Chapter 14

CHAPTER 14 Financial Institutions

INTRODUCTION

In Chapter 13, money as a legal tender was discussed. Also, it was discovered that in ancient times, trade by barter was the order of the day, while in modern times money (coins and paper money) is used to transact businesses, such as buying and selling of goods. It is not advisable to keep a large sum of money in our homes. Financial institutions such as; banks and insurance firms help us by keeping our money safe. This chapter will therefore deal with; the meaning of financial institutions, segments of financial institutions, money and capital markets, and advantages and disadvantages of capital markets.

OBJECTIVES

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

- State the definition of a financial institution;
- Explain the segments of the financial institutions;
- Provide the definitions of money and capital markets;
- State the advantages and disadvantages of money and capital markets.

14.1 Definition of a Financial Institution

Financial institutions are establishments or business organisations that primarily have dealings (keeping, lending, etc.) with money. They also deal in financial assets such as bills of exchange, company shares and letters of credits. Th e establishments offer exhaustive financial advices to their clients so that proper and profitable financial steps can be taken so as to reap profits of such financial guides. Th e establishment of the different financial institutions is backed up by the Nigerian Banking Decree of 1969 that spelt out the financial institutions that can be established in Nigeria as follows: commercial banks, discount houses, acceptance houses and finance houses. Th e duties of the financial institution included the acceptance of deposits from the public. The financial institutions can be classified bank and non-bank. Th e composition of the bank as financial institution includes commercial banks, merchant banks, development banks and the Central Bank. Non-bank financial institutions include insurance companies, discount houses, building or mortgage houses, issuing houses and stock exchange. Th e non-bank financial institutions usually operate in the financial markets through the financial instruments which are used to acquire funds for investment. Others include: bank of industry, community banks and microfinance banks.

14.2 Categories of Financial Institutions

The categories of financial institutions are (i) the traditional financial institutions and (ii) the modern financial institutions and these are as enumerated below.

14.2.1 Traditional Financial Institutions

The traditional financial institution is the foundation upon which the modern financial institution is built. The traditional financial institutions also performed the banking functions relative to that period. The traditional financial institutions are as follows:

(a) Money lenders: Money lenders are individuals that usually set aside some amount for the purpose of lending to individuals in the society. The lenders charge interest that are exorbitant and which in most cases cannot be paid by their beneficiaries within the stipulated period.

Adashi/esusu/isusu: This is a traditional or local banking system in which members that are working in the same organisation or establishment contribute agreed sum of money on regular basis (may be daily, weekly, monthly, bimonthly, quarterly, etc.) as may be deemed fit. The members are experts or workers in different areas or fields of interest. Participating members can borrow specified amount of money from the fund and members are charged moderate rate of interest. Monies that are lent to members are retrieved back at an agreed period. Esusu is a bit different because contributing members agree on how much members should contribute on a regular basis. A time table of how and when each of the members will collect his / her sum of money will be made until the last member in the group collects his / her share.

14.2.2 Modern Financial Institutions

Modern financial institutions came up because of the limitations associated with the traditional financial institutions. Among the modern financial institutions are: Central Bank, commercial banks, development banks, merchant banks, mortgage banks, insurance companies, and stock exchange market.

14.2.2.1 Central Bank

The Central Bank is known as the apex bank of all other banks in a given country. The Central Bank of Nigeria is owned by the Federal Government of Nigeria. It is saddled with many responsibilities such as the regulation and direction of institutions so as to ensure that their activities are not at variance with the country's fiscal and monetary policies. The Central Bank ensures that there is proper flow of money into the economy and also controls it. The Central Bank does not have any competitive tendencies from the other banks, because they (other banks) have the responsibility of reporting their activities to the Central Bank. There is a governor who directs the affairs of the Central Bank.

Functions of the Central Bank

(a) Financial adviser to the government: The Central Bank acts as a banker to the federal government and other levels of government, while it also offers financial advice to government in areas of revenue collection, taxation and other matters relating to monetary issues.

(b) Banker to other banks: The Central Bank is the apex of all other banks. So, commercial banks and other financial institutions keep a specified percentage of their deposits (accounts) with the Central Bank. These deposits are called legal reserves or special deposits. The commercial bank and other financial institutions withdraw specified amount from their account(s) kept with the Central Bank.

