**FINANCIAL RE-ENGINEERING AND SUSTAINABLE DEVELOPMENT IN NIGERIA**

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**Abstract**

*This paper highlights the need for financial policy makers in Nigeria to live up in order to speed up the sustainable growth of the nation’s economy. Empirical evidences in the write up are considerably sufficient to shore up the thinking capabilities of the policy makers to see reasons why the cost of capital must be brought down low. Reading through the article is good for political leaders, researchers, financial authorities and scholars in all developing countries.*

**Keywords**

*Financial-re engineering, domestic-credit, financial-intermediation, financial-assets, financial-spread, financial-depth, financial-systems, sustainable-growth, economic-development.*

**Sustainable economic development**

One could say that economic development simply refers to the sustained, concerted actions of an economy’s policy makers that promote the people’s standard of living and the economic health of a given area. Simply put, it is a policy interventionist endeavour that has at its backdrop the economic and social well-being of the people. It becomes sustainable when resources used and the extent of the development does not become hazardous to the future generations.

**Financial sector deepening**

The US Department for International Development (DFID 2004) defines the financial sector as all the institutions in an economy that offer financial services. Asekunowo (2009) broadens it that the financial sector includes everything from banks, stock exchanges, insurers, credit unions, microfinance institutions and moneylenders.

Hence, one could define financial deepening as increasing the supply of financial assets in the economy. Financial depth could be defined as the sum of all the measures of financial assets in the economy (Ndebbio, 2000). In a rather simple way, Ardic and Damar (2006) define financial depth as commercial bank deposits divided by GDP.

As outlined by DFID, the financial sector could deepen by improving the efficiency and competitiveness of the sector. Economies could achieve this by increasing their range of available financial services, increasing the density of financial institutions, which operate in the sector and by increasing the amount of money being intermediated through the sector.

Moreover, the following four alternative indicators as enunciated by Khan and Senhadji (2000) measure financial depth. First, is the sum of domestic credits to the private sector as a share of GDP. Second, is the addition of domestic credit lent to private sector as a share of GDP plus the stock market capitalisation as a share of GDP. The third is the total of domestic credit lent to private sector as a share of GDP plus the stock market capitalisation as a share of GDP, and the private and public bond market capitalisation as a share of GDP. Then fourth is the stock market capitalisation.

Even though the sum of domestic credit to private sector as a share of GDP is the most common for measuring financial depth, it appears to be a mere proxy for financial depth. The most exhaustive indicator of financial depth is the total of domestic credit to private sector as a share of GDP, plus the stock market capitalisation as a share of GDP and the private and public bond market capitalisation as a share of GDP. Moreover, only the advanced countries use it because bond markets are either not existing or they are just developing in the developing countries. In Nigeria for instance, bond market only started booming recently when some state governors embraced the issuance of public bonds as an alternative to funding infrastructural development. In addition to this, some Nigeria banks led by Guarantee Trust Bank successfully issued Eurobonds.

In their further description of what financial depth connotes, Khan and Senhadji put forth some aggregates that could measure financial depth in emerging economies, where capital markets are not fully developed. These are the liquid liabilities of banks and non-bank institutions as a share of GDP, which measures the size of financial intermediaries in an economy, the ratio of banks’ credit to the sum of banks and central bank’s credit, which measures the degree to which banks versus central bank allocate credits. In addition, they point to the ratio of private credits to domestic credits, and private credits as a ratio of the GDP.

**Financial/Economic growth**

Ndebbio (2004) in a study of some selected Sub-Sahara African countries sums up: ‘economic growth cannot be possible without the combined role of investment, labour, and financial deepening’. Ndebbio notes that ‘developed economies are characterized by high financial deepening; meaning that financial sector in such countries has had significant growth and improvement, which in turn, led to the growth and development of the economies. This points to the fact that financial institutions in an economy must be able to design articulate financial instruments that would mop up excess liquidity and at the same time efficiently allocate the mopped-up capital to the most productive sectors of the economy (Ojo, 1992).

Goldsmith (1969), as cited by Ndebbio, declares that financial structure hastens economic growth to the extent that it enhances the allocation of funds to the place where such funds yield the highest social return in an economy. In conformity with this view, Ndebbio cites Greenwood and Jovanovic (1990) who mention that financial intermediation promotes economic growth because it enables the earning of higher rate of return on invested capital.

