Economic and Financial Review

Volume 36 | Number 2 Article 3

6-1-1998

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NIGERIAN DISCOUNT HOUSES: PERFORMANCE, PROBLEMS AND RE-POSITIONING

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ABSTRACT

The paper sets out to assess the performance of discount houses in Nigeria and in particular to identify their achievements and problems with the aim of articulating measures to re-position the institutions for improved performance. As a background, the paper reviews the concept of discount houses, the origin of discount house system, their global spread and alternative systems as well as their variations over the years within and among economies. The British model was applied as the basis of the comparative analysis in the paper. This review offers good insight into the rationale and philosophy of adopting the discount house system in Nigeria. Thus, Nigeria's discount house system, which was patterned after the existing discount houses in other economies, commenced operations in 1993 but started in 1995 to experience serious liquidity and viability problems. These problems which followed a short boom between 1993 and 1994, were traced to a number of factors. First, the accelerated deregulation of the money market since 1995 removed direct control and resulting distortions on which the discount houses thrived. Second, the pursuit of tight monetary policy by the Monetary Authorities moderated liquidity whose management in the past provided substantial profit to the discount houses. Third, the improved distress resolution measures restored confidence to the banks which attracted some of the business hitherto done by the discount houses. Finally, the enhanced efficiency and stability in the foreign exchange market reduced the need to keep overnight funds with the discount houses in order to make purchases at the hitherto volatile foreign exchange market. The paper examines two options for resolving the observed problems. While the first option seeks a protected discount house system in which banks would be excluded, the second explores a situation in which discount houses and banks would participate jointly in both discount house and banking business. Finally, the paper considers the second option as *more appropriate in Nigeria's deregulated financial setting in which distortions, inefficiencies, and excessive liquidity has been reduced, thereby making it difficult for the existing discount houses to survive under the resulting contraction in pure discount house business which focuses attention on managing liquidity in the money market.*

I. INTRODUCTION

Every economy recognises the need for institutional support to foster the growth of an active money market, deepen money market transactions, underwrite government short-term securities and promote active trading in private sector financial instruments. However, there is no consensus on institutions which should perform these functions. This explains why different countries use different institutions for this purpose. For example, in the Philippines and the United States of America, a consortium of financial institutions are relied upon more or less to undertake these activities while in Zimbabwe, Malaysia, India and recently Ghana, discount houses are used largely to perform the above-named money market functions. Britain, which pioneered the discount house system, has de-emphasised reliance on discount houses. Other countries use variants of these systems with or without the same nomenclature.

Before discount houses were established in Nigeria, commercial and merchant banks, along with the Central Bank of Nigeria (CBN), had started to perform some money market functions which discount houses perform in those countries where they are in existence. When Nigeria wanted to strengthen the performance of its money market activities, the choice was between the continued use and improvement of services rendered by banks in this direction and the establishment of discount houses to take over the functions.

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In 1991, the decision to establish discount houses in Nigeria was taken while the modalities for its establishment were completed in 1993 when the new intermediary came on stream. As the discount houses were being established, there were divergent views on the role which the new institutions would play vis-a-vis the existing banks which had been holding the fort. The differing views has led to subseqtent reviews of the operating guidelines for discount houses. Despite these changes, there have been persistent calls for further reviews. These calls, led by discount houses themselves, seek to improve their relative position to banks in performing the relevant money market functions, especially at this time when the fortunes of the discount houses are on the decline. The ensuing debate is complicated by the fact that the banks seek to continue with the money market activities which the discount houses want to restrict to themselves. These developments call for a critical review and streamlining of the activities of discount houses in relation to other money market operators.

This paper has two-fold objective, namely, to undertake a critical assessment of the progress and problems of discount houses in Nigeria so far and to identify a package of measures which would enhance the contribution of the discount houses to the development of the money market and the economy without provoking another round of protest from banks.

To achieve the twin-objective of the paper, the rest of the paper is organised in four sections. Section 11 explains conceptual issues relating to discount house system and its international perspective while section III examines the operations and the appraisal of discount houses in Nigeria. Section IV draws from the operating environment and international experiences in proposing a package of measures to enhance the contribution of discount houses to money market development before Section V which brings the paper to an end by a summary and concluding remarks.

II. CONCEPTUAL ISSUES IN DISCOUNT HOUSE OPERATIONS AND INTERNATIONAL EXPERIENCES

To appreciate the need or otherwise for operating discount houses, it would be instructive to examine the meaning and rationale for such a system.

II.1 Meaning and Rationale

Discount houses are usually non-bank financial institutions which specialize in intermediating funds between the Central Bank on one hand and the banking institutions on the other with the primary purpose of assisting the monetary authorities in monetary management. Indeed, discount houses are usually associated with liquidity management in the money market. According to Revell (1973), one important aspect of the functions of discount houses has always been the service provided to banks by enabling them to adjust their liquidity as conveniently as possible. Most observers of the discount house system hold similar view. For example, Bank Negara Malaysia (1994) considered the traditional functions of discount houses to be keepers of liquidity. In the same vein, a Review of the Banks and monetary system in the United Kingdom, edited by Wardsworth (1971), showed that discount houses rendered a double service by first taking loans from the banks repayable at call, and secondly providing a ready market for short-term government securities. Thus, as money market institutions, discount houses assist in promoting orderly development of the market by smoothening out the surpluses and short falls in the supply of and demand for liquid funds in the system. This is achieved usually through their participation in the open market operations of the Central Bank. Through the sale and purchase of short-term securities, the discount houses influence bank reserves in the desired direction and by interacting with the monetary authorities on daily basis, the houses assist in the goal of creating an optimal liquidity profile for the system.