(c) Agent and banker to the government: The Central Bank serves as an agent and banker to the government because it borrows from the public through the sale of treasury bills and further ensures that a country's national debt is properly managed. The Central Bank services the government of a country just as it provides monetary and financial services to other financial institutions.

(d) Lender of last resort: The Central Bank of Nigeria lends money to banks and other financial institutions when they run out of money. In as much as commercial banks and other financial institutions have their accounts with the central bank and also have some monetary deposits in its custody, they approach the apex bank to salvage them when they are in period of difficulty.

(e) Issuance of currency: Each of the countries of the world has her own currency. For example, Nigeria's currency is Naira (N) and Kobo (K); America's currency is Dollar ($) and Cent (¢); British currency is Pound Sterling (£) and Pence (d), and so on. Th e Central Bank of each of the countries has authority to issue these currencies. The currencies are also sent to other financial institutions for distribution to the public under the direction of the Central Bank.

(f) Implementation of government monetary policy: The government is at liberty to carryout monetary policies which are under the auspices of the Central Bank. Such policies include directives, bank lending rates, Open Market Operations (OMO), cash deposit ratio, and so on. These policies help in the proper and up-to-date regulation of the supply of money into the economy.

(g) Control of foreign exchange: In as much as there is trade interaction between Nigeria and other countries of the world, the goods and services that are traded with other countries are paid for in foreign currencies. Nigeria has the foreign currency account in dollars, pound sterling, euros and other currencies. These foreign currencies in foreign accounts are reserved and these are under the control of the Central Bank. In case the Nigerian government needs some foreign currencies for business transaction, the Central Bank is ordered to transact such businesses on behalf of the government.

(h) Debt servicing: The monetary resource Nigeria has is not enough to accomplish her programmes in the different sectors of the economy. To this end, the Nigerian government borrows money from the International Economic Organisations such as International Monetary Fund, World Bank, and so on. Monies lent to Nigeria are debts, which are paid over some period of time or years and in some instances with moratorium (grace for payment). It is one of the functions of the Central Bank to ensure that these debts are serviced as and when due from the foreign reserves.

(i) Promotion of economic development: The Central Bank of a country must perform the function of promotion of economic development by attracting investors into the country. They invest in different sectors such as electricity (or power), agriculture, transportation, manufacturing and even tourism. Different projects are financed and there is the judicious application of monetary policy. These and many more encourage economic development.

Instruments used by the Central Bank to control credit: There are many instruments available to the Central Bank which are used to control money supply in the economy. These tools include

(a) Open Market Operation (OMO): This is one of the tools used by the Central Bank to eff ect increase or decrease in available cash reserves to the commercial banks. At the open market operation, the Central Bank purchases treasury bills from the members of the public. Th e implication of purchasing of the treasury bills from the public is that there will be enough cash available to the members of the public through commercial banks. So, commercial banks will be at liberty to lend money out to investors at an agreed interest rate. If, however, the Central Bank sells treasury bills to the public, through such sales, excess money or liquidity within the economy is withdrawn from circulation. The implication of this is that there will not be enough money for the public through the commercial bank.

(b) Bank rate: The bank rate is the determinant factor of whether the available money to be lent to farmers, investors and the public will be relatively affordable or not. If, however, the bank rate is low, borrowers will be able to borrow money from the commercial banks. But if the bank rate is high, borrowing of money will be costly. The bank rate is said to be a “penal rate” which is usually above the rate at which the bills are discounted. In order to ensure that the bank rate is effectively carried out, the Central Bank embarks on the OMO simultaneously.

(c) Liquidity ratio: This can otherwise be called the cash deposit ratio. The Central Bank determines how much cash the commercial banks and other financial institutions must have with them. The consequent effect is that if the Central Bank requests for a high cash deposit ratio from the commercial banks, they will not have enough money to be lent to their customers, and if the cash deposit ratio is low, there will be enough money available for lending purposes.

(d) Special deposits: The Central Bank is further empowered to request for special deposits of money from commercial banks. It is an additional tool made use of to ensure that supply of money into the economy is appropriate.

