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SCHOOL OF HUMANITIES, MANAGEMENT AND SOCIAL SCIENCES

Mountain Top University

Kilometre 12, Lagos-Ibadan Expressway, MFM Prayer City, Ogun State.

PHONE: (+234)8053457707, (+234)7039395024, (+234) 8039505596

EMAIL: support@mtu.edu.ng

Website: www.mtu.edu.ng.

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COURSE GUIDE



**COURSE TITLE: Introduction to Banking and
Finance 1**

COURSE CODE: BFN 101

LECTURER(S): Ojo J.A.T. (Prof)

Omokehinde J.O. (Dr)

Olurin, E. O. (Mr.)



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COURSE OBJECTIVES



General Information and Course Objectives

1. To introduce the students to the basic knowledge on the importance of finance in the environment and the rudiments on what finance entails.
2. To introduce the basic ideas, concepts and structure of financial markets as a foundation for understanding their operations and functions in the economy.
3. To make the students understand the concept and importance of Time Value of Money.
4. To familiarize the students with the overview of the financial system and its relationship with the Economic System.
5. To introduce the students to the process of financial intermediation, financial intermediaries, monetary system and the banking system.



COURSE CONTENTS

- Lecture One:** The Finance Functions
- Lecture Two:** The Role of Finance in the economy
- Lecture Three:** Form of Business Organisations
- Lecture Four:** Sources of Business Finance
- Lecture Five:** Time Value of Money: Simple and Compound Interest; Present and Future Values
- Lecture Six:** Financial Statement Analysis
- Lecture Seven:** Financial Ratio Analysis
- Lecture Eight:** Basic Ideas and Concepts of the Financial Markets and their Operations
- Money Market – Roles, Instruments and Operations
 - Capital Market—Roles, Instruments and Operations
- Lecture Nine:** Principles of Financial Intermediation
- Lecture Ten:** Financial intermediaries and Markets
- Lecture Eleven:** The Stock Exchange/ Stock Market
- Lecture Twelve:** Foreign Exchange Market
- Lecture Thirteen:** Money and Banking – Overview and Nature
- Monetary Processes
 - Monetary creation and Monetary Policy
 - Banking Development, Institutions and Operations



Recommended Textbooks

- 1 Ade T. Ojo, **The Maladapted Financial Systems**, The CIBN Press Ltd, Yaba, Lagos, 2010
- 2 Olowe R.A, **Financial Management: Concepts, Financial System and Business Finance**, Brierly Jones Nigeria Ltd, Lagos 1997.
- 3 Onofowokan O, **Fundamentals of Finance, Money and Banking**, Kings & Queens Associates, Ogun State.
- 4 Gibson C.H, **Financial Statement Analysis (Using Financial Accounting Information)**. International Thomson Publishing, Cincinnati, Ohio.



LECTURE ONE

FINANCE FUNCTIONS

1.0 Introduction

Finance can be defined as a subject, discipline or field of study that deals with the acquisition of fund for an organization or individual as well as the management of such fund for the benefit of the owner(s). It can also be referred to as the management of money. It is the management of the flows of money through an organization (whether it is private or government organization and claims against money.

Objectives

At the end of this lecture the students should be able to:

1. Identify what is finance and its importance for business success
2. The functions that finance performs in an economy
3. How decision is taken concerning finance in an organization

Pre- Test

- a) Why do you think finance is essential for a business concern?
- b) Must a business man has all the money the needs before starting his business?

CONTENT

1.1 Finance Functions

This deals with how to manage a firm's financial resources so that it can meet its goals and objectives. This includes, the interpretation of financial reports as prepared by the accountants to make necessary recommendation to the top management regarding the strategies for improving the financial health of the company. The finance functions include those at the managerial or executive and those on routine function or basis.

- 1.2 The finance functions include those at the managerial or executive and those on routine function or basis

Managerial Finance Function

- Financial Planning
- Budgeting
- Credit Administration

Financial planning: Is the analysis of short, medium and long term finances to and from the company to achieve the desired goal of optimizing profit. This includes forecast of financial needs,



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development of budget to meet those needs and establishment of control for following the financial plan.

Budget: Is a financial plan that sets out the management expectation for revenue and expenditure for a particular period, usually a year. The budget serves as the primary basis and guide for a company's financial operation.

Credit management: Is the way in which accounts receivable, accounts payable and other forms of loans and advances are managed to ensure complete compliance with the terms and conditions of the agreement for each class of account. By so doing, the corporate value of the firm is enhanced which leads to better goodwill before loan providers, suppliers and customers.

Post Test

1. What is finance?
2. List and explain the finance functions?
3. Explain the concept of finance to your friend who studied History.

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Olowe. R.A. (1998). Financial Management: Concepts, Analysis and Capital Investments, Brierly Nigeria. Limited



LECTURE TWO

2.1. ROLE OF FINANCE IN THE ECONOMY

Introduction

Finance is critical to the functioning of the economy as a whole and banks are central to the Financial system. Finance is the elixir that assists in the formation of new businesses, and allows businesses to take advantage of opportunities to grow, employ local workers and in turn support other businesses and local, state and federal government through the remittance of income taxes. Finance is the process of creating, moving and using money, enabling the flow of money through a company in much the same way it facilitates national and global money flow.

Objectives.

At the end of this lecture the students will be able to know:

1. The role being played by finance in the economic growth of a nation
2. The way to enhance these roles.
3. The shortcomings in playing these roles

Pre test

1. What do you think will happen to a nation if there is shortfall of finance in the economy?
2. Can an economy have too much finance?
3. Apart from liquid fund in what other ways can finance be?

In addition to providing substantial employment, finance serves three main purposes:

- Credit Provision
- Liquidity Provision
- Growth Enhancement

Credit provision: Credit fuels economic activity by allowing businesses to invest beyond their cash on hand, households to purchase homes without saving the entire cost in advance, and governments to smooth out their spending by mitigating the cyclical pattern of tax revenues and to invest in infrastructure projects

Liquidity provision: Businesses and households need to have protection against unexpected needs for cash. Banks are the main direct providers of liquidity, both through offering demand deposits that can be withdrawn any time and by offering lines of credit.

Growth enhancement: The economy of a nation is enhanced when there is finance to support the development in different sectors of a nation. Finance is needed for development of infrastructures.



It is needed for distribution of wealth and for meeting the payment for services and products. It is a growth- enhancement factor.

The financial system play a critical role in the economic development of any nation. A well developed and integrated financial institutions speed up the process of development in three ways:

- By encouraging a more efficient mobilization of resources and allocation of a given amount of tangible wealth; through changes in wealth ownership and composition;
- By encouraging a more efficient allocation of new investment; and
- By inducing an increase in the rate of capital formation

Finance affects economic development, either aiding or constraining capital formation, according to the kinds of Propositions financiers will entertain.

Decisions made by financiers influence the amount and kinds of capital formation which can take place. Capital formation activity in turn, affects economic growth

Post Test

1. What are the major functions of a financial manager?
2. How dose finance affect an economy.

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LECTURE THREE

3.1. FORMS OF BUSINESS ORGANISATION

Introduction

In any nation, there exists different forms of organizations with different motives for their establishment. It could be established by a single person, while it could be a combination of persons who have the same goals and aspirations. These goals most times are the driven force behind their actions.

Objectives.

At the end of this lecture the students will be able to know:

1. Different forms of organization
2. How organizations are formed.
3. What are the characteristics of each form and their advantages

Pre Test

1. Must a business be registered before starting any business?
2. Can government be involved in business organization?
3. What do you think is the driving force behind businesses?

Organizations can be classified into two: Business organizations and Government organizations. Business organizations engaged in economic activities to make profit. Government organization includes central, state and local governments; and nationalized industries. They are run in the interest of the society as a whole and their activities do not necessarily result in profit. Business organizations take three forms:

- Sole Proprietorship
- Partnership
- Companies

3.2. Sole Proprietorship.

A sole proprietorship is a firm owned by one person. The single owner has the right to all assets and is responsible for all the firms' debts. The owner also receives all the firms' profits and suffers all the losses. It is the most common form of business organization

Characteristics features of a sole proprietorship.