In the process of assisting the Monetary Authority in liquidity management, discount houses are known to have provided a number of specific services to the money market. These include-

(a) intermediating funds between the Central Bank and the banks thereby limiting direct access of these banking institutions to the Central Banks;

(b) promoting growth and efficiency of the money market by bringing orderliness in money market transactions;

(c) providing discount and rediscount facilities to banks so as to relieve the Central Bank of the burden of carrying out such tasks;

(d) facilitating the issue and sale of short-term government securities in several ways, including sometimes by serving as underwriters;

(e) accepting short-term deposits, especially overnight deposits from banks, thus allowing the Central Bank to concentrate on other tasks; and

(f) providing short-term accommodation to banks which otherwise would have been provided by the Central Bank.

The foregoing functions have varied over time and places as each economy searches for ways and means of making its money market more effective. To appreciate the evolving functions and uses of the discount house system, it would be instructive to draw from international perspectives and experiences.

2.2 International Experiences In Discount House Operations

While the general focus of discount houses remains that of enhancing the money market by intermediating funds between an economy's Central Bank and other financial institutions especially the banks, their operational characteristics have shown significant differences among those nations which have utilised their services. Even in the same nation, changes in operational outlook over the years are also observed. These changing features can be illustrated from the experiences of discount houses in Britain. Although the experiences of other countries could be explored, the case of Britain will be given prominence because of its uniqueness.

2.2.1 British Model of Discount House Operations

The origin of discount houses is often traced to Britain where they have over the years served as a link between banks and the Bank of England. They started largely through private sector initiatives to provide a medium for the deployment of short-term funds of banks and the channel for smooth interchange of banks' funds as well as access to the Bank of England as a lender of the last resort. From the 19th century to early 20th century, commercial bills constituted the main trading instrument for the British discount houses in the money market. However, subsequently treasury bills replaced commercial bills as the major trading instruments, though with fluctuating fortunes over the years. In effect, the major contribution of Britain to the global economy in the area of money market management is the "exportation" of the discount house system to several countries to assist their central banks in liquidity management. The experiences of Britain over the years have indicated that discount houses have tended to survive not on the main activity of discounting bills but through other innovative services outside their main functions. In the early years in Britain discounting of trade bills dominated their activities while many also relied on secondary market trading in treasury bills which became important as means of government financing. During the 1930s discount houses in Britain also acted as jobbers in the short end of gilt-edged market. However, in the last few years bill financing has once again become important in both internal and international trade, and discount houses have resumed some of their old functions. They have also begun to operate on the parallel money market in several ways including dealings in both dollar and sterling negotiable certificates of deposits and in local authority negotiable bonds. Discount houses have also established subsidiaries which have acted as brokers in money market and engaged in foreign exchange transactions.

The British model thus implied that over the years, discount houses have transformed into a veritable institutions in the money market and have expanded in scope to include activities in both the capital and foreign exchange market essentially through subsidiaries. Now their function in the trading of gilts remained substantially important in spite of the transformation the institutions have undergone over the years. The Bank of England reliance on them for the conduct of monetary policy actions might have somewhat diminished, but their importance in the overall institutional management in the British financial system remained important. The houses have also engaged in investment banking functions in addition to their traditional roles in an effort to remain relevant in the financial system.

2.2.2 Other Countries Experiences

(1) Malaysia

The traditional role of discount houses in Malaysia has been that of "keepers of liquidity". Thus, they specialized originally in short-term money market operations by mobilising funds from other financial intermediaries and large enterprises in the form of overnight money, money at call and short-term deposits. However, following the financial reforms adopted in that country from 1989 in order to provide a level playing field for financial institutions, the role of discount houses was transformed into bona fide securities dealers. Consequently, the guidelines for discount houses were reviewed to enable them to compete with other financial institutions.

Between 1989 and 1991, several changes were made in the existing laws and guidelines in search of level playing field for discount houses with other financial institutions. These changes could be summarized as follows:

a) The eligibility liability base for computing liquidity ratio was harmonized for banks and discount houses.

(b) Discount houses along with 11 other financial institutions were appointed principal dealers to underwrite primary issues of government securities.

(c) The operations of discount houses were brought under the country's Bank Act.

(d) Discount houses were allowed to invest in authorised assets with maturity periods of up to 10 years as against shorter periods previously.

(e) Discount houses were permitted to invest, trade, underwrite and manage issues of eligible private debt securities as may be approved by the Malaysian Central Bank.

What makes discount houses operation unique in Malaysia is the involvement of the houses in both money and foreign exchange market apart from being relevant in discount of domestic trade bills.

(ii) Singapore

Discount houses in Singapore were introduced to foster growth of a more active money market and to play the role of stimulating competition among participants in the market. In this regard, the discount houses traditionally have provided the link between the country's Monetary Authority on one hand and the banks together with other financial institutions on the other hand.