(e) Directives: The Central Bank issues directives (instruction) to other banks and these must be carried out without questioning. These directives could be targeted at encouraging making of loans available to farmers and industrialists and also to encourage self-employment amidst high rate of unemployment among the youths. The directive can be in twofolds: an increase in the amount of money made available for lending or reduction in the amount of money available for lending. Further, the Central Bank gives directives to commercial banks with respect to which sector of the economy should be better funded.

(f) Moral suasion: This has to do with gentle persuasion, where the Central Bank appeals to commercial banks in terms of monetary lending practices. For instance, the commercial banks might be interested in financing a specific area of the economy, which might be at variance with the interest of the Central Bank. The Central Bank will in a gentle manner appeal to the commercial banks to shift their interest from financing their own area of the economy, to that of interest of the Central Bank.

14.2.2.2 Commercial Banks

Commercial banks are financial institutions or establishments that accept deposits into different accounts such as savings, current and fixed deposit accounts. Commercial banks are publicly owned in which members of the public subscribe to their shares. The commercial banks have their branches all over the country and some have other branches in other countries outside the shores of Nigeria. The banks accept deposit from their customers through savings account (time deposits), current account (demand deposits) and fixed deposit accounts.

Functions of commercial banks: Commercial banks carryout lots of functions for the public and these include:

(a) Acceptance of deposits: Commercial banks accept money deposit from the public and save it in different accounts like savings, current and fixed deposit accounts. So far it is not advisable to keep huge sums of money at home; hence, individuals keep these different accounts with the commercial banks. Th e accounts are

◆ **Savings Account:** Th is is an account in which money saved earns specified percentage of interest quarterly in each year. The account is operated with the aid of savings passbook. Money can be saved in the account at anytime and can be withdrawn only by the savings account holder. Both the husband and

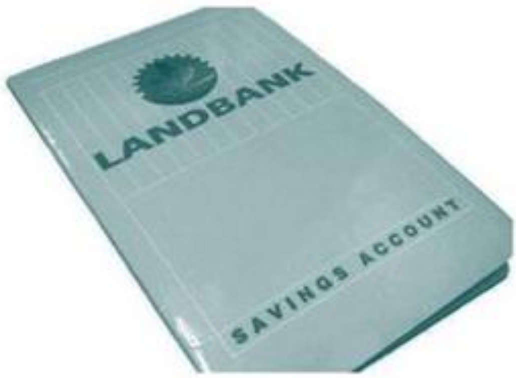
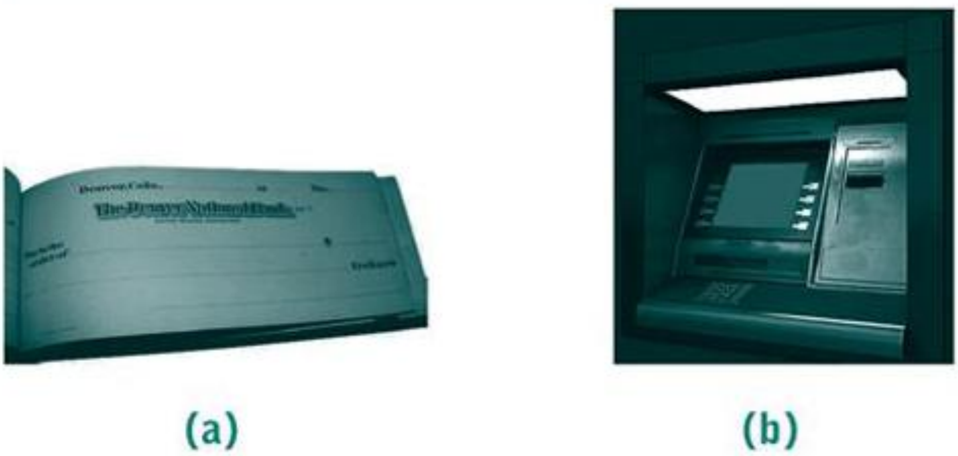


FIG. 14.1 A Passbook

wife can jointly open and operate a savings account. Churches and mosques (religious organisations) operate open savings account in which their monies are kept. In instances where an account is not operated for about 6 months, the account becomes dormant in the bank. Letter of reactivation is written to the management of the bank if the account holder(s) is / are interested in making the savings account active again.

