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SUBJECT: ECONOMICS

TOPIC: FINANCIAL INSTITUTIONS

Financial institutions are organizations that deals primarily in money. They constitute the

Financial framework of an economy, it helps to pool savings and excess liquidity from millions of individuals and firms within the country arid make them available to those who require them for various purposes. Financial institutions include; Commercial banks, Discount houses, Acceptance houses (Merchant banks), Finance houses, Central bank, Savings bank, Development bank, Insurance companies, Hire-Purchase companies, Stock Exchange, Building Societies, etc.

The banking decree (1969) in Nigeria specified four types of financial institutions that carry out banking business. The 4 institutions were;

- Commercial Banks
- Discount Houses
- Acceptance Houses; and
- Finance Houses.

TRADITIONAL FINANCIAL INSTITUTION

Traditional financial institution involves a number of persons come together and perform some major banking functions such as saving and lending, such organization are called 'Isusu' or 'Asusu' (local bank). This is common among rural folk and spread among low income earners.

The traditional banking system involves members contributing an agreed sum and the money so contributed is given to the members in turns. This is common among income earners as a way of raising a substantial amount of money at the time, which the receiving member can channel into a meaningful project. It is a form of compulsory savings since each members tries not to default when it is the turn of others to receive their contribution.

COMMERCIAL BANKS

A commercial bank is a financial institution that deals in money and credit, it receives deposits from the public and various organizations for safe keeping, some of which are repayable on demand by cheque. They are limited liability companies owned by shareholders and operate on commercial basis (to maximise profit by trading in money).

FUNCTIONS OF COMMERCIAL BANKS

1. Mobilization of savings or acceptance of deposits from the public and firms for safe keeping. The amount deposited are credited into customers account which is classified into 3 types;

- Current account: (cheque account) money deposited in this account is called demand deposit, money is withdrawable from this account on demand by cheque. The current account customer could withdraw money at any time during normal banking hours without prior notice.
- Savings account: is an account operated with a pass book.

- Fixed deposit account: money deposited in this account cannot be withdraw on demand, there is usually a fixed period of time before money can be withdrawn from the account.

2. Commercial banks acts as agent of payment on behalf of their customers through giving standing order to banks to make several payments on their behalf (bills, fees, rents).
3. Commercial banks acts as lending agents by giving direct loans to borrowers who have collateral security and also gives overdrafts to current account customers.
4. They help in the safe keeping of their customers' valuables and important document.
5. They give financial and technical advice to their customers' in matters relating to investment and how to carry out their business operations.
6. They help in foreign exchange transactions to facilitate travelling and foreign trade.
7. They help directly in economic development by investing in productive sector of the economy,

CREDIT CREATION

This is one of the most important functions of commercials bank, by granting loans, overdraft and discounting bill they increase the quantity of money in circulation. The total purchasing power increases by the amount loaned out.

Commercial banks create credits by;

- giving out direct loans to people and organizations and charging interest on the loans;
- granting overdrafts to customers with current account; and
- purchasing treasury bills from government and by discounting bills of exchange.

The creation of credit by commercial banks involves the multiple expansion of banks credit. In the process of credit creation some assumptions are made;

- all commercial banks act as a unit to create money;
- the law requires commercial banks to keep only a fractional part of the amount deposited with them as reserves;
- there must be no leakages in the process of credit creation.

LIMITATIONS TO CREDIT CREATION BY COMMERCIAL BANKS

The abilities of commercials bank to create money depends on the following;

1. The amount of leakages/ cash drain from the banking system.
2. The willingness of people to take loans and advances that is not all are interested in taking loans.
3. The total amount of cash in existence that is the amount of cash within the economy.
4. The amount of collateral securities available to borrowers.
5. Restrictions imposed on commercial banks by the central bank.
6. The cash deposit ratio that is the minimum legal cash reserve requirement that commercial bank must keep with the central bank.

CENTRAL BANK

A central bank is an exclusively federal government owned bank which helps to control and supervise the entire monetary and financial system of the country. Central bank carries out the major financial operation of the government, it regulates, directs, assists and coordinates the operations of other financial institutions so as to comply with the monetary and economic policies of the government. They constantly monitor the performances of the economy with a view to keeping the financial structure in proper balance.

FUNCTIONS

1. Central bank acts as a banker and financial adviser to the government.
2. It acts as a bankers' bank to commercial banks (they keep a certain percentage of their deposit in central bank).
3. They act as a lender of last resort to all commercial banks in the country.
4. Central bank is the sole authority empowered by law to issue currency within the economy.
5. Maintenance of monetary stability of all financial institutions in the economy.
6. They promote economic growth and development.
7. They engage in external businesses for the country.

ASSIGNMENT: State 5 financial institution in Nigeria.