- It is easy to form and establish
- No financial security is required as a proof of ownership
- The liabilities of the owner are unlimited. They can extend to his or her personal assets



- It is the easiest means of maintaining control over organization
- The business might not have perpetual existence

3.3. Partnership

A partnership is a business firm carried on by two or more persons with a view to profit. The general limit on partnership membership is maximum of twenty. To avoid conflicts or misunderstanding over internal management of the business, it is wise to draw up a partnership deed.

There are two types of partnership:

1. **General Partnership:** This is the most common form of partnership in which all the partners are liable for the debt of the partnership.
2. **Limited Partnership:** This is a partnership in which some individuals would be designated a limited partner, whose liability is limited to the amount stated in the partnership agreement. However, there would be one or more general partners in a limited partnership

Characteristics of Partnership.

- No financial security is required as an evidence of ownership of the business. The partnership agreement is only a legal contract. The partnership can however issue debt securities.
- Except limited partners, the liabilities of all partners in a partnership are unlimited
- The business might not have a perpetual existence. The death of a partner might lead to the dissolution of a partnership

3.4. Limited Companies

A limited company is an artificial legal entity incorporated by registration under the law. The law regards a limited company as an artificial being that can own assets, enter a contract, sue and be sued, have a bank account in its own name, incur liabilities to other people and companies, and employ other people to work for it. A limited company thus is legally separate from all other persons including those who own and manage it

Characteristics of Limited Companies.

- **Limited Liability:** While sole proprietors and general partners are personally liable for the debts of their businesses; and the creditors can force the owners to sell their personal assets. However, for a limited company, the liability of the owners is limited to an unpaid amount on the shares they have purchased
- A company exists apart from its owners



- A company has perpetual existence
- A company has perpetual existence
- Because a company is a separate legal entity, the ownership of a company can be easily transferred by the sales of the share.

Post test

- 1) Sole proprietorship is the largest form of business in Nigeria. Why do you think so?
- 2) In view of the demerits of partnership business, why do people prefer it?
- 3) If you are to invest in a business, which type of business organization would you prefer?

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LECTURE FOUR

SOURCES OF BUSINESS FINANCE

4.0 Introduction

Every organization be it commercial or governmental need finance for carrying on the activities that it set out to achieve. Although most commercial have profit motive for their establishment, those who are not pursuing profit maximization also need finance for their operations. It is therefore imperative that these financial requirements should have a source or sources as the case may be.

Objectives

At the end of this lecture, students are expected to have been conversant with:

- 1) The forms a business finance can be
- 2) The duration for classification of business finance
- 3) The different form of business for specific project

Pre test

- 1) What form of finance do you think can finance capital project?
- 2) Is the form of finance the same for all project?
- 3) Where can finance necessary for business be sourced?

4.1 FORMS OF BUSINESS FINANCE

Sources of business finance can be classified into three main groups: Short term, Medium-term and Long-term sources. Short term sources are financing sources of up to 1 year duration. Medium-term sources are financing of 1 year to 7 years duration, while long term sources are financing sources of 7 years or more duration.

4.1.1 SHORT-TERM FINANCING

Flexible source of finance usually used in financing short term working capital. They include:

- Borrowing from friends and relatives
- Borrowing from cooperatives
- Trade Credits
- Accruals
- Bank Borrowing
- Speeding up payments from Trade Debtors

Borrowing from friends and relatives

This is unreliable and risky for the provider of finance. He might find it difficult to enforce repayment against a defaulting relative.



Borrowing from cooperatives

It is restricted to only members. The amounts that can be raised are limited. Depending on the cooperatives, the loans from the cooperatives might be interest free or carry a little interest.

Trade Credits

They are created when the firm purchases raw materials, supplies or goods for resale on credit terms without signing any formal agreement for the liability.

Accruals

These are amount owing on services rendered to the firm for which payment has not been made. Accruals include wages payable, taxes payable

Bank Borrowing

■ Bank Overdraft

Bank allows firm to overdraw its account with it though the firm has insufficient fund.

■ Bank Loans

A formal agreement between a bank and the borrower that the bank will lend a specific amount for a specified period. Interest is payable on the whole of this sum for the duration of the loan. In granting the loan, the bank takes into consideration the following factors:

Speeding up payments from Trade Debtors

This depends on the availability of sound credit control and reminder system. This may involve giving the debtors some discounts to stimulate them to pay.

Factoring of Debtors.

Factoring involves turning over the responsibility for collecting a firm's debt to a specialist institution. A factor (an agent that manages trade debts) usually offers three main services:

- i. Taking over the management of client's sales ledgers
- ii. Inuring their clients against the risk of bad debt. This can be done with recourse or without recourse.
- iii. Providing finance by means of advances against the security of trade debtors.

A factor will usually charge a fee for all these.

4.1.2 MEDIUM-TERM FINANCING

The following are the major sources of medium-term financing:



- Term Loans
- Hire Purchase
- Lease
- Sale and Lease Back

Term Loans

This is negotiated loan between a bank and a company for between 4 – 10 years usually at a fixed rate of interest. Bank lending can be secured or unsecured. Unsecured lending is not common and is only available to creditworthy companies. Except for the duration of the loan, the will usually take into consideration the same factors as we have discussed earlier on short-term borrowing.

Hire Purchase Agreement

A hire purchase agreement is a credit sale agreement by which the owner of the asset or supplier grant the purchaser the right to take possession of the asset but the ownership will not pass until all the hire purchase payments or installments have been made. The purchaser will pay the hire purchase payment over an agreed period. A hire -purchase agreement conserve the company's resources and liquidity for another purpose.

Lease

A lease is a contract between the owner of an asset (lessor) and the user of the asset (lessee) granting the user or lessee the exclusive right to use the asset, for an agreed period in return for the payment of rent. A lease transaction is different from a hire purchase contract. In hire purchase, the intention of both parties is that the equipment passes to the purchaser on the fulfillment of certain conditions state in the agreement. The lease agreement merely creates the right to use an asset for a definite period and at specified rent, the lessor may not necessarily transfer title of the asset.

There are two types of lease:

- a) Finance leases (Full payout leases)
- b) Operating leases



A Finance lease is medium-term lease agreement between the lessee (use of the asset) and the lessor (owner of the asset or the provider of the finance). The provider of the finance is not necessarily the supplier of the leased item. The lessor might buy the asset from the supplier and immediately leases it to the lessee. The features of a finance lease are as follows:

- i. It is usually non-cancellable.
- ii. The lessee is responsible for the upkeep, insurance, servicing and maintenance of the asset.
- iii. The lease has a primary period that covers the whole or most of the useful economic life of the asset

An operating lease is a short-term cancellable lease between the lessor and the lessee. The term does not cover most of the useful economic life of the asset. The lessor is responsible for the upkeep, insurance, servicing and maintenance of the asset.

Sale and Lease-back

Sale and lease-back is an arrangement by which a firm sells its asset to a financial institution (usually insurance companies) or a leasing company for cash and the financial institution or leasing company immediately leases it back to the firm. The assets involved are usually properties and sold at approximately market price. The main advantage of sale and lease-back arrangement is that the firm (Lessee) can raise a large amount of cash through it.

Syndicated Loan

At times, the amount of cash outlay required by some big enterprises may be so much that a bank may find it very risky to give such magnitude of loan to a single customer. However, to satisfy the customer, the bank may package a syndicated loan for such customer.

Syndicated loan therefore is a loan arrangement whereby two or more financial institutions pool their financial resources together and jointly give out loan to an organization. One of the lenders will serve as the “leading bank” but the name of other participating lenders will appear in the entire document relating to the facility. Risk is thus spread on the member of the consortium. The cost of syndicated loan may include commitment charges, documentation fee, legal fee, loan interest, participating fee and facility fee.



4.1.3 LONG-TERM FINANCING

The following are the sources of long-term financing:

- Loan Stock/Debentures
- Preference Shares
- Ordinary Shares
- Retained Earnings

Loan Stock/Debentures

Loan stock is a long-term debt finance raised by a company for which interest is paid usually at a fixed rate. It is part of the capital of a company that is borrowed from outside sources such as banks, finance houses, individuals' etc. The company must pay interest whether it makes profit or not. Debentures are a form of loan stock that is legally defined as the written acknowledgement of a debt incurred by a company usually given under the company seal and contain provisions as to the payment of interest and eventual repayment of principal.