◆ **Current Account:** It is otherwise called demand or cheque account. Most of the salary earners have their salaries paid into the current account. The current account is operated with the use of a cheque. Non account holder can be issued cheque leaf to withdraw money from such account, and it earns no interest. Rather the bank charges what is called Cash on Transfer (COT) on each of the current account operated with the bank. Just like the government and business organisations, individuals operate current account with commercial banks. Religious bodies too operate current account with different banks in order to make their monetary and business transactions easy. Th ere can be instances where the signature of the account holder is irregular, and the bank will request that such cheques be signed again. Th e statement of account is issued by the bank to the account operator on request. In these days of



i **FIG. 14.2** (a) A bank cheque (b) An Automatic Teller Machine (ATM)

customers' statement of account is sent to their electronic mail boxes on a regular basis. Th e current account is also operated with the use of automatic teller machine (ATM) card where bank customers with their ATM card can withdraw from their account at any branch of the bank that has the ATM facilities.

◆ **Fixed Deposit Account:** Th is is sometimes called the time deposit account. In this account, the culture is that someone or a fixed deposit account holder will keep huge sum of money which probably is not needed as at the time the account is being opened. Such money can be kept in the bank for a minimum of 3 months and this will be with interest. The money can further be kept in such account for a given number of years as may be deemed fit. But the account holder must give the bank not less than 7 days notice if he/she wants to withdraw his/her fixed deposited money, so that the bank will have enough time to get the money ready for such customer.

(b) Agents for payment: Commercial banks help to settle debts on behalf of their customers, and this is done by the use of cheques, because the cheques are safer to carry about than cash. Cheques are used to pay for hire purchase instalments, transfer remittances such as payments of school fees of primary, secondary and tertiary students at the end of the term, session or end of the semester. Commercial banks also pay insurance premiums to insurance companies as and when due, and according to the instruction that account holder gives to the bank.

(c) Lending agents: Commercial banks make loan advances to their customers through the bank overdraft, loan account, discounting of bills of exchange and purchase of treasury bills. The banks also give loan facilities to their customers who are of good financial standing with the bank, but the bank will request for collateral security from such customers. This is meant to forestall loan beneficiary default to pay back the loan(s). In situations where the beneficiary is not able to pay back such loan(s), the collateral security is converted back to the loan(s) that was granted to the beneficiary.

(d) Giving advice to customers: The commercial banks carry out the function of giving or rendering adversarial services to their customers. Th is is to ensure that their customers do not fall prey to fake business partners either at home or abroad. The banks help their customers with their feasibility study, which shows the path to tread in terms of establishment of business. If the banks refuse to carry out this duty of giving the necessary financial advice to their customers, they too might be at the receiving end when their granted loans are not recoverable on time from their beneficiaries.

(e) Issuing traveller's cheques and bankers drafts: Commercial banks buy traveller's cheques and also change such cheques to foreign currencies on behalf of their customers. If a customer's cheque will not be honoured in the host country because he/she is not known, such customer can obtain a banker's draft from his banker by surrendering his own cheque to his banker in exchange for the bank's cheque. Th e banker's draft that will be obtained will then be honoured in any country such customer takes the banker's draft to.

(f) Storing valuables: Valuables could be school certificates obtained from diff erent institutions, gold necklace, gold wrist watch or even share certificates that each and everyone had worked to acquire at one time or the other. In order to protect these valuables from being stolen or destroyed by fire or flood, individuals are usually advised to have them in the commercial banks, though the bank will charge some fees for rendering such services to their customers.

(g) Transacting foreign exchange: Banks undertake foreign exchange transactions on behalf of their customers and this makes it possible for nationals of other countries residing in Nigeria to transfer their savings money to their home country. Such services make financial transaction dignifying and less cumbersome.

(h) Commercial banks purchase shares and stocks: Commercial banks on instruction from their customers purchase shares and stocks from the stock exchange market. Individuals cannot trade in stocks and shares on the stock exchange market. So, the bank as part of its functions buys shares and stocks from the stock market on behalf of its customers.