McKinnon (1973), Levine and Zervos (1996), King and Levine (1993b) and DeGregorio and Guidotti (1995), and many others (as cited by Ndebbio) posit that financial development enhances economic growth. More particularly, DeGregorio and Guidotti, and (King and Levine 1993a) as cited by Ndebbio, ‘convincingly argue that developments in the banking sector strongly correlates with economic growth’. All these are of the opinion that a well-functioning financial structure is critical to sustainable economic growth. As further cited by Ndebbio, empirical studies carried out by Shaw (1973), Jao (1976), Fry (1978) and Ogun (1986) justify this view that growth of real money balances aids economic growth, even in developing countries.

Moreover, in the words of Okonkwo (2009), ‘better functioning financial systems ease the external financing constraints that impede firms’ expansion. Okonkwo posits that ‘since the work of Gurley and Shaw (1955), Goldsmith, and McKinnon a growing body of empirical research has affirmed that the level of financial development could positively influence long-run economic growth. He further argues that countries with more developed financial systems tend to grow faster than countries with lower levels of financial development. Okonkwo therefore recommends financial sector reforms to enhance economic growth of less developed countries.

In the words of Ojo, many less developed countries have started becoming aware of the potential roles that finance sector could play in promoting economic development. What seems to be the major problem confronting them in this respect is that many of them do not know the exact financial techniques to use and what policies to pursue that could make the financial sector play its desired roles adequately.

The financial sector contributes to economic activities, as Ojo puts it, ‘by mobilizing savings and channelling them towards most productive investments. One should however pay attention to the phrase ‘most productive investments’.

DFID further outlines that those countries that desire growth could improve upon regulation and stability of their financial sector. By so doing, more of the population could gain more access to financial services. More importantly, the extent to which private sector financial institutions allocate capital to private sector enterprises in response to market signals should increase.

Ndebbio (as cited by Asekunowo) makes it clear that some empirical evidences have shown that the available financial depth in countries in sub-Sahara Africa is too shallow. There is the yawning need to improve on expertise in formulating policies, which target at enhancing increase of financial instruments. There is also the need to improve upon banking efficiency measures like the intermediation spread and the intermediation margin.

A loan stock that attracts less than 5% rate of interest could be good enough for the small-scale enterprises to obtain towards business expansion. Reports show that loans obtained from commercial banks in even South Africa used to attract such a low interest rate. Such loans have interests charged at less than 1% in the United States.

The act of churning out of policies could not solve problems on its own. One would have suggested that the government should do more than designing of laudable policies. Policies formulated ought to be functionally delivered, with all intended results achieved. It is no news that the authorities in Nigeria recently came up with a financial system strategy (FSS 2020), to induce growth.

**Induced growth financial system**

In the words of Nwaoba (2009) among others, the projection of Goldman Sachs in a series of reports that Nigeria had the potential of emerging as one of the 20 largest world economies by 2025 provoked the new zeal for fast-tracking preparation of the blue-print for the development of the country’s finance sector. Goldman Sachs had based his reports on studies, which used the country’s GDP growth rates and some other environment scores.

Consequently, the Central Bank of Nigeria, in conjunction with other regulatory bodies and stakeholders had to strategize. They continually initiate moves to re-engineer the nation’s financial system. Finally, they came up with the FSS 2020.

While the mission of the financial system strategy is to drive rapid and sustainable economic growth, its vision is to be the safest and fastest growing financial system among other identified emerging market economies (FGN, 2007). Considering the vision and mission of the FSS 2020 one expects the nation’s financial structure to deepen in earnest.

The expectation is that the local financial depth would deepen by providing financial support for industries to expand productions and for new firms to emerge and engender growth. Nwaoba observes that deepening of the capital market could be through foreign direct and portfolio investments. Consequently, the domestic financial market could integrate with the foreign financial markets. Apart from these, Nwaoba asserts that the financial authorities would build an international financial centre. The government would quarantine the centre from the rest of the country.

The induced growth financial system would have a physically quarantined location. Such a location would be equipped with the entire necessary infrastructure for its growth. There would be sound judicial services and up to date information technology.

Moreover, one should note that the Nigerian financial system has gone through several reforms. Therefore, the underlying problem may not be in policy formulation. What seems to be a fundamental problem is capitulated in Ojo as financial sector mal-adaptation. Ojo defines a financial sector as being maladapted when its structure, culture, orientation and modes are foreign. That is when not appropriated to suit local peculiarities, as well as not made relevant to the development needs of the host economy.