Preference Shares

Preference shares are shares which carry with them a prior claim to profit at a fixed rate of dividend and which must be paid before any dividend can be paid to the ordinary shareholders. They are regarded as part owners of the company rather than creditors hence they are usually referred to as a hybrid form of financing

Features of Preference Shares

The main features of preference shares are;

Dividend

This is the fixed rate of interest the shares attract per year. It is expressed as a percentage of the nominal value of the shares. For example, a 10% ₦1 preference share will pay a dividend of 10k per share per annum.

Cumulative and Non-Cumulative Preference Shares

The cumulative feature of the preference share means that if the dividend is not paid in a particular year; it will be carried forward and paid the following year, before any is paid to the ordinary shareholders. In the case of non-cumulative preference shares, missed dividends are lost completely, that is, not carried forward.



Redeemable Preference Shares

Redeemable preference shares are shares having their principal value being repaid after a given time. The redemption may be at share par value or a premium over the share par value.

Participating Preference Shares

If a preference share has a participating feature, it means that the preference shareholder can participate or share in the residual earnings of the company with the ordinary shareholders according to a stipulated formula.

Priority over Ordinary Shareholders

- a) Preference shares have priority over ordinary shareholders in the event of the company going into liquidation. It should, however, be noted that they receive only the nominal value of the shares as they are not allowed to participate in any surplus that may arise.
- b) They also have priority of dividend over the ordinary shareholders. This means that the ordinary shares dividend must not be paid until preference shareholders have received theirs.

Ordinary Shares

Ordinary shareholders are the owners of the firm. They receive control over the firm through their voting rights. Ordinary shareholders bear the greatest risk in the firm. They also benefit from the success of the firm. Ordinary shares have nominal or par value. The holders of ordinary share earn their rewards from the firm in the form of ordinary dividends. The amount of an ordinary dividend a company declares varies depending on the fortunes of the company. However, a company must pay all fixed obligations before it can pay ordinary dividends.

Retained Earnings

Retained earnings are part of a company's profits not paid out as ordinary dividend. It is thus a source of financing. It is cheap source of raising finance as compared to share issue, as no issue cost is involved. Retained earnings are an important source of financing for companies that do not have access to the capital market

Preference Shares and Loan Capital compared.



The similarities and the dissimilarities between preference shares and loan capital discussed need to be clearly stated since both of them have been generally classified as fixed-income earning securities.

- 1) Preference share are less secured compared to loan capital because the holder of loan capital have first claim on the net assets of the company in the event of liquidation before the preference shareholders. However, preference shareholders have priority over other shareholders such as the ordinary shareholders.
- 2) Preference shares are more risky compared to loan capital, although invariably they offer better return.
- 3) Preference shares compared to loan capital are generally less attractive to the issuing company. The reason for this is that whereas the interest paid on loan is allowed as a deduction in arriving at taxable profit, preference dividend is not allowed as a deduction before arriving at the taxable profit of the company.
- 4) Both preference share dividend and interest received on loan capital suffer withholding tax.
- 5) Preference shares are less attractive to individual investors compared to loan capital because the higher the yield, the greater the risk and therefore the lesser the likelihood that the dividend will be paid regularly in the future.

Post test

- 1) Differentiate between leasing and hire purchase with example
- 2) A company is desirous of financing her working capital. Explain how this can be done to the Managing Director.
- 3) Differentiate between equity capital and loan capital

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LECTURE FIVE

THE CONCEPT OF THE TIME VALUE OF MONEY (TVM)

5.0 Introduction

A naira expected sometime in the future is not equivalent to a naira held today, because of the time value of money. We can invest the naira available today to earn interest, so that it will increase in value to more than one naira in the future. Consequently, we would rather receive a naira now than receive the same amount in the future, even if we are certain of receiving it later.

Most financial decisions, such as the purchase of asset or procurement of funds, affect the firm's cash flows in the different time periods. For example, if a fixed asset is purchased, it will require an immediate cash outlay and will generate cash flows during many future periods. Sound decision making requires that the cash flows, which a firm is expected to receive or give up over a period of time, should be logically comparable.

Objectives

At the end of this lecture, students should be able to:

1. explain in details the various concepts as stated above;
2. application of the various concepts of TVM; and
3. distinguish between Compounding, Discounting, and Annuity.

Pre-Test

1. What do you understand by Time Value of Money?
2. State five concepts of TVM and explain three of them?
3. What do you understand by the phrase 'Annuity'?

CONTENT

5.1 Time Value of Money

The concept of TVM states that a specified amount of money received (paid) in a specific time period has a different value than the same amount received (paid) in a different time period.

TVM can be applied to:

- Valuing stock and bonds
- Valuing Investment projects
- Computing loan repayments
- Computing how much to save for retirement or to fund a child education



- Calculate the length of time it takes a certain amount of money to grow to some desired amount
- Compute the return that is earned on an investment

If an individual behaves rationally, he would not value the opportunity to receive a specific amount of money now equally with the opportunity to have the same amount at future date. Most individuals value the opportunity to receive money now higher than waiting for one or more years to receive the same amount. This phenomenon is referred to as an individual's time preference for money. Thus, an individual's preference for possession of a given amount of cash now, rather than the same amount at some future time, is called "time preference for money"

5.2 REASONS FOR INDIVIDUAL TIME PREFERENCE FOR MONEY

Risk and uncertainty

Risk and uncertainty although sometimes used interchangeably are different. Risk is described as the possibility of loss, or other adverse or unwelcome developments. Risk occurs where it is unknown what the future outcome will be but where the various possible outcome may be expected with, some degree of confidence from knowledge of existing past events, in other words probabilities of alternatives could be estimated while uncertainty is described as a situation where future outcomes cannot be predicted with any degree of confidence from knowledge of past or existing events thus probability estimates are not available for possible outcomes. This is an indication that risk and uncertainty affects investment decision and therefore directly or indirectly affects individual time preference for money.

Inflation

Inflation is defined as a sustained increase in the general level of prices for goods and services. It is measured as annual percentage increases. As inflation rises, every naira you own buys a smaller percentage of a good or service. In an inflationary economy, the money received today, has more purchasing power than the money to be received in the future. In other words, a naira today represents a greater real purchasing power than a naira a year later.

Consumption

Most people have preference for present consumption over future consumption of goods and services either because of the urgency of their present wants or because of the risk of not being in a position to enjoy future consumption that may be caused by illness or death, or because of inflation. As money is the means by which individuals acquire most goods and services, they may prefer to have money now. Individually generally prefer current consumption to future consumption.



Investment opportunities

Most individuals prefer present cash to future cash because of the available investment opportunities to which they can put present cash to earn additional cash. For example, an individual who is offered 100 naira now or 100 naira one year from now would prefer 100 naira now if he could earn on it an interest of, say 5 naira by putting it in the savings account in a bank for one year. His total cash in one year from now will be 105 naira. Thus, if he wishes to increase his cash resources, the opportunity to earn interest would lead him to prefer 100 now, not 100 naira after one year.

5.3 TIME VALUE OF MONEY ARITHMETICS

5.3.1. SIMPLE INTEREST

The Simple Interest is the interest earned on an original amount invested (The Principal). The amount of Principal and the interest payments remain the same from period to period.

The Simple interest is computed as: Interest = Principal x Rate (% per year) x Time (in years).

Example 1: Assume David Company Ltd invests ₦3000 for a period, at a simple interest of 16% per year. Calculate the interest due to David Company Ltd at the end of the two years.

Solution: Interest = Principal x Rate x Time

$$= ₦ 3000 \times 16\% \times 2$$

$$= ₦ 960$$

5.3.2. COMPOUND INTEREST

The compound interest is the interest earned on the principal plus previously earned interest. Interest is added to the principal as we earn it during any period. We then compute interest on the new balance (often called the compound amount) during the next period.

Interest can be compounded in many ways, such as daily, monthly, quarterly, semi- annually, or annually.

Example 2: Assume that the investment of David Company Ltd is the same as described in the previous example, except that the interest is compounded annually. Calculate the total interest for the two year period.



Solution: The total interest for the two-year period can be computed as:

Year	Balance at Begin	Compound Interest	Balance at the end
1	₦3000	₦480.00	₦3480.00
2	₦3480	₦556.80	₦4036.80

In example 2, the total interest is ₦1036.80 compared with the ₦960 computed in example 1 earlier. The difference of ₦76.80 represents interest earned in the second year on the first year's interest (₦480 x 0.16) and is the product of using compound interest rather than simple interest. In most cases involving time value of money, compound interest is applicable.

