellers cheque, has its unique and peculiar characteristics and vulnerability. Compared to corporate cheques, individual cheques are more vulnerable to theft and fraud since they do not necessarily require confirmation as in the case of corporate cheques.
b) **Cash fraud:** This includes suppressing and converting customers' cash lodgements by fraudulent bank cashiers. Bank depositors who are illiterate are always victims of this kind of bank fraud.
c) **Cross firing of cheques or kiting:** This involves using bank funds without proper authority, whereby the customer usually has two or more accounts at two or more different banks or branches. He draws a cheque on his account in bank A, (knowing fully well that there are no funds in that account) and deposits the cheque into his account with Bank B. He then draws on the uncollected funds at bank B and immediately deposits in bank A another cheque drawn on non -existing funds in his account at Bank B.
d) **Foreign exchange malpractices:** These involve unlawful trafficking in foreign exchange and non-adherence to official guidelines on foreign exchange transactions.
e) **Printing of Bank Stationary and Carving of Bank Rubber Stamps:** These forged papers and stamps are usually used by unscrupulous people to prepare forged letters of and other international trade instruments which are circulated all over the world with a view to obtaining goods worth millions of naira under pretence.
f) **Spurious letters of Credit:**This kind of letters of credit is usually accompanied with spurious "bank drafts" on the reserve of which are fake endorsements which guarantee payment.

4.0. CONCLUSION

While managing the resources of a bank prudentially and in the most efficient way enhances the attainment of the bank's basic objectives with less time and efforts and at minimal cost, bank regulations keep the banking system under check and guides the back staff, its shareholders, customers and all who are involves in the system from any form of irregularity for the smooth operation of the system. On the other hand, bank fraud is a very serious cankerworm that has caused failure in many banks in Nigeria and it requires all hands on deck to fight the menace to a halt and total elimination for economic development.

5.0. SUMMARY

In this unit, we have learned about;

- Managing the available resources in a bank
- Bank regulation in Nigeria
- Bank fraud in Nigeria.

6.0. TUTOR-MARKED ASSIGNMENT

Discuss the objectives of bank regulation in Nigeria

7.0. REFERENCES/ FURTHER READINGS.

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