Instruments traditionally traded include treasury bills, Singapore dollar negotiable certificates of deposit, commercial bills of exchange and short-term government securities. The discount houses are required to underwrite weekly treasury bills issues and participate actively in secondary market for government securities. On the other hand, discount houses are to refrain from competing with commercial banks in attracting deposits from individuals and corporations. Although banks have not been forbidden to discount treasury bills among themselves, they have preferred to do so with discount houses. However, by the end of the 1980s discount houses in Singapore had become ineffective in performing the these functions. Subsequently, other securities dealers were encouraged to play the role of market makers in government securities. The discount houses in Singapore are encouraged to be involved in certain areas of business like investment banking activities traditionally reserved for banks.

(iii) Zimbabwe

The money market in Zimbabwe has been patterned after that of Britain. This linkage implied the establishment of similar institutions, including discount houses which numbered three by 1990. In Zimbabwe, money at call from the banking system has formed the basis for discount house operations. Such fund is invested by the discount houses in a range of risk-free securities, mainly short-term negotiable instruments with fixed interest rates. Banks in Zimbabwe prefer to leave money at call with discount houses, not only because it is risk-free but also because such a fund is easily recoverable on demand.

The major instruments traded include treasury bills, bankers acceptances, negotiable certificates of deposit, government stocks and corporate debentures. Thus, discount houses make markets in the securities by quoting buying and selling prices to all participants. To consolidate the stability of the market, the discount houses ensure that they maintain adequate portfolio holdings. The relative success of discount houses in Zimbabwe has been attributed to the confidence banks have in them, the high standard of their infrastructure such as functional telecommunication and a regular power supply as well as the optimal size in the number of the houses. Discount houses in Zimbabwe are moving towards investment banking functions apart from being dominant in the trading of short-dated government securities.

(iv) Ghana

Prior to the setting up of discount houses in Ghana, money market activities followed the traditional banking pattern. When discount houses were introduced in Ghana, they were meant to complement and not compete with the banks. Consequently, the Bank of Ghana conducts open market operations (OMO) through the discount houses, commercial banks, merchant and development banks, non-bank financial institutions, corporate bodies and individuals. However, since non-bank institutions and individuals have no account with the Central Bank, they are required to submit their bids through their banks. The discount houses and banks have become the major players in the primary market while the discount houses, as a group, are the major players in the secondary market. The discount houses in Ghana remained active in the primary and secondary market for government treasury bills while seeking other functions in the money market to stay afloat.

2.3 Nigerian Experience in Discount House Operations

The concept of discount houses in Nigeria is similar to that in those countries reviewed earlier. Discount houses in Nigeria were modelled along the British experience. However, their operators have deferred in some respects. Indeed, before the discount houses were established in Nigeria, the operations of such institutions in Zimbabwe, Malaysia and Ghana were closely observed along with money market practices in countries such as the Philippines and the United States of America where discount houses do not exist as separate institutions. These experiences influenced the basis for the form of discount houses introduced in Nigeria. Consequently, a discount house in Nigeria is defined operationally as any person who transacts discount house business which in the main consists of trading in/and holding of treasury bills, commercial bills and other securities and whose operations are in the opinion of the CBN, those of a discount house. Thus, the discount houses facilitate financial intermediation through transactions in those securities.

In the next section, the operations of discount houses in Nigeria would be reviewed and appraised. The discount houses in Nigeria because of the problems they have encountered have tended to shift grounds like the experiences in Britain. They now engaged in other functions which are traditionally hitherto reserved for banks, while creating market for investment in government securities. They are also active in the secondary market for treasury bills.

3.0 THE REVIEW AND APPRAISAL OF DISCOUNT HOUSES IN NIGERIA

Drawing from the needs of the Nigerian money market and the experiences of other countries, efforts were made between December 1991 and September 1992 to determine the "mission" and limits of discount houses in Nigeria. From the guidelines issued on 7th September, 1992, discount houses in Nigeria were expected to:

(a) promote rapid growth and efficiency of the money market in Nigeria;
(b) act as intermediary between the Central Bank of Nigeria and the licensed banks;
(c) facilitate the issue and sale of short-term government securities by tender;
(d) provide discount/rediscount facilities for treasury bills and other eligible financial instruments as required by banks;
(e) accept short-term deposits from banks; and
(f) perform other functions which may be prescribed by the CBN from time to time.

These goals formed the basis for the initial guidelines with which the discount houses commenced operations.

3.1 Operating Guidelines for Discount Houses in Nigeria

Section 28 of Central Bank of Nigeria Decree, No. 21 and Banks and Other Financial Institutions (BOFI) Decree, No. 25 of 1991 empowered the CBN to issue appropriate guidelines for the operations of discount houses in Nigeria. Consequently, the CBN issued the guidelines with which the discount houses commenced operations. These guidelines, which were issued on 7th September 1992, can be summarised as follows:

(a) Preamble

The guidelines, which replaced an earlier one issued in December 1991, traces its legal backing to both the CBN and BOFI Decrees and provides an operational definition of a discount house as stated earlier. Furthermore, the guidelines indicate that only local banks, financial institutions and insurance companies with or without the participation of international finance institutions acceptable to the CBN can subscribe to the shares of a discount house business while the maximum permissible equity holding for a single investor in a discount house shall be 40 per cent. Also, the introductory part of the guidelines gives the objectives and principal duties of discount houses as indicated earlier.

(b) Procedure for Application for Discount House Business:

This section of the guidelines requires the following procedure to be followed:

(i) submission of the application to the Governor of the CBN

(ii) attachment of all relevant documents;

(iii) incorporation/registration of name with the Corporate Affairs Commission (CAC) before approval-in-principle is obtained from the CBN;

(iv) satisfying the CBN with the quality of management; earning prospects and objects of the discount house;

(v) showing evidence of payment of the relevant deposits and payments;

(vi) getting approval-in-principle from the CBN; and
(vii) getting a licence from the CBN after fulfilling all relevant conditions.