Post Test.

- 1) What interest rate compounded quarterly will make ₦5000 now to calculate ₦20000 in a five years' time?
- 2) Olu Johnson has the option of receiving ₦200000 now or ₦300000 in four years' time. Which option should he chose if he can invest at the rate of 20% interest per annum?

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LECTURE SIX

6.1 FINANCIAL STATEMENT ANALYSIS

The selection, evaluation, and interpretation of financial data, along with other pertinent information, to assist in investment and financial decision-making. Financial analysis may be used internally to evaluate issues such as employee performance, the efficiency of operations, and credit policies, and externally to evaluate potential investments and the credit-worthiness of borrowers, among other things.

The **FOUR** main statements generally prepared by publicly-traded companies are as follows:

- i. Statement of Financial Position (Balance Sheet);
- ii. Statement of Profit or Loss and Other Comprehensive Income;
- iii. Statement of Changes in Equity;
- iv. Statement of Cash Flows.

Other Reporting Ares:

- This topic introduces financial statements by reviewing the forms of business entities, sequence of accounting procedures (called the accounting cycle), and other financial reporting related areas that contribute to the understanding of financial reporting like:
- Human resources (our people);
- Chairman's Statement;
- Chief Executive Officer's Report;
- Sustainability and Corporate Social Responsibility Report;
- Corporate Governance Report;
- Directors' Report;
- Audit Committee Report;
- The Auditor's report;
- Management's responsibility for financial statements;
- Report of the Independent Auditor to Management;
- Notes to the Account

Users of Financial Statement

- *Financial statements* are meant to present the financial information of the entity in question as clearly and concisely as possible for both the entity and for other stakeholders like:
- Shareholders (owners of the firm) .Regulators (CBN, SEC, NSE, NAICOM etc.)
- Creditors .Management .Government .Financial Analyst .Media
- Potential Investors. Students



LECTURE SEVEN

7.0. RATIO ANALYSIS

Introduction

A ratio is a mathematical expression of relationship between two or more variables or accounting figures. A ratio analysis is also a quantitative analysis of information contained in a company's financial statements. It is a technique of processing accounting data into a more informative and meaningful indicators (in rates and percentages) with a view to speeding the process of evaluation, analysis, better comparisons, and judgement of companies, and industry's performance and financial health. Ratio analysis is used to evaluate various aspects of a company's operating and financial performance such as its efficiency, liquidity, profitability and solvency.

Objective

At the end of this lecture, the students will be conversant with:

- 1) How ratios are derived from the financials
- 2) Which ratio is applicable for different situations?
- 3) How to use ratios to predict the future

Pre test

- 1) What is a financial statement?
- 2) Where do you get figures that are found in financial statements?
- 3) Is balance sheet more important than other financial record of a business

Types of Financial Ratios:

- Liquidity
- Profitability
- Solvency
- Efficiency
- Activity
- Leverage ratios

Importance of Financial Ratios

- In order to make sense of a ratio, we must compare it with some appropriate benchmark(s)
- Examine a firm's performance relative to:
 - The aggregate economy
 - Its industry or industries
 - Its major competitors within the industry



Its own past performance (time-series analysis)

Post-Test

1. Write short notes on the four major types of financial statements
2. What do you understand by Profitability ratio, Liquidity Ratio, Leverage ratio and Efficiency ratio?

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LECTURE EIGHT

8.0 INTRODUCTION TO FINANCIAL MARKETS

Market means different things to different people and to different profession professions, for example,

- **Physical Market** – Yaba, Ojuelegba, Oshodi Market etc.
- **Economist** – Market means all the buyers and Sellers involved in actual or potential transactions of goods and services, e.g. Food Stuff market means all the buyers and sellers of food stuff irrespective of their location.
- **Marketer** – Market means set of all persons or organizations who are actually or potentially involved in the buying of goods and services.
- **Business Man** – Market means a group of people with the purchasing power who are willing to part away with their money on their needs and wants.

Objective

At the end of this lecture, the students will be aware of:

- 1) How funds are sourced by business organizations
- 2) The types of financial markets available in the country
- 3) The condition that determines which market to go for funds.

Pre test

- 1) Where do you buy some commodities when they are needed?
- 2) Are markets found only in physical locations?
- 3) What are the necessary infrastructures found in markets?

8.1 FINANCIAL MARKETS

Financial Markets encompass financial institutions and financial intermediaries that help direct financial resources from the owners of these resources (Savers) to those who use them to finance productive activities i.e. those who invest. Thus, the main economic function of financial markets is to direct saving to those who wish to make capital investments.

Financial markets facilitate the lending of funds from saving to those who which to undertake investments in capital goods. Companies or individuals that wish to finance investment projects sell IOUs to savers. The Financial Market occupies an important place in most economies of the world. The primary function of a financial market is to enable funds to be efficiently allocated from the surplus units of the economy to the deficits units for productive investment. The greater the transmission efficiency is, the higher the growth rate of the economy.



Financial markets are markets for the IOUs sold to savers by those who wish to borrow to finance investment projects. The various form of IOUs are known collectively as **financial investments**. Such investment which also are called **securities** are claims that those who lend their savings have on the future incomes of the borrowers who use the funds for investment.

8.2. Classification of Financial Markets

There are two basic ways to categorize financial markets. One which distinguishes between primary or secondary markets, separate type of financial markets depending upon whether or not they are markets for newly issued instruments. The other, which distinguishes between capital and money markets, defines financial markets on the basis of instruments maturities.

8.3 NATURE OF THE FINANCIAL MARKET

The financial market is a mechanism by which surplus and deficit units of an economy can be brought together. Specialist traders operate in this market by buying and selling financial claims.

The functions of the financial market are as follows

- i. It eases the flow of fund from the surplus units to the deficit units, thus ensuring efficient allocation of resources.
- ii. It facilitates the issue of instruments or securities of varying maturities.
- iii. It facilitates the transformation of maturity of financial instruments

The Financial market has two segments:

I. **The Primary Market:** This is the market for new issue of funds or securities. It provides a focal point for lenders and borrowers to meet. New finance is raised in this market.

II. **The Secondary Market:** This is the market that allows existing holders of financial claims to sell them to other investors. Thus, it provides liquidity for financial claims in the primary markets.

The Major financial Markets in Nigeria are made up of:

i. **The Money Market:** This is the market for funds of less than one year duration.

Instruments traded in the market are called money markets instruments.

ii. **The Capital Market:** This is the market for funds of more than one year duration.

Instruments traded in the market are called Capital market instruments.



iii. **The Securities Market:** This is the market for the issue and purchase of both primary and secondary securities, the latter being securities that are already in existence.

iv. **The foreign exchange Market:** This covers all transactions involving the sale and purchase of foreign currencies or conversion of naira to foreign currencies and vice versa.

8.4 MONEY MARKET

The Money market is the market where money is borrowed or invested for periods of up to one year maturity. The instruments are securities traded in the market are called money market instruments. Thus, the money market is the market for trading in short term financial instruments with maturities of less than one year. The major participant in the money market includes individuals, companies, banks, discount houses and government.

The money market has both primary and secondary segments. In Nigeria, the discount houses and Central Bank of Nigeria rediscount windows enhanced marketability of some money market instruments in the secondary market.

There are several instruments available through which funds can be raised in the money market. The instruments used in the Nigerian Money Market are as follows:

8.4.1 Treasury securities

These are short term obligations of the Federal Government to pay the bearer a fixed sum of money after a specified number of days from the date of issue. The Central Bank of Nigeria auctions the instruments for the Treasury at a discount through competitive bidding and non-competitive bidding. The two types of securities in Nigeria are: Treasury Bills and Treasury Certificates.

Treasury Bills

The Treasury Bills are 91-day discount obligations of the Federal Government issued by The Central Bank of Nigeria. The return of the bill is the difference between the face value and the purchased value of the instrument. The Central Bank issues treasury bills basically for two purposes:

- I. To raise short term finance for the government
- II. As an instrument of monetary policy to mop up excess liquidity in the economy through direct control or when executing open market operations.

Open market operations (O.M.O) is the buying and selling of short-term and long-term government securities in the money and capital market such as treasury bills, treasury certificates and development stocks by the Central Bank of Nigeria at a market determined rate with objective of increasing or restricting money supply in the economy.