(i) Executors of wills: Wealthy individuals who have amassed wealth over their lifetime do write a will. It shows the direction of how their wealth in terms of money, houses, vehicles, estates of businesses and foreign currencies abroad should be shared among the wives, children and other relatives. Th e commercial banks are therefore saddled with the responsibility of executing the wills when the owner of the wealth is dead. Th e commercial bank's proper execution of the will will not give room for bitterness and rancour among the beneficiaries of such will(s).

Diff erences Between a Commercial Bank and a Central Bank

There are notable differences between a commercial bank and a Central Bank. These differences can be easily recognised when one carefully examines the functions performed by a commercial bank and those performed by the Central Bank and these are laid out in the table below.

Table 14.1 Differences Between a Commercial Bank and a Central Bank

Commercial Bank	Central Bank
Is a public limited company owned by the members of the public through their shares subscription	Is not publicly owned, but owned and directed by the central (federal) government of a country
Has the motive of making profit and that is why they are into series of businesses	Is not out to make profit, but to render financial services to other financial institutions targeted at ensuring that there is smooth running of the financial sector of the economy
Gets necessary directives pertaining to distribution of notes and currencies from the Central Bank of the country	Is the sole body that is saddled with the authority of issuing of a country's notes and currencies and is directed by the federal government
Keeps valuables such as certificates, gold, etc. for members of the public	Does not keep certificates or gold for members of the public. It keeps the accounts for federal, state and local government. Further, commercial banks also keep their accounts with the Central Bank, and so it is with other financial institutions
Implements monetary policies that are formulated by the Central Bank	Formulates the different monetary policies which she expects the commercial banks to implement fully
Does not have anything to do with the management of national debt	Has the responsibility of managing the national debt and even has the debt management office

(*continued*)

Table 14.1 (Continued)

14.2.2.3 Development Bank

Development bank may be defined as a financial institution set up purposely to offer long-term loans meant for development of projects. Examples of the development banks are: Nigerian Agricultural and Cooperative Bank (NACB), Nigerian Bank for Commerce and Industry (NBCI) and Nigerian Industrial Development Bank (NIDB).

In addition, functions and coverage of development bank are heavier and larger in scope than the commercial bank. These banks are established by the government and do not contract businesses with individuals as done by the commercial banks.

Functions of development banks

As mentioned above, development banks have wider and larger coverage than the commercial banks. To this end, their functions are as follows:

(a) Offering of technical and financial advice to investors: Investors are individuals who have the financial backbone to establish firms where goods and services are produced. These investors might truly be wealthy but may lack the needed technical and financial advice that will lead to the success of their business enterprise.

(b) Provision of long-term capital for investors: Commercial banks provide short-term loans, but development banks are saddled with the responsibility of making available long-term loans needed for investment within the economy. Investment projects such as agriculture, commerce and tourism will initially require huge sums of money before it starts to yield returns. The bank provides financial assistance to industrial and mining sectors of the Nigerian economy.

(c) Funding of research: In order to discover new findings and to further solve some of the problems that face human beings, researches in different areas must be conducted. Such is done either in the university or in the different independently controlled research institutes. These researches are funded by government through the development banks. There are outcomes of their application to solving problems facing human beings. A single individual or commercial banks will not be willing to venture into such because it is money gulping.

(d) Investment in productive sector of the economy: There are many productive sectors of the economy such as commerce, industry, agriculture, and so on. Venturing into agriculture is a risk, just as investing in industry and commerce. But the development banks venture into such risks because investment in these sectors goes a long way at improving lots of the economy and humanity.

Differences Between a Development Bank and a Commercial Bank

The differences between the development bank and the commercial bank are presented in Table 14.2.

TABLE 14.2 Differences Between a Development Bank and a Commercial Bank

Commercial Banks	Development Banks
Are public limited companies owned and directed by the shareholders	Are owned and directed by the government
Are owned by the shareholders and can give short-term loans to their customers. This is because the shareholders will expect their dividends at the end of a trading year	Give long-term loans, which are targeted at improving the economy

(continued)

TABLE 14.2 (Continued)

Commercial Banks	Development Banks
Different accounts (savings, current and fixed deposit) can be opened	Savings, current and fixed deposit accounts cannot be opened
Valuables such as certificates, jewelleries made of gold are kept	Do not keep the valuables for their customers
Trade in foreign exchange	Do not trade in foreign exchange

14.2.2.4 Merchant Banks

They are financial institutions that provide medium- and long-term loans, accept large deposits, discount bills of exchange and buy and sell stocks. Merchant banks are established to satisfy and meet the needs of a country's big time commercial and industrial activities. Further, it engages in activities that promote industry and commerce. Examples of merchant banks are Nigerian Acceptances Limited (NAL) and Chase Merchant Bank.