(c) Management Requirements

This provision gives the minimum qualification and experiences which are mandatory for officers who may occupy the key/top management positions in a discount house. The managing director and departmental heads are expected to be university degree holders or to have professional qualifications that are acceptable to the CBN. The managing director is expected to have fifteen years post qualification experience while the departmental heads should possess ten years post qualification experience.

(d) Conditions Precedent to the Commencement of Operations

After fulfilling the foregoing preliminary conditions, the promoters of a discount house are expected to comply with the remaining conditions before the house can commence business:

(i) submission of a number of documents which include shareholders' register; a copy of share certificate issued to each share holder; two certified copies of Form C02 on the return of allotees filed with Corporate Affairs Commission (CAC); two copies of form C07 on the particulars of directors; two certified true copies of the memorandum and articles of association; the opening statement of affairs audited by a firm of accountants practising in Nigeria; two copies of the incorporation certificates; and two copies of letters of offer and acceptance of employment indicating that the management team, approved by the CBN, has been installed;
(ii) providing the CBN with the location and address of the Head Office of the discount house;
(iii) receiving a written authorisation by the CBN to commence business;
(iv) displaying the operational licence at a conspicuous position at the Head Office; and
(v) providing the CBN with the date for commencement of business.

(e) Sources of Funds:

According to this section, the authorised sources of funds for a licensed discount house include equity (i.e. paid up capital and reserves); call money and short-term borrowing of not more than twelve months maturity; overnight advance from the CBN against acceptable collateral provided it is not more than 20 per cent of the total assets of the discount house; and utilisation of the re discount facilities for its holdings of treasury bills, treasury certificates or securities issued by the CBN.

(f) Structure of Assets

The short-term nature of the liabilities of a discount house makes it necessary for its assets to be substantially liquid. Consequently, this section of the guidelines stipulates the asset composition of discount houses to consist of treasury bills; treasury certificates, negotiable certificates of deposits (NCDs); bankers' acceptances; eligible commercial papers; eligible development stocks, eligible state bonds; promissory notes issued by state governments; and any other securities that may be approved by the CBN.

(g) Prudential Requirements

To guide the discount houses in self-regulation, the guidelines stipulate a number of safety measures. These include:

(i) transferring to the reserve fund a minimum of 15 per cent of profit after tax until thc reserve fund equals the authorised capital and a minimum of 10 per cent subsequently.

(ii) maintaining capital funds to risk asset ratio as may be prescribed by the CBN;

(iii) maintaining a ratio of not more than 50:1 between its total borrowing and capital plus reserves without the prior approval of the CBN;

(iv) not granting to any bank, loan or credit facility of more than 75 per cent of its shareholders' funds unimpaired by losses without the prior approval of the CBN;

(v) maintaining not less than 70 per cent of its assets in treasury bills with maturity not exceeding 90 days; and

(vi) maintaining proper book of accounts as specified by the CBN.

(h) Requirements For Returns, Accounts, Adverts and Structural Changes

To have continuous grip on the discount houses, some directives are issued with respect to the procedure and timing for a number of returns which include returns on settlement each day, each week and each month as well as the responsibilities of the discount houses with respect to audited accounts, interest rates, adverts, changes in management and board of directors, and obtaining relevant approvals for different activities.

(i) Prohibited Activities

To allow the discount house to concentrate on its approved business, the guidelines provide a list of prohibited activities. These include granting loan facilities to directors or the general public; dealing in gold or foreign exchange; payment of dividend on its shares before its preliminary expenses and non- recapitalised expenses have been completely written off, accepting any money or deposit or loan which is payable by cheque, draft, order or any other instrument drawn by the depositor on the discount house; and engaging in any business other than those for which it was licensed.

(j) Conditions for Revocation of Licence

To serve as a deterrent to reckless operation of discount house business, there is a provision in the guidelines to revoke the licence for serious breach of the guidelines. Some of the offences which may attract revocation of licence include submission of false information during and after the processing of application for licence; engaging in activities outside the scope of the licence and persistent failure to comply with any guidelines of the CBN or provisions of the BOFI Decree, 1991, as amended. Other conditions for revocation are engaging in activities prejudicial to the economy; having insufficient assets to meet its liabilities; and any other acts which, in the opinion of the CBN, constitute a violation of any of the provisions of the guidelines and the BOFI Decree of 1991 as amended.

(k) Miscellaneous Provisions

To plug the remaining loopholes in the operation and regulation of discount houses, miscellaneous provisions have been included. These provisions touch on the role of the CBN with respect to the regulation and supervision of discount houses; factors which could disqualify people from the management of a discount house; and the consequences of failing to take reasonable steps to ensure the accuracy of returns to the CBN. Finally, the miscellaneous segment of the guidelines explains the treatment of capital invested in discount houses in determining credit ceilings and prescribes penalties for breach of the guidelines.