Treasury Certificates

These are Federal Government obligations that have maturities of one or two years. The Treasury Certificates are similar to Treasury Bills in all respects except that they have longer maturities and consequently higher return. They are also issued on discount basis.



The main advantages of investing in Treasury bills and Treasury Certificate can be summarized as follows:

- I. They are first class collateral securities
- II. They are near cash investments and the holder can discount them at a better rate, especially at a discount Houses.
- III. Because they can be split into certain denominations are usually in multiples of N10000, the holder can easily discount only the portion of total holdings he wishes to dispose.

8.4.2 Certificate of Deposit

A certificate of deposit (CDS) is a receipt from a bank for deposit of funds for a specified period of time at a specified interest rate with maturity period ranging from 3 months to 36 months. It is an inter-bank debt instrument and serves as a means for channeling commercial banks' cash surpluses to merchant banks who are the main issuers of the instrument.

There are two types of Certificates of deposit: Negotiable Certificates of deposit (NCD) and Non-Negotiable Certificates of Deposit (NNCD).

- a. A Negotiable Certificate of Deposit (NCD) is a promise by a bank to pay the principal and interest at the maturity of the deposit. It is a negotiable instrument which has a maturity period of 36 months. Being a negotiable instrument, an investor in NCD can dispose of the investment the investment before the end of the maturity of the instrument.
- b. Non-Negotiable Certificate of Deposit (NNCD) has features of a time deposit receipt. As they are not negotiable, they are normally held to maturity.

8.4.3 Commercial Paper

A commercial Paper is a short term unsecured promissory note issued by a company at a discount to an interested investor for cash for a specified maturity period. The investors in CPs are usually high net-worth individual institutional investor such as pension fund, insurance companies, banks etc. Commercial Papers have a maturity range of 30 days and 270 days. The return on the notes is the difference tween the face value of the notes and the purchase value. Because Promissory Notes are unsecured obligation and bear only the name of borrower, the commercial paper market is dominated by large publicly quoted companies with very good credit ratings.

8.4.4 Bank Acceptances

A bankers' acceptance is a bill of exchange or draft accepted by the drawee bank specifying that a certain amount will be paid after a specified period of time. The drawee bank accepts the draft by writing on the draft the word "accepted" with the appropriate authorized signature across the face of the draft. By the acceptance, the drawee banks acknowledge its obligation to honour the draft on the due date. With the acceptance, the bill of exchange or draft can be discounted by the payee at a fine rate of discount. The instrument becomes a desirable credit instrument since it is now the obligation or the liability of a bank.

8.4.5. Bank Deposits

This is a placement of funds by investor/depositors with a bank at an agreed rate of interest. There are various types of bank deposits and they are differentiated by their maturities:



8.4.6 Call Deposit: This is a deposit of funds made with no specified maturity period. Either the bank or depositor can terminate the arrangement by giving the other party due notice based on the agreed notice period. The recall notice can be 24 hours, 7 days, 1 month etc. The rate of interest applicable on the deposit is normally agreed upon between the bank and the call depositor.

8.4.7 Fixed Deposit: This is a deposit of funds with a bank for a fixed period of time at a specified rate of interest which could be fixed or floating. In the case of floating rate deposit, the interest rate will be linked to a base rate which could be the prime lending rate of the bank or the Central Bank of Nigeria Monetary Policy Rate.

8.5 THE CAPITAL MARKET

The Capital market is the market for long term funds. The apex and regulator of this market is the Securities and Exchange Commission (SEC). Other participants include the Nigerian Stock Exchange, Stockbrokers, and Issuing houses. The instruments or securities traded in the capital market are called capital market instruments. However, capital market has both securities based segment (the stock market i.e. Stock Exchange) and non-securities based segment (market for long term loans).

Roles of the Capital Market

- I. Mobilization of savings to aid capital sourcing for industries and commerce
- II. Ready assurance of loanable funds to government and its agencies to support provision of social services.
- III. Liquidity of investments to facilitate reactive portfolio switches to changes in returns and/or prospects of economic units.
- IV. Regulation of operations in the market to ensure confidence of the public

Capital Market instruments can be categorized into three major groups of securities

8.5.1 Debt instruments

Debt instruments are long term loans raised by a company or government or government parastatals for which interest is paid and at a fixed rate. A debt instrument has a nominal value, which is the debt owed by the issuer, and interest is paid at a stated coupon rate on this amount. For example, if a company issues 12% loan stock, the coupon rate will be 12% of the nominal value of the stock, so that ₦1000 stock will receive ₦120.

Debt instruments issued by a company are usually evidenced in form of debentures. Debt instruments issued by the government can also be in the form of bonds. In Nigeria, Federal Government debt instruments are evidenced in form of Federal Government Development Loan Stock. Whatever the form the debt instruments take, it is an evidence of indebtedness of the issuer specifying the rights of the holder and the duties of the issuer

8.5.2 Preference Shares

This is another major source of long term financing to a company. The holder of preference shares are entitled to a fixed percentage dividend before any dividend is paid to ordinary



shareholders. However, preference dividend can only be paid if sufficient distributable profits are available, although with cumulative preference shares the right to an unpaid dividend is carried forward to later years.

8.5.3 Ordinary Shares

Ordinary shares are issued to owners of company. They have a nominal or face value. The memorandum and articles of Association of a company specifies the number of authorized ordinary shares a company can issue. The ordinary shareholders of a company have residual claims in the company; their claims to income and asset come after the creditors (debt holders) and preference shareholders have been paid in full. As a result, a shareholder's return on investment is less in certain than the return to a lender or to preference shareholders.



LECTURE NINE

9.1. THE PRINCIPLES OF FINANCIAL INTERMEDIATION

Introduction

Financial intermediation is the process by which indirect finance through the services of an institutional middleman gets funds channeled from savers (surplus economic units) to those who ultimately make capital investments (deficit economic units). It is the mechanism whereby surplus funds from ultimate savers are matched to deficits incurred by ultimate borrowers i.e. the process by which ultimate savers are matched to ultimate borrowers.

9.2. Benefits of Financial Intermediation

1. Financial Intermediaries exist to save one and the other potential holders of financial investments from incurring additional costs which direct finance would entail in the presence of asymmetric information in financial markets as well as the **adverse selection** and **moral hazard problems** that stem from asymmetric information would entail in the presence of asymmetric information.

Asymmetric Information

Why should savers wish to channel their funds through some other institutions instead of lending them directly? One key reason for doing so is the presence of asymmetric information in financial markets. Asymmetric information is the possession of information by one party in a financial transaction but not by the other party.

Adverse Selection is the tendency for those who desire funds for unworthy projects to be the most likely to want to borrow or issue debt instruments. The existence of such poor quality instruments can make people less willing to lend or hold debt instruments issued by those seeking to finance high-quality projects.

Moral Hazard is the possibility that a borrower might engage in behaviour that increases risk after a loan has been made or a debt instrument has been purchased.

2. Financial intermediation results in lower interest rate costs to investors undertaking real investment. At the same time, the efficiencies of financial intermediation also raise the interest rates that can be paid on deposits.

3. By maximizing the return it earns on its asset portfolio, and minimizing the costs of carrying out its administrative functions, a financial intermediary can offer attractive interest rates on its deposits compared to the case of direct financing, where an individual does not enjoy economies of scale and must bear the higher administrative costs in the form of lower rates of return.

4. Lowering the interest rate costs for an investor in real capital is the advantage derived from financial intermediation that gives intermediaries an important macro-economic function.

5. The introduction of financial intermediaries into an economy should thus have an expansionary impact because it should lower the effective rate of interest, which should lead



holders of real capital to desire a larger optimal capital stock. This induces a larger amount of investment and thus a higher level of income.

6. The beneficial effect of intermediation on economic growth can also be seen from the viewpoint of risk bearing.

7. Intermediaries are better able than individuals to bear the risks of lending out capital mainly because of their ability to diversify, economies of scale, and expertise in lending.

Disintermediation is the reverse of intermediation: savers take funds out of deposit accounts, or reduce the amounts they normally put in, and invest directly in primary securities such as stocks and bonds.

Post test

- 1) What role do financial markets play in an economy?
- 2) How does a well-functioning financial market help the financial manager?