Functions of merchant banks
(a) Issuing of new shares: Th e merchant banks issue shares to the public for their subscription because companies that are public limited exist through the issue of shares and eventual subscription by the members of the public. Th ere can be over subscription, moderate subscription or under subscription of shares. Public subscription of shares of companies enables such outfit to raise capital for continuity of their businesses.
(b) Provision of medium and long-term loans: Merchant banks are known to provide both medium and long-term loans for individuals who are into promotion of commercial and industrial activities. The bank is one of the engines of growth and development of commerce and industry in a given country.
(c) Takes responsibility to underwrite the issue of shares: Merchant banks agree to buy shares of companies that were not publicly subscribed to, and issue such shares to members of the public whenever there are demands for them. So the merchant bank takes responsibility to underwrite the issue of shares.
(d) Provision of financial and technical advice: Merchant banks have experts that provide both the financial and technical advice to the industrialists that require either the medium- or the longterm loans from the bank. The reason is to ensure that the loans that were granted to the industrialists yield further returns. In the course of granting of the loans, collateral securities are requested for by the merchant banks.
(e) Acceptance of bills of exchange: Th e merchant bank provides temporary financial assistance by accepting the customers' bill of exchange pending when the customer is able to pay back the debt owned. In this wise, the bank accepts to pay the discount of the importer (drawee) that does not meet up with the date of maturity
of the bill of exchange. The importer (drawee) invariably settles with the merchant bank, when the bank might have bailed such a customer out.

14.2.2.5 Mortgage Banks

A mortgage bank may be defined as a financial institution established for the acceptance of fi xed deposits from members of the public. This is with the aim of encouraging them to build their own houses by offering them long-term loans.
Example of the mortgage bank is the Federal Mortgage Bank of Nigeria (FMBN). The FMBN provides banking and advisory services and undertakes research activities pertaining to housing. Following the adoption of the National Housing Policy in 1990, the FMBN was empowered to licence and regulate primary mortgage institutions in
Nigeria and also to act as the apex regulatory body for the mortgage finance industry. Th e financing function of the FMBN was carried out and transferred to the federal mortgage finance, while the FMBN retains its regulatory role. Th e FMBN is under the control of the Central Bank of Nigeria.

Functions of Mortgage banks

(a) Constructs and provides houses and social amenities to low income groups.
(b) Advices and assists the government on housing matters.
(c) Encourages public to build their own houses by offering them long-term loans especially to those who have an account with them.

14.3 Non-Banking Financial Institutions

14.3.1 Insurance Companies

An insurance company is a non-banking financial institution involved in the protection of persons and objects against risks. Th e insurance companies collect sums of money called premiums from individuals in order to insure life and properties. Th e insurance companies are into various areas of specialisation such as life and non-life as well as re-insurance. Th ey establish contract with either the individuals or the organisations (otherwise called insured) with the aim of indemnifying (putting their clients back into the state they were before any occurrence happened to them) their clients (individuals and organisations) that took out policies with them.
Insurance companies mobilise relatively long-term funds and also act as financial intermediaries, and their investments are majorly in government securities and mortgage industry. Over the years, the Nigerian insurance industry has grown tremendously. The National Insurance Commission was established to provide insurance cover for the differently established and legally backed up insurance companies in Nigeria. The commission also helps the Nigerian government in achieving its economic and social objectives in the fi eld of insurance and re-insurance.