3.2 Review of the Operation of Discount Houses in Nigeria

After fulfilling the necessary requirements, three discount houses commenced operations in Nigeria in 1993. Between 1995 and 1996, two more discount houses joined the system. The commencement of the discount houses came at a time the money market was relatively inefficient, regulated and distorted. The prevailing inefficiency and distortion created an environment which favoured the discount houses, at least, temporarily. For example, the distress among the banks and the declining confidence in them enhanced the patronage of the discount houses. Thus, banks with surplus funds preferred investing them in the discount houses than in distressed banks. For the same reasons, banks, which accumulated funds for the use in the foreign exchange market, placed them temporarily with the discount houses for some return before they were required for the purchase of foreign exchange. Besides, the market was surfeit with excess liquidity. Thus, the inefficiency in the money market provided initial benefits to the discount houses.

Using the balance sheet as an indicator of growth, it could be seen that the discount houses experienced initial boom from 1993 to 1994 and fluctuating fortunes subsequently. Total assets/liabilities which stood at

N4.5 billion in 1993 more than doubled to N9.6 billion in 1994 when the number of the discount houses were still three. In spite of the increase in the number of discount houses in 1995 by one to four, the total assets/ liabilities fell sharply to N3.4 billion at the end of the year. However, in 1996 total assets/liabilities rose substantially to N11.8 billion. This coincided with the growth in the number of discount houses by one to five during that year. In 1997, the total assets of the five discount houses dropped sharply to N7.0 billion, thus repeating the 1995 experience. It was not surprising, therefore, that the discount houses had been complaining of poor business. A close look at the balance sheet of the discount houses shows that by 1997, they had exhibited strong signs of illiquidity with declining cash balances and reduced investments in government debt instruments. With the foregoing insight into the operations of the discount houses, it would be appropriate at this point to appraise the overall performance of the discount houses with respect to their mandate and people's expectations.

3.3 Appraisal of the Overall Performance of the Discount Houses

This appraisal would concentrate on the extent the discount houses have achieved the objectives for which they were set up and the constraining influences in this regard. These are reviewed below:-

(a) **Achievements:**

There is no doubt that discount houses embarked on some services they were established to provide to the money market. Thus, they have:

(i) intermediated funds between the Central Bank and the banks;
(ii) served as dealers in the open market operations (OMO);
(iii) accepted short-term deposits from banks;
(iv) provided short-term accommodation to the banks; and
(v) traded in both treasury and commercial securities.

Through these services, the discount houses made reasonable profit, especially between 1993 and 1994 and assisted in liquidity management, thereby helping to promote growth and orderly development of the money market.

As already noted, the initial modest success of the discount houses were accounted for by a number of factors. First, their operations were protected and enhanced by a relatively inefficient, regulated and distorted market which made it possible for them to make huge profit margins initially. Second, the liquidity of the financial system was high and sometimes excessive, thus providing the houses with the opportunity to benefit from its management. Third, the placement with the discount houses attracted high interest yield and therefore reasonable margins. Fourth, the pricing of treasury bills, the main item of trade, was at some point considered adequate by the discount houses. Finally, the unpredictable foreign exchange market encouraged the banks to keep the funds for such transactions at call with discount houses which benefitted financially from the banks' placements.

(b) **Constraining Influences**

Since 1995, the discount houses started to find it difficult and less profitable to provide some of the services they started with and to meet other expectations. By 1997, the observed difficulties were reflected in (a) declining balances with the banks; (b) declining balances with the Central Bank and (c) declining claims on the Federal Government. Also declining was the discount houses' lending to the banks through call money and loans and advances. These developments adversely affected their total assets which declined sharply in 1997 as shown earlier. The corresponding fall in total liabilities was explained largely by declining borrowings, especially through call money from banks and other financial institutions.

Another way in which discount houses have failed to live up to expectation is in terms of their inability to underwrite treasury securities. Although the guidelines have not made it mandatory for them to perform this task, money market observers expected them to mature into performing such a task as discount houses do in some other countries. The discount houses, on their part, are prepared to perform this task but they hold the view that their operational environment is not conducive for such a function. For example, they argue that the issuance of securities must be market determined if they are to take up the underwriting of such securities.

Having reviewed the areas in which discount houses in Nigeria have experienced problems, it would be necessary to identify the factors which have influenced the turn of events. These factors, which are traced largely to the reversal of their operational and regulatory environment, include the accelerated deregulation of the money market, improved confidence in the banking system, the pursuit of tight monetary policy, and enhanced foreign exchange market as reviewed below:

(i) **Deregulation of the Money Market**

Although deregulation of the money market started before the establishment of the discount houses, it suffered many reverses in the distant past. Since 1995, deregulation became more steady with profound effect on the money market. The market became less distorted with stiff competition. The resulting efficiency removed the protection hitherto conferred on discount houses through regulation. This impinged on their profit margins.

(ii) **Improved Confidence in the Banking System**

Following the success in the efforts to resolve the distress in the banking sector, confidence returned to the system while the interbank market started to boom once again. Consequently, the patronage which would have gone to the discount houses switched over to healthy banks with surplus funds. This has increased the number of banks which compete with the discount houses in several ways, including dealing in treasury bill transactions.

(iii) **Tight Monetary Policy**

The tight monetary policy measures pursued in recent years especially since 1995, has moderated liquidity significantly. As a result, the size of excess liquidity has reduced considerably. Thus, the financial benefits which discount houses derived from the management of the surfeit of liquidity between 1993 and 1994 have declined.

(iv) **Enhanced Foreign Exchange Market**

The stability and improved efficiency of the foreign exchange market since 1995, coupled with the restoration of confidence in the banking system, has reduced the need for banks to keep large amount of funds on call with the discount houses. This contrasts with the practice during the unpredictable foreign exchange market era and the height of distress in banks when substantial funds had to be kept by the banks with the discount houses on call in order to meet their foreign exchange needs at short notice.