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LECTURE TEN

10.1 FINANCIAL INTERMEDIARIES AND MARKETS

Introduction

Financial intermediaries are in a better position than individuals to bear and spread risks of primary security of ownership. Since financial intermediation tends to lower interest rates, or at least to moderate any increase, it has been found beneficial to the boosting rate of economic growth in many countries. The lower the rate of interest that ultimate borrowers must pay, the greater their expenditure on real investment.

Since financial intermediation tends to lower interest rates, or at least to moderate any increase, it has been found beneficial to the boosting rate of economic growth in many countries. The lower the rate of interest that ultimate borrowers must pay, the greater their expenditure on real investment.

Objectives

At the end of this lecture, the students will be able to:

- 1) Identify the financial intermediaries that are available in the financial markets
- 2) Know the functions performed by these intermediaries.
- 3) Understand how these intermediaries are able to sustain their existence.

Pre test

- 1) What do you understand by the term intermediary?
- 2) Why do you think intermediaries are needed in the financial markets?
- 3) Are financial intermediaries paid for their services?

10.2 Benefits of Intermediation

The beneficial effect of intermediation on economic growth can also be seen from the viewpoint of risk bearing. Intermediaries are better able than individuals to bear the risks of lending out capital mainly because of their ability to diversify, economies of scale, and expertise in lending.

The financial intermediaries cannot eliminate the adverse selection and moral hazard problems that stem from asymmetric information. What they can do, however, is to specialize in collecting information about the prospects of financial instruments and in monitoring the performance of those who issue such instruments.



Economies of Scale is another reason why financial intermediaries exist. Economies of scale is the reduction that can be achieved in the average cost of managing funds by pooling savings together and spreading the management costs across many savers.

Some intermediaries make it possible for many people to pool their funds together.

This increases the size, or scale, of the amounts of funds that are saved.

It also enables intermediaries to simultaneously manage the larger pool of funds for all individuals. This can reduce the average fund management costs below those that individuals would incur if they all were to manage their savings alone.

Thus, financial intermediaries exist for the following reasons:

- i. To address problems arising from asymmetric information, which can cause adverse selection and moral hazard problems;
- ii. To achieve financial economies of scale or the ability to spread costs of managing funds across large numbers of savers.
- iii. To confer liquidity on financial instruments.

Liquidity refers to the ease and speed with which a person can sell an asset for a given amount of money at low cost

10.3. Types of Intermediaries

The simplest form of intermediary is the **broker** who facilitates transactions between lenders and borrowers without acquiring the debt of the borrowers or issuing claims to the lenders.

In contrast, the “true” financial intermediary becomes a party to the financing activity by simultaneously holding claims on the borrower and issuing claims to the lender.

Among true intermediaries, a distinction can be made between mutual funds and deposit-taking institutions.

A **mutual fund** offers investors a proportionate claim on a portfolio of assets that fluctuates in value with the value of the underlying collection of assets that make up the intermediary’s portfolio

The deposit-taking intermediary offers investors a claim, the value of which is stated by contract to be independent of the value of which is stated by contract to be independent of the value of the portfolio held by the intermediary.

Post test

- 1) Identify the major functions performed by the money markets and explain their importance of each function for corporate financial management
- 2) List and discuss three ways of raising long term capital.

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LECTURE ELEVEN.

THE STOCK EXCHANGE / MARKET

11.0 INTRODUCTION

A common stock (typically just called a stock) represents a share of ownership in a company. It is security that is a claim on the earnings and assets of the company. Issuing stock and selling it to the public is a way for company to raise funds to finance their activities.

Objectives

At the end of this lecture, the students will be able to:

- 1) Identify the characteristics of stock market
- 2) Know the factors that distinguish the market from any other markets.
- 3) Identify the operators in this market

Pre-test

- 1) Why is it necessary to have a specialized market?
- 2) Can any other products be sold in specialized markets?

The Stock Exchange is a formal, organized and specialized market where shares, stocks and bonds are bought and sold by individuals and corporate bodies through the stockbrokers. It serves as a channel through which government and companies raise long term fund, either equity or loan capital with ease by complying with rules and regulations of the market.

It provides a mechanism for mobilizing private and public savings and making such funds available for productive purposes. It assists in the allocation of the nation's capital resources among numerous competing alternatives uses, thus, serving as an aid in financing. The Exchange also provide a means for trading in existing securities, thus, making the securities marketable

Examples of Stock Exchanges are: The Nigerian Stock Exchange, New York Stock Exchange (NYSE), London Stock Exchange, Paris Stock Exchange (BOURSE) and Tokyo Stock Exchange

11.1. MEMBERSHIP OF THE NIGERIAN STOCK EXCHANGE.

- **FOUNDATION MEMBERS:** They are pioneer members who signed and subscribed to the share of the exchange at inception when it was formed and registered. They are the members who signed the memorandum and article of association of the exchange.
- **ORDINARY MEMBERS:** They are the ordinary shareholders of the exchange that were admitted into membership after the establishment of the exchange in 1961.
- **DEALING MEMBERS:** They are those licensed by the exchange to deal (buy and sell) in securities that are traded on the exchange. This group include stockbrokers and issuing houses.



11.2. FUNCTIONS OF NIGERIAN STOCK EXCHANGE

- It enables companies and government to raise long term fund for development and expansion purpose.
- It serves as a platform for sales and purchases of existing securities.
- It acts as an outlet for investment to individuals and organizations with surplus funds.
- It helps to attract foreign capital into Nigeria with the listing of international companies and conglomerates.
- It assists in the decentralization of assets ownership in the economy.
- It brings about prudence and accountability into corporate organizations.
- It ensures compliance by listed companies with the laid down rules and regulations.
- It serves as an avenue for proper pricing of securities.
- It assists in the implementation of government indigenisation programme.
- It provides timely information on daily trading on the exchange.
- It reviews, responds and addresses complaints from shareholders, investors etc. about any securities and capital market operators

11.3. SECURITIES AND EXCHANGE COMMISSION (SEC)

The foundation to the establishment of SEC was the Capital Issues Committee that was inaugurated in 1962 as an ad-hoc committee to handle the issues of securities.

SEC is the apex regulatory and supervisory institution over the capital market in Nigeria. According to SEC Decree of 1988, The Commission is expected to perform the following functions:

- To value the securities to be sold to the public. By reason of the 1993 SEC decree that replaced that of 1988, this function has been transferred to the issuing houses.
- To determine the basis of allocation of securities to the public, Stock Exchange and securities dealers
- To ensure orderliness in the conduct of activities/ transaction in the capital market
- To authorise the establishment of unit trust.
- To approve and regulate mergers and acquisitions of quoted companies.
- To register all private and public securities to be traded in the capital market.
- To determine the contents of prospectus and other documents used in respect to all issues of securities.
- To audit books and records of organisations dealing on the exchange.
- To promote capital market growth and development.
- To regulate and supervise the activities of other capital market operators.

11.4. CENTRAL SECURITIES CLEARING SYSTEM (CSCS).

CSCS is a separate organisation set up within the Nigerian Stock Exchange to take care of all clearing and settlement system due to the change of trading activities at the exchange from the manual call-over system to the automated or computerized trading system.



The CSCS commenced operation in 1997 to implement the computerized Stock Exchange Management System. This system was put in place to serve as a central deposit for share certificate in an automated manner so as to reduce the regular bottlenecks faced between a company and the registrars in the issuance of share certificates to investors.

11.5 FUNCTIONS OF CENTRAL SECURITIES CLEARING SYSTEMS (CSCS) LIMITED

- It issues centralised identification number to shareholders
- It serves as a central deposit where all shares certificates of quoted securities are kept.
- It maintains a register of all quoted securities separately in conjunction with the registrar of quoted companies.
- It acts as a clearing and custodian agency for foreign and local instruments traded in the Stock Exchange

11.6. STOCKBROKERS

Stockbrokers are key operators in the stock market. They are members of the Stock Exchange who buy and sell securities on behalf of the investing public.

Apart from acting as key operators in the secondary market, stockbrokers also sponsor issues to the Stock Exchange for listing; underwrite and handle primary distribution of securities; and provide investment/management advisory services.

11.7. INVESTMENT ADVISERS

These are key operators in the capital market, who perform some functions similar to those of stockbrokers but are not members of the recognized Stock Exchange.

- They cannot sponsor issues to the Stock Exchange for listing.
- They can also not deal in listed securities.
- They can however provide investment and management advisory services.