In such an economy, funds are inefficiently mobilized, financial instruments are not quite attractive, limited mobilized funds are inefficiently allocated. Funds allocation is mainly on short-term basis. Hence, the cost of capital appears usually too high. Summarily, Ojo sums up that the British financial system, which Nigeria inherited and was then relevant to the then economic structure and empire status, has failed to change in line with the present industrial growth needs of the country.

Ojo points out that such a financial structure is in sharp contrast with what obtains in the financial sector of Germany, Japan, and France. According to Gerschenkro, as quoted by Ojo, ‘a German bank … accompanied an industrial enterprise from cradle to grave, from establishment to liquidation; through all the vicissitude of its existence’.

This observation is in sharp contrast to what Ojo refers to in (Edwards, 1987) as the inherited British financial system, which flourished even while the British economy depressed, as a paradox of a low growth industrial sector.

In sum, there would be no considerable development if there were no funds to finance long-term investments. Bodie and Briere (2011) suggest that very-long dated conventional bonds could as well be appropriate for long-term investors. Most bonds that are available on the market today have maturities shorter than 30 years. More so, majority of the bonds are shorter than 10 years. The operations of the nation’s capital market for instance are mainly restricted to the most urban centres.

Equally, the two suggest the creation of derivatives market that would be able to match certain liabilities of lower duration. Nevertheless, they posit that the authorities could develop a project bond market designed to finance very long-term infrastructure and other capital projects. Such a market, they claim, could extend financing to other innovation-based projects and researches.

In Nigeria, the situation is not as good as it is in the developed markets. The Nigeria’s Stock Exchange is the only one in the country. On it, trading in bonds takes place on the counter. Also on it, trades in bonds and treasury bills used to be confined to government securities.

Moreover, the need to restructure the fixed income market has led to various initiatives, which target at deepening the Nigerian capital market. For instance, mortgaged backed securities, derivatives, options and futures market were scheduled to take of this year, 2013. Beside this is the year 2006 $1trillion market capitalisation target for the Nigerian Stock Exchange.

Administratively, the bonds market, which hitherto had many challenges relatively due to inexperience, overcame teething problems, and the market is now becoming more liquid. With increased liquidity, which was occasioned by the adoption of new trading platforms by the financial dealers, which has aided the expansion of traded volumes and also increased the transparency of transactions, overall market efficiency and investors’ confidence have increased. Beside these, in order to make federal government bonds accessible to retail investors, the debt management office appointed a stockbroker who now takes charge of the federal government securities.

According to some researchers conducted by an industry player, Consolidated Discounts Ltd, the financial policy stance of Nigeria has led to increases in the number of foreign investors in the Nigerian capital market. Notably, foreign portfolio investors now have easy entry and exit into any portfolio investments of their choice. This is due mainly to a central bank of Nigeria’s circular of 24 June 2011, which erased the restrictions on foreign portfolio investors to trade and invest in federal government bonds and treasury bills with maturities of less than one year.

In sum, Consolidated Discounts perceived that the increased foreign exchange inflow from these foreign investors has contributed to stability in local currency and to increases in foreign reserves. From diverse fronts, Nigeria’s credit rating has increased, as exemplified recently by Standards and Poor’s Ratings Services. Earlier, Fitch Ratings had affirmed Nigeria’s long-term foreign and local currency issuer default ratings (IDR) at ‘BB-' and ‘BB’ respectively with a stable outlook.

How these would transform to increased GDP growth through becoming industrialized is becoming clearer. The $500million credit obtained from China Exim Bank to enhance the transmission of electricity targets at increasing industrial growth rate. Electricity transmission is such long-term investment the economy needs to grow now, which it would still need in the future. Another example of such is the abandoned Ajaokuta steel rolling mill.

What these portend for the relevant authorities is to perfect their acts. It is no news that emerging market economies are sought after by would be investors to diversify risks and for the prospects of high returns.

A cue ought to be taken from the investment drives into Asia prior to the 1997 crises. Foreign investments would not have flown into the Asian cities if the prevalent business climate there had not been peaceful and accommodating. Equally, lessons could be drawn from the economic histories of Dubai, Singapore, Panama, Monaco, and Liechtenstein.

What the government needs to do in this regard could be to encourage more of transparent economic decision-making and due processes in governance. Besides, strict adherence to rules must be seen to permeate all contracting processes by both the local and the foreign investors.

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