From the foregoing assessment, it is clear that the viability of the discount houses is threatened. This has, no doubt, constrained the effectiveness of the institutions and dampened the enthusiasm for their establishment. In the next section, the measures to re-position the discount houses for enhanced performance would be identified and appraised.

4.0 MEASURES TO ENHANCE THE CONTRIBUTION OF DISCOUNT HOUSES TO MONEY MARKET DEVELOPMENT

4.1 Focus of Required Solution

To provide adequate solution to the problems of discount houses, there is need to focus attention on those measures which enable them to achieve the main objective for their establishment, namely, to make the money market more effective. Consequently, the required solution should be properly focussed. First, the solution should be comprehensive to avoid measures which could create bottlenecks in other segments of the market, thereby neutralizing the effects of the solutions provided. Second, the expected solution should move away from a protected market and uphold the current de-regulatory stance of the market, thus encouraging healthy competition among money market operators. Finally, the required solution should have a lasting favourable impact on the money market to prevent a re-occurrence of the transient relief or boom they had between 1993 and 1994. To uphold these principles, it would be useful to consider the recent experiences of Nigeria and other countries in managing the money market.

4.2 Valuable Considerations in Seeking Solutions

From the experiences of Nigeria and other countries, it is clear that the Nigerian money market can develop into an effective system with or without discount houses. However, it remains a fact that Nigeria has made a deliberate choice of the discount houses to assist in making the market effective. There is no doubt that the fortunes of the discount houses have declined since 1995 because of changed operational and regulatory environment which has reduced their viability. Consequently, there is need to ensure that discount houses are viable without which they cannot perform their functions effectively.

One of the suggestions for making discount houses viable is to keep their traditional functions exclusively to them, for example, by serving as principal dealers in the securities traded in the market. Although the creation of a protected market for the discount houses can enhance their viability, it should be noted that such a protection is inconsistent with the current de-regulatory stance of the money market. Besides, Nigerian commercial and merchant banks which were providing these services before the establishment of discount houses still want to share these functions with discount houses. Furthermore, the prevailing non-market contest for market shares does not create harmony in the market, hence its elimination should be part of the desired solution to the problems of the discount houses.

In view of the foregoing facts and valuable considerations it would be necessary to provide solutions that would combine the following elements as much as possible-.

- (i) making discount houses viable;
- (ii) bringing harmony among all money market operators;
- (iii) encouraging emphasis on market orientation;
- (iv) discouraging a protected market;
- (v) deepening the money market; and
- (vi) making money market activities supportive of monetary management.

4.3 Providing a Lasting Solution to the Problems of Discount Houses in Nigeria

Efforts to provide a lasting solution to the problems of discount houses in Nigeria could be enhanced by learning from the recent experiences of Nigeria and other countries in money market management, as well as focussing attention on the objectives and peculiarities of the Nigerian situation. Three options come to mind. The first is to create a protected market for discount houses while the second one is to allow open competition between discount houses and banks. The third option is to permit discount houses, banks and non-bank financial institutions to undertake discount house business. However, since non-bank financial institutions in Nigeria, have neither demonstrated serious interest in such business nor exhibited potentials for such, the third option is not considered here. This leaves us with options One and Two for consideration. These options are as follows:

Option One: Creating a Protected Market for Discount Houses in Nigeria

This implies keeping discount house business exclusively for discount houses. This would be in keeping with the traditional practice of discount business in which the discount houses intermediate funds between the banks and the Central Bank, thereby minimizing direct dealings of the banks with the Central Bank in a number of activities. In Nigeria, the creation of a protected market would imply taking measures to make the discount houses viable by reserving their traditional functions for them. This would mean:

(i) making sure that banks do not engage in the traditional functions of the houses, including acting as principal dealers in government Securities; and

(ii) creating the enabling environment for the discount houses to embark on the underwriting of government securities which is not only the expectations of the founders of discount houses in Nigeria but also the task performed by discount houses in many other countries where they exist.

Creating a protected market for discount houses in Nigeria, however, has a number of problems. First, a protected market at this point in time would be inconsistent with the current de-regulatory stance of money market management. Indeed the deregulation of the financial sector has come to stay especially because of the enhanced efficiency in resource allocation stimulated by competition. Second, the so-called traditional functions of the discount houses are also fundamental to the banks. In fact, the banks in Nigeria were performing these functions before the discount houses were established. Consequently, efforts to restrict these functions to the discount house is likely to continue to create friction. While those banks which own discount houses can be persuaded easily to keep away from discount house business, other banks may be difficult to convince. Third, it is even difficult to see how the five discount houses can survive on the traditional functions. Since the discount houses depend largely on the margin they make in securities trading, the existing volume of business can hardly support the five discount houses already in existence. Besides, as the financial sector becomes more efficient and less distorted with other operators performing their functions more effectively, the margin which discount houses make from liquidity management would become less and less. Thus, the observed threat to the viability of the discount houses on its traditional functions appears to be real. This realization creates the need for considering the second option for bringing relief to discount houses which are experiencing declining fortunes currently.