11.8 ISSUING HOUSES

An issuing house is an organization that advises or arranges on behalf of a company or some other organization (e.g. government agencies) the raising of funds through issuance and sale of securities. Its functions:

- An issuing house examines in detail the circumstances and financial position of the company or organization proposing to raise funds; evaluates the intended use of funds and advises its clients on the most suitable capital structure.
- It put together a buying group or selling syndicate and arranges for underwriting of the issue; and coordinates the activities of other parties to the issue



11.9. REGISTRARS

The registrars are also key operators in the stock market responsible for the administration of company's shares and keeping of the register of members.

Registrars can be corporate bodies employed by their principal, i.e., companies or can be employees of a company if an in-house share registration department is established.

The registrars also handle the security printing of blank dividend warrants and share certificates on behalf of client companies; and carry out the confirmation of signatures of transferors in the case of transfer of shares

Post test

1. What are the functions of Nigerian Stock Exchange?
2. What are the benefits of Central Securities Clearing System?
3. Distinguish between CSCS and Nigerian Stock Exchange

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LECTURE TWELVE

THE FOREIGN EXCHANGE MARKET

12.0 INTRODUCTION

THE CONCEPT OF INTERNATIONAL TRADE

Countries are characterized by differences in the level of endowment of natural resources, human and capital resources and technical knowhow available to them. Some countries have an adequate level of some or all these resources necessary to ensure economic growth and a high standard of living for their citizens. Thus they must engage in some form of trade across their boundaries, in an attempt to gain access to these resources (natural, human, capital and technical) which they require to sustain economic growth.

Simply put, international trade is the process of buying and selling between buyers, sellers and merchants in different countries. International trade entail the conduct of trade in goods and services across national boundaries.

Objectives

At the end of this lecture, the students will be conversant with:

1. How payments for exports are effected.
2. The needs for foreign exchange
3. Currencies of other countries

Pre test

1. Can you spend the Nigerian naira outside the shore of the country?
2. Can a citizen of Nigeria has other currencies apart from the Nigerian naira

12.1. THE NEED FOR FOREIGN EXCHANGE DEALINGS

When firms deal in international trade, they undertake normal business transactions- i.e. they buy, sell, borrow and lend. However, these transactions cross international boundaries.

In international trade, the local currency of one trader is a foreign currency to the other.

If the exporter asks for payment in his currency, the foreign buyer must obtain some of that currency to make payment. He will do this by asking his bank to sell him the required quantity of the foreign currency (in exchange for his domestic currency).

If the exporter asks for payment in the local currency of the foreign buyer, the exporter will receive payment in foreign currency and must then do something with it.

The exporter might ask for payment in a foreign currency which is also a foreign currency to the foreign buyer. For example, a Dutch exporter might sell goods to a buyer in Mexico and ask for payment in US Dollar.



In international trade, traders will either want to buy or to sell foreign currency, and they will do this through their bank. When traders buy currency, the bank sells it, and when traders sell currency, the bank buys it.

12.2 WHAT IS FOREIGN EXCHANGE

- It can be defined as any currency other than the local currency and in the case of Nigeria, any currency other than Naira.
- It can also be defined as the mathematical expression of the international medium of exchange and the monetary system as a process of settling foreign accounts or debts arising of international activities

12.3. DEFINITION OF FOREIGN EXCHANGE RATE

- It is the rate at which one currency is exchange for another currency.
- It is the rate at which banks sell or buy one currency in exchange for another currency.
- Foreign exchange rates do fluctuate because they are allowed to respond to the forces of supply and demand in the foreign exchange market. For example, if the demand of customers to buy US Dollars and sell Naira exceeds the counter balancing demand to buy Naira and sell US Dollar, Naira will lose value against the US Dollars.
- It is described as the price unit of one country's currency quoted in terms of another.
- It is the quantitative expression of a country's currency in term of another

12.4 FOREIGN EXCHANGE MARKET

- It is a market for foreign exchange where buyers and sellers come together to determine the price of foreign currencies according to the forces of demand and supply.
- It is market, either physical or otherwise where users of foreign exchange meet for the purpose of selling or buying the needed international currencies.
- The aim at this market is for the supplier of foreign exchange (forex) to meet and interact with the buyer or user of international currencies

12.5 REASONS WHY PEOPLE DEMAND FOR FOREIGN EXCHANGE

Foreign exchange are demanded for the following reasons:

- 1) Trading
- 2) Investment in Overseas
- 3) Speculation
- 4) Personal Uses

12.5.1 TRADING.

Nigerians importers buy goods and services from overseas individuals and companies who involved those (Nigerian Importers) in foreign currencies. In order for Nigerians to



pay for their imports they need foreign currencies which are available from foreign exchange dealers.

12.5.2 INVESTMENT IN OVERSEAS

The difference in interest rates between Nigerian and London may attracts a Nigerian investor to invest an additional pound in London; if the interest rate in London is more favourable than that of Nigeria, thus creating a demand for pound sterling.

12.5.3 SPECULATION

People do demand for foreign currencies in order to make a profit on anticipated changes in exchange rates

12.5.4 PERSONAL USES

Travelers, Students, Bankers, Accountants and many others sometimes demands for foreign exchange to spend on overseas tour and for the payment of their examination and subscriptions fees to overseas organizations and institutions.

12.6 SOME COUNTRIES AND THEIR CURRENCIES

AUSTRALIA	AUTRALIAN DOLLAR
AUSTRIA	SHILLINGS
BELGIUM	BELGIAN FRANC
BRAZIL	REAL
CANADA	CANADIAN DOLLAR
CHINA	YUAN
DENMARK	KRONE
FRANCE	FRENCH FRANC
GERMANY	DEUTSCHE MARK
INDIA	RUPEE

12.7 TRANSACTIVE RATES OF THE FOREIGN EXCHANGE MARKET

Transactions are categorized into three on the Foreign Exchange Market depending on the currency and the market rate system in line with the development world-wide. Such follows:

- 1) Spot rates
- 2) Forward rates
- 3) Cross rates

- **SPOT RATES**

These are the rates for sales and purchases of foreign currency for delivery within 48 hours

- **FORWARD RATES**



These are the transaction rates for future delivery other than that of the spot market, usually after 48 hours

- **CROSS RATES**

A cross rate is a rate which prices one currency (of country A) in terms of another currency (of country B) but in a dealing centre of third country (country C)

Post test

1. How can the payment for services payable in three months' time be effected?
2. Where there is not direct conversion between a currency and another, how can such problem be resolved?
3. Where can other currencies be purchased in the country.

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LECTURE THIRTEEN

MONEY AND BANKING

13.0 INTRODUCTION

Money does not fall from sky, different event led to the creation of modern day usage. Prior to the advent of money, the system in operation at that time was trade by barter or barter system. Trade by barter is a situation whereby goods and services are exchange for another goods and services. This type of arrangement is very cumbersome and time consuming especially where someone's need is very urgent. This deficiency in barter system was the beginning for the need to create something that can be readily acceptable by everybody as unit of measurement for the exchange of goods and services.

Objectives

At the end of this lecture, the students will be able to know:

1. The definition of Money
2. What constitutes Money.
3. The Functions of Money.
4. The quality of Money

Pre test

1. Is there anything you cannot buy with money?
2. What do you think is spent in Nigeria before money?

13.1. DEFICIENCIES OF TRADE BY BARTER

- **LACK OF COMMON UNIT OF MEASUREMENT**

No financial value can be placed on goods and services; the only way of measurement during barter system was to list the different inventories and commodities one by one with their names and quantity possessed.

- **PROBLEM OF DOUBLE COINCIDENCE OF WANT.**

In the operation of barter system, someone who has goat and needs palm oil has to look for another person who has palm oil and needs goat before his need of palm oil can be met.

- **NO MEANS OF DEFER PAYMENT**

It was not possible to obtain goods and services on credit under barter system with the intention of paying latter because those commodities used lacked durability. Even, if future contracts were to be possible under barter, the questions that will arise are the type of goods to be used in settlement, the quantity and the quality



- **LACK OF STORE OF WEALTH OR VALUE**

It is difficult to ascertain the value or wealth of individual in the era of trade by barter. What was done then was a guess work. The guess cannot be correct since there is no way of comparing the financial value of two or more persons i.e. their worth economically.