14.3.2 Stock Exchange Markets

Th e stock market is a market that deals with the buying and selling of long-term financial assets such as stocks, shares and debentures. The Nigerian Stock Exchange was established in 1960 then known as The Lagos Stock Exchange. By December 1977, it was changed to Nigerian Stock Exchange. It had branches in the major commercial cities in the country as follows: Th e Lagos branch was established in 1961, followed by that of Kaduna that was opened in 1978. By 1980, the Port Harcourt branch was opened and in 1989, Kano branch was opened. By 1990, two branches in Onitsha and Ibadan were opened in February and August, respectively. In addition, the Abuja and Yola branches were opened in October 1999 and April 2002, respectively. By 1961, the Exchange started operations with 19 securities that were listed for trading, and by the year 2010, there are 262 securities that were listed on the Exchange. Th e composition of the securities is as follows: 11 government stocks, 49 industrial loan (otherwise known as debenture/preference shares) stocks and 194 equity/ordinary shares of companies; the total market capitalisation is approximately N287.0 billion as at the end of August 1999. As at 2010, it has further increased to N5579.9 billion due to the patronage from the members of the public.

14.4 Capital Markets

The capital market is a market for short, medium and long-term permanent loans offered to the government, industry and commerce. In the Nigerian capital market, there are some institutions such as Nigerian Stock Exchange, the different issuing houses and the stock broking firms. There is also the Securities and Exchange Commission
(SEC) which is the apex of such institutions and serves as the regulatory authority of the stock market. One important function of the capital market is the raising of capital by issuing of new shares to the general public and other investors of stocks and shares. Th e capital market is essentially the market for new issues.

Summary

This chapter examined the following:

- Meaning of financial institutions;
- Categories of financial institutions which are:
  (a) Traditional financial institutions made up of:
  • Money lenders: Adashi, esusu, isusu;
  (b) Modern Financial Institutions made of:
  • Central bank, its functions and instruments of control.
  Other topics examined in this chapter:
    - Commercial banks, their functions and differences between commercial banks and the central bank
    - Development banks and their functions
    - Th e merchant bank and their functions
    - Mortgage banks and their functions
    - Insurance companies
    - Stock Exchange Markets
    - Capital Markets

Class Activities

(a) Students should go on an excursion to any of the commercial banks that is nearby their school to find out the functions that such banks perform.

(b) Students should go on an excursion to the Central Bank office in their state to find out its functions and how it is different from the other banks.

Revision Questions

Objective Questions

1. Which of the following is the most liquid asset to a commercial bank?
(a) Money at call and short notice
(b) Treasury bills
(c) Commercial bills

(d) Stocks and shares
(e) Cash
2. One major function of the Central Bank is to:
(a) Mint money
(b) Hold demand deposits and honour cheques
(c) Act as a medium of exchange
(d) Create money
(e) Control and regulate money supply
3. Th e amount of money to be created by the commercial banks is actually influenced by the:
(a) Legal reserve ratio
(b) External reserve
(c) External borrowing
(d) Availability of money and capital
(e) Bank deposits
4. Open market operations are the processes by which:
(a) The Central Bank purchases and sells securities
(b) Commercial banks purchase and sell securities
(c) Business firms buy raw materials freely
(d) Households buy consumer goods openly
(e) The money market takes over the function of the Central Bank
5. The Central Bank controls commercial banks through all the following except:
(a) The use of directives
(b) The use of bank rate
(c) Open market operations
(d) Accepting deposits
(e) Demanding special deposits

Essay Questions

1. How can the World Bank contribute to the economic development of your country? **(SSCE 2000)**
2. (a) Distinguish between (i) mortgage bank and a merchant bank,
(ii) a commercial bank and a development bank.
(b) Explain any four functions of commercial banks. **(SSCE 2004)**
3. Outline the role of development banks in the economic development of West African countries.
4. (a) What is a commercial bank?
(b) Describe any four ways by which the Central Bank controls the amount of credit given by the commercial bank. **(SSCE 2010)**

Glossary

Capital market: Market for short-, medium- and long-term loans to government, industries and commerce.
Central bank: Central government's bank that is responsible for the control and regulation of monetary activities in the economy.
Commercial bank: Banks that accept deposits from the public. They are mainly profit oriented.
Development bank: Financial institution that offers long-term loans for development purposes.
Merchant bank: Financial institution that provides medium- and long-term loans to the public. It also accepts large deposits of money, while it discounts bills of exchange and deals in stocks.
Mortgage bank: Financial institution that provides loans to prospective house owners on long-term basis.
Stock exchange market: A market that deals with buying and selling of long-term financial assets such as stocks and shares.