Option Two: Allowing Competition Between Discount Houses and Banks

Another way of making discount houses viable, so as to enhance their capacity to perform their functions effectively, is to allow them to compete with banks in performing not only the traditional functions of the discount houses but also selected banking functions. There are several reasons for this alternative solution. **First,** it is a realistic way of making the discount houses viable without which the discount houses cannot perform their traditional functions at both the primary and secondary levels. There is already enough evidence to show that they can hardly survive on their traditional functions unless they are given some protection which, in itself, has its problems. **Second,** since the banks seek to perform discount house functions and discount houses, in turn, contest for banking functions, an appropriate compromise is to allow them to undertake both functions especially under the current deregulated environment. **Third,** the persistence with which discount houses and banks want to perform each other's functions underline the fact that discount house system in Nigeria is an artificial creation, hence the need to throw their respective functions open to each other. Indeed, in many countries (including the Philippines and the United States of America), as noted earlier, there are no discount houses. Consequently, a selected group of banks and related institutions carry out discount house business without assuming the nomenclature of discount houses. Since the discount houses in Nigeria have viability problems because of restricted market there is need to increase the scope of their operation.

Finally, the experience of some countries operating the discount houses system provides some useful lessons in the restructuring of the discount houses in Nigeria. A review of the growth of discount houses in such countries show that over the years, economic and financial reforms have transformed the discount houses from either short-term securities dealers to long-term securities traders or to investment bankers and related functions. Like Nigeria, these other countries find a protected discount business inconsistent with the de-regulatory reforms which have swept the world economy, especially since the turn of the 1980s. This explains why Britain has de-emphasized the use of discount houses, thereby allowing the existing ones to diversity into all sorts of financial business.

Although discount houses in Zimbabwe are still largely in pure discount houses business, their continued survival is attributed mainly to the confidence the banks have in them and the deliberate effort by the regulatory authorise to keep their number low so as to ensure business for them in the relatively limited discount house market. In Nigeria, the confidence which banks had in discount houses in 1993 and 1994, at the height of banking system distress, started to decline since 1995 as confidence returned to the banks and discount houses started to be less liquid. In Malaysia, discount houses which were introduced as "keepers of liquidity" in the money market were, by 1989 - 1991, brought under the Banking Act and were permitted to expand the scope of their operations as may be approved from time to time by the Malaysian Central Bank.

The Preferred Option

From the foregoing analysis, the second option of allowing discount houses to be involved in some areas traditionally reserved for banks is preferred. Although, some of the reasons for the preference are already indicated. The most important is the operating environment which has tended to put the houses at a disadvantage vis-a-vis the banks. In fact this has been adduced as the principal reason for the poor performance by the houses. Furthermore, the predominant global practice has been increasing liberalization in the functions of discount houses relative to banking operations. Indeed, only a relatively small number of countries have experimented money market management with the services of discount houses while the larger number of countries use a combination of institutions for this purpose including discount houses. The observed widening of the scope of discount houses beyond the traditional discount house business in the countries where they exist, appear to confirm the fact that the market for pure discount house business is limited. the strategy whereby discount houses are offered greater flexibility in operation is recommended in order to re-position the discount houses in Nigeria for improved performance. The essence is to allow the houses to be involved in areas outside the discount business which was traditionally reserved for banks. This could be in areas of investment banking and other fee based activities that could enhance their operational performance.

5.0 SUMMARY AND CONCLUDING REMARKS

5.1 Summary

The five-part paper attempts to review, appraise and find solutions to the current problems of discount house business in Nigeria. To this end, Section One identified the focus of the paper which is to find solution to the declining fortunes of discount house business in Nigeria. To appreciate the characteristics of discount houses, Section Two explored the meaning and rationale for discount houses and underlined their international perspectives by examining their operations and progress in several countries. Section Three of the paper reviewed and appraised the establishment, operations and performance of discount houses in Nigeria. In particular, their achievements and constraining influences were noted. This Section observed that while the discount houses performed some of their functions fairly well between 1993 and 1994, they started from 1995 to experience problems which affected their viability adversely. In fact, these problems, which translate into insufficient business, affected their margins, hence they started to look beyond discount house business for survival. In Section Four, the paper sought solutions to the problems of insufficient business within the traditional discount houses. It was observed that the solution to the current problems of discount houses is either to promote a protected discount house business for discount houses or to allow discount houses and banks to compete for discount house and banking businesses.

5.2 Concluding Remarks

The paper concluded its findings by preferring a joint action option in which the existing discount houses are allowed to expand the scope of their operations by including banking functions. This ensures that they are viable without which they cannot perform their primary responsibility in the money market. In the same way, the banks which have been itching to perform discount house business and which meet a minimum performance criteria, should be allowed to do so.

The benefits of this partnership are many. **First,** harmony could be brought to the money market as the banks and the discount houses would be engaged in those functions they have struggled over the years to perform. **Second**, the arrangement could be equitable in the sense that those banks which do not own discount houses would be allowed to undertake discount house business. **Third**, the restructuring or re-positioning of discount houses would be an appropriate solution to their viability problems in view of the limited market for pure discount house business, especially when the money market becomes more efficient and less distorted. **Fourth**, the proposed arrangement is in line with the de-regulatory reforms in the money market which relies heavily on market forces with emphasis on competition in the provision of financial services. The envisaged solution is also consistent with the predominant global practice in which a selected group of financial institutions are utilized to carry out discount house business in addition to performing other money market functions assigned to them. Finally, the joint option would provide a consortium of discount houses and banks whose financial "muscle" would be adequate for the task of underwriting government securities.