13.2. MONEY

- Money has been defined people in various way. To the economist, “money consists of currency, coins and demands deposit”.
- Money can be seen as “anything with legal backing of the government that is generally acceptable for the exchange of goods and services and foe settlement of debt in a community or society”.
- Money is a medium by which goods and services are measured and exchanged between two or more parties.

13.3. TYPES OF MONEY

There are various types of money that evolved as a result of the shortcomings of barter system. These include:

- **COINS**

Coins were the first type of money to meet all the qualities of a good medium of exchange despite the fact that it is derived from melting of silver and gold

- **CONVERTIBLE AND INCONVERTIBLE MONEY**

Inconvertible money is bank notes used and accepted for the exchange of goods and services on demand or at a future date. A good example is Naira notes used in Nigeria.

Convertible money is the first set of bank notes used immediately after barter system that are exchanged on demand for gold or silver coins. This was necessary because people were skeptical and were only ready to accept early bank notes on the assumption that they would convert them on demand to gold or silver coins

- **QUASI MONEY**

Quasi money or near money are those assets that are not real money, but perform functions that are similar to real money. Quasi money serves as a store value like real money but they do not serve as a medium of exchange. These include: savings deposit with bank, money and postal order, share and stocks.

- **DEPOSIT WITHDRAWABLE BY CHEQUE (DEMAND DEPOSIT)**

These are different accounts maintained by bank where the owner uses cheque to withdraw cash from the bank either in person or through a third party.



13.4 FUNCTIONS OF MONEY

Money is not just existing for nothing sake, its existence is to perform some basic functions which other things cannot perform. These functions are:

- **MEDIUM OF EXCHANGE**

As a medium of exchange, goods and services can be priced and paid for in monetary terms. A person in need of a particular item do not need to keep looking for another person who has what he needs and want what he has. Such person only needs money to buy whatever he wants i.e. money is exchange for goods and services.

- **UNIT OF ACCOUNT**

With money, value of goods and services can be measured and broken down into smaller transactions which enable people to buy and sell in little fractions of money according to their abilities. This also makes payment in fractions possible.

- **STORE OF VALUE**

Money enables owners of different goods, commodities and assets to sell them and keep the money in the bank. This is storing value of the goods in monetary terms instead of allowing the commodities to rot under barter system

- **MEASURE OF WEALTH**

Money is the only means through which the wealth of an individual, organization and government can be measured and compared with another. Without money, it will be impossible to know or determine how wealthy a person is.

- **STANDARD FOR DEFERRED PAYMENT**

The possibility of credit sales and credit purchases with payment at a later date is made possible because of money. People can buy now and pay later since the value of the goods is already calculated in monetary terms. It also serves as a means for which lending and borrowing by individuals, banks, government, organization etc. on certain terms and conditions are done.

13.5 CHARATERISTICS OF MONEY

Before anything can be regarded as or called money, it must possess some basic qualities as enumerated below:

1. **GENERAL ACCEPTABILITY**

Anything that is called by the name money must be acceptable by the general public of such country since it will be used for payment and exchange of goods and services. Everyone in that nation must be ready to accept it without questioning it's acceptability in other part of the country.



2. HOMOGENEITY

This means that each unit of money be the same in quality, colour, size, shape, weight, texture and other features. The money in circulation in Lagos, Nigeria must not be different from the one in Ibadan, Oyo State, Nigeria. This explains why all Nigerian currencies are the same. The only difference is the identification number on Naira note which is imputed as part of security measure to guide against counterfeits.

3. PORTABILITY

The quality here is that money should be portable and easy to carry from one place to the other without people knowing that someone is holding money until is shown to them. In essence the weight of money should not be too much to over burden the owner.

4. RELATIVE SCARCITY

The supply of money should not be more than demand; hence it will lose its value if people can easily get it with less labour. In actual sense, money should not be acquired easily. People must labour and/ or sacrifice something to get money. Hence, money should be relatively scarce.

5. DIVISIBILITY

Money should be easily divided into smaller units without losing its value and still maintains proper relationship with other smaller and bigger units. This is the reason why we have ₦1000, ₦500, ₦200, ₦100 etc. in Nigeria apart from the coins

6. DURABILITY

It should be possible to keep money for a longer period without losing its value nor getting it spoiled like perishable goods.

7. RECOGNITION

It must be easy to recognize any unit of currency called money without any professional or technical assistance as far as the person can see.

13.6. BANKING SYSTEM

ORIGIN OF BANKING

Prior to the establishment of Bank of England , in the 17th Century, the London Goldsmiths began to accept valuable items for deposits from merchants or traders and others who, unlike the goldsmiths had no place for safe keeping of money and other valuables. The goldsmiths issued notes for any item collected by them. This note can be referred to as a receipt to the owner as a confirmation that a particular item was collected from the person



Gradually, the service offered by these goldsmiths became popular that the receipts issued by them were accepted by third party as a means of payment for debt and other financial transaction.

With this development, the goldsmiths receipt alongside with the silver and gold were used for conducting commercial activities whereby goods is transferred as an exchange for the goldsmith receipts. Later on, the goldsmiths

Receipts was changed to goldsmiths' notes and the goldsmiths began to function as bank to the extent that if those valuables kept with them are not collected on time they were lent out to other users for a profit.

As the goldsmiths "banking business" began to grow, the government recognized the need to curb their activities and also to get them registered and regulated. This led to the establishment of Bank of England 1694 as the only bank in London with the right to issue bank notes.

13.7. BANKING IN NIGERIA

Nigeria banking system had its source from the Bank of England. This was made possible because of our colonization tie with them. Hence, the modern banking in Nigeria started from the colonial period and through the colonial master. With the winding up of barter system of trade, the need to have bank in Nigeria became pronounced, more especially as a result of trans-border commercial/business activities whereby the British silver currency has gained wider acceptance in payment for goods and services. Moreover, there was the need for the British government to cater for their interest in Nigeria and also to remit money for the up-keeping of its citizen and government of Nigeria. To alleviate the problem that may be faced by the citizen, the West African Currency board (WACB) was established in 1912 by the Secretary of the State for the Colonies for safe and efficient transfer of funds with currency centres in Lagos, Banjul, Dakar and Ghana.

However, the first bank to commence operation in Nigeria was pioneered by shipping firm, Elder Dumpsters and Company that operated between Liverpool and West African countries. Elder Dempsters and Company made it possible for African Banking Corporation with head office in South Africa to open a branch office in Lagos, Nigeria. This development was short lived as a result of trade recession in Lagos same year the bank started. This made Elder Dempsters and Company to take over the bank and run it as a private bank till December 1892 when the name was changed to Bank of British, West Africa. This registration of Bank of British West Africa in London in 1892, signifies the actual beginning of commercial banking in Nigeria. This bank is known today as First Bank of Nigeria Plc. After 1892, many banks were established that were owned by Nigerian and/or foreigners. For example, in 1929, Barclays' Bank, DCO (Dominion, Colonial and Overseas) was established which is now known as Union Bank of Nigeria Plc. 1949



saw the establishment of British and French Bank which is now called United Bank for Africa Plc. National Bank of Nigeria Limited was established in 1933 and African Continental Bank Limited in 1947. Agbonmagbe Bank was incorporated as a private limited liability company on May 2, 1945 with ₦10000 share capital under the defunct Western Region of Nigerian government. This bank is now known as Wema Bank Plc. Between 1959 and 1962, eight commercial banks were established in Nigeria in addition to Western and Eastern Region Agricultural and Cooperative Banks that were converted and licensed as Commercial banks in 1962. For the Merchants banks, there are two of them in operation between 1960 and 1969, namely Philip Hill (Nigeria) Limited and Nigerian Acceptances. Both of them merged together in 1969 to form Nigerian Acceptance Limited. There was no more Merchant Bank until August 1973 when Union Dominion Trust Bank (Nigeria) Limited joined.

13.8. STRUCTURE OF THE NIGERIAN BANKING SYSTEM

The structure of the Nigerian Banking system is very dynamic from inception of Commercial banking in 1892. These structures over the years are as follows:

1. Central Bank
2. Nigerian Deposit Corporation
3. Commercial Banking
4. Merchant Banking
5. Universal Banking
6. Profit and Loss Sharing Banks
7. Mortgage Banking
8. Microfinance Banks.
9. Development Financial Institutions

Post test

1. Anything can serve as money. Discuss
2. Explain in detail, the barter system
3. What are the significance of money to modern economic system

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