While endorsing joint action by discount houses and banks in providing discount house and banking services, efforts should be made to provide adequate direction for the proposed restructuring. Although details of such restructuring is not the focus of this paper, it would suffice here to suggest that institutions which would be affected by the envisaged re-positioning should meet a minimum performance criteria to be determined by the regulatory authorities.

DISCOUNT HOUSES' STATEMENT OF ASSETS AND LIABILITIES

(₦' million)

ITEMS	1993 (1)	1994 (2)	1995 (3)	1996 (4)	1997 (5)
ASSETS					
CASH & BALANCE WITH BANKS	6.4	50.5	71.3	203.3	99.5
i) Cash on hand	0.1	0.2	0.2	0.3	0.4
ii) Balances with CBN	0.0	15.4	(2.3)	0.0	0.0
iii) Balances with other banks	6.3	34.9	73.4	203.0	99.1
CLAIMS ON FEDERAL GOVERNMENT	4,213.2	7,125.9	2,468.4	6,479.9	1,506.4
i) Treasury Bills	4,029.6	7,125.9	1,552.6	6,479.7	1,499.2
ii) Treasury Certificate Maturing	0.0	0.0	0.0	0.0	0.0
iii) Treasury Bonds	0.0	0.0	0.0	0.0	0.0
iv) Eligible Development Stock	183.6	0.0	915.8	0.2	7.2
CLAIMS ON STATE GOVERNMENTS	0.0				
CLAIMS ON BANKS	138.7	2,308.1	662.2	2,522.2	3,082.0
i) Money at Call	0.0	232.0	252.0	179.6	115.0
ii) Loans and Advances	0.0	0.0	0.0	1,583.8	78.0
iii) Commercial Bills	138.7	2,076.1	410.2	693.8	2,789.0
a) Bankers Acceptances	138.7	2,076.1	410.2	555.4	2,789.0
b) Promissory Notes	0.0	0.0	0.0	0.0	0.0
c) Negotiable Certificate of Deposit	0.0	0.0	0.0	0.0	0.0
d) Stabilisation Securities	0.0	0.0	0.0	138.4	0.0
iv) Others	0.0	0.0	0.0	65.0	100.0
CLAIMS ON OTHER FINANCIAL INSTITUTIONS	0.0	0.0	0.0	338.7	0.1
Money at Call	0.0	0.0	0.0	338.7	0.0
Loans and advances	0.0	0.0	0.0	0.0	0.0
Commercial Bills:	0.0	0.0	0.0	0.0	0.0
a) Promissory Notes	0.0	0.0	0.0	0.0	0.0
b) Negotiable Certificate of Deposit	0.0	0.0	0.0	0.0	0.1
CLAIMS ON OTHERS	0.0	0.0	0.0	1,890.7	1,777.6
i) Commercial Bills	0.0	0.0	0.0	1,865.7	1,580.0
ii) Loans and Advances	0.0	0.0	0.0	25.0	0.0
iii) Others	0.0	0.0	0.0	0.0	197.6
	0.0	0.0	0.0	0.0	0.0

DISCOUNT HOUSES' STATEMENT OF ASSETS AND LIABILITIES
(₦' million) (Contd.)

ITEMS	1993 (1)	1994 (2)	1995 (3)	1996 (4)	1997 (5)
ASSETS					
OTHER ASSETS	103.5	98.4	169.0	207.9	335.7
FIXED ASSETS	0.0	0.3	61.0	135.7	174.9
TOTAL ASSETS	4,461.8	9,583.2	3,431.9	11,778.4	6,976.1
LIABILITIES					
CAPITAL AND RESERVES	436.0	565.7	865.6	1,251.7	1,430.5
i) Paid-up Capital	385.0	437.5	667.5	948.5	950.4
ii) Statutory Reserves	0.5	18.5	51.0	127.8	141.2
iii) Share Premium	0.0	0.0	0.0	37.9	113.7
iv) Other Reserves	50.5	109.7	147.0	51.6	155.4
v) General Reserve	0.0	0.0	0.0	85.9	69.8
MONEY-AT-CALL	3,350.0	5,517.6	707.9	7,653.1	1,617.3
i) Commercial Banks	3,350.0	5,517.0	707.9	6,125.8	701.1
ii) Merchant Banks	0.0	0.0	0.0	313.2	5.7
iii) Non-Bank Financial Institutions	0.0	0.0	0.0	1,214.0	907.4
iv) Others	0.0	0.0	0.0	0.1	3.1
OTHER AMOUNT OWING TO:	0.0	0.0	0.0	251.1	2.6
i) Commercial Banks	0.0	0.0	0.0	0.0	0.0
ii) Merchant Banks	0.0	0.0	0.0	0.0	0.0
iii) Non-Bank Financial Institutions	0.0	0.0	0.0	1.1	0.0
iv) Others	0.0	0.0	0.0	250.0	1.6
BORROWINGS	2.9	2,347.5	610.0	13.4	2,219.9
i) Central Bank of Nigeria	2.6	0.0	0.0	0.0	2,016.3
ii) Overdrafts	0.0	0.0	0.0	13.4	3.6
iii) Other Banks	0.3	2,347.5	610.0	0.0	200.0
OTHER LIABILITIES	672.9	1,152.4	1,248.5	2,609.1	1,705.8
TOTAL LIABILITIES	4,461.8	9,583.2	3,431.9	11,778.4	6,976.1

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