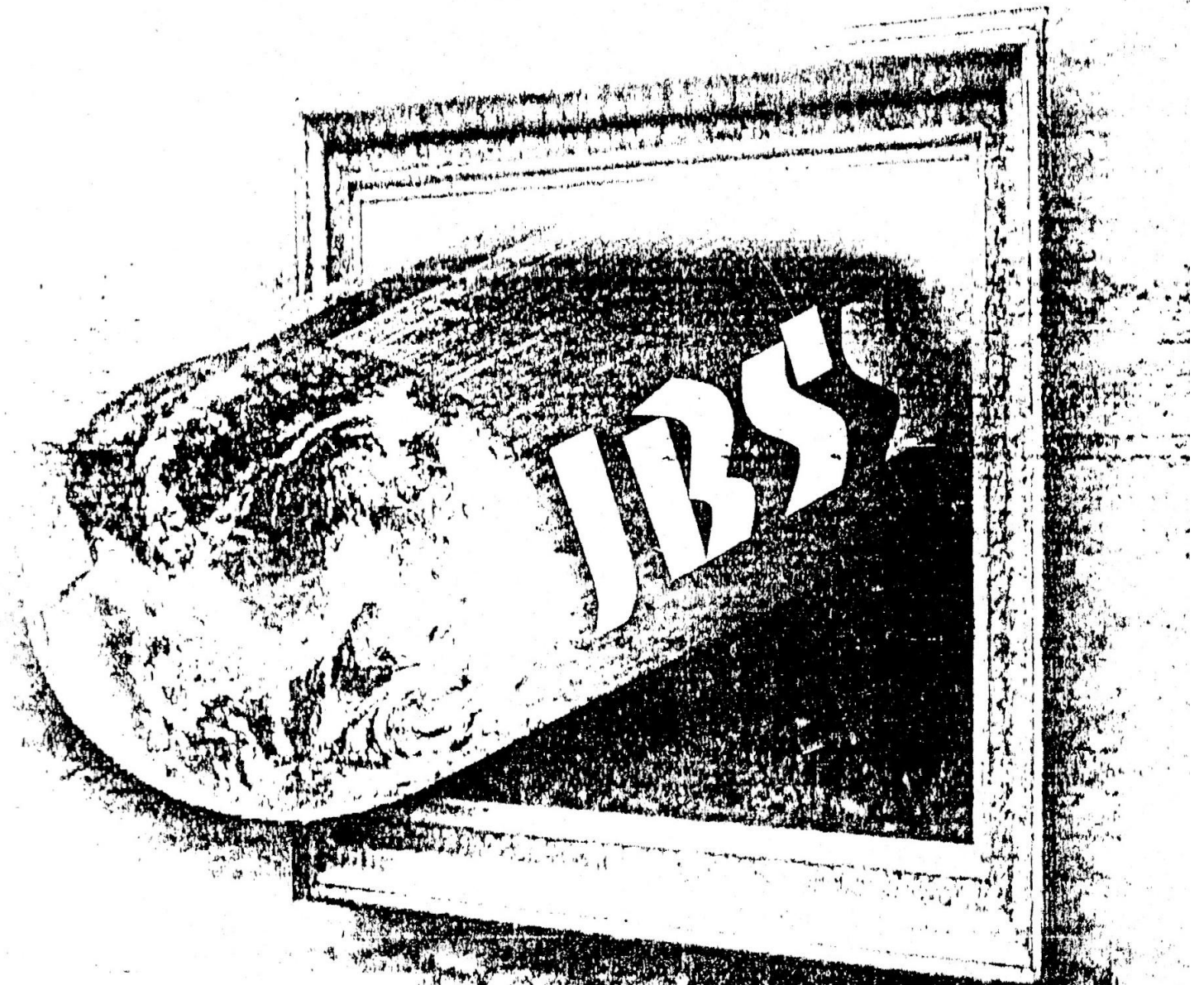


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PROBLEMS AND PROSPECTS OF CENTRAL SECURITIES CLEARING SYSTEM (CSCS) IN THE NIGERIAN CAPITAL MARKET

ABSTRACT

In an effort to ensure the efficient operation of the Nigerian Stock Exchange (NSE) and in conformity with the International Federation of Stock Exchanges Standards for emerging markets, NSE, in 1992, incorporated a subsidiary company: Central Securities Clearing System Limited (CSCS) which started operation in April 14, 1997. The company is confronted with a number of problems militating against its operations. This paper attempted to identify these problems using both primary and secondary data while at the same time uncovering some strengths of the new regime. It was found, among others, that the capital market operation has significantly improved with the introduction of CSCS especially in the area of transfer of purchased shares to their new owners. It now takes about 6 days ($T + 5$) as opposed to about 18 months to complete a transaction and there are plans to reduce the transaction period to about 4 days ($T + 3$).

The inefficient pricing of stocks in the market has been properly addressed as the new system makes it very difficult for stockbrokers to price stocks arbitrarily and to buy at all cost. Generally, there is reduction in transaction cost, increase in market capitalization network, more realistic principles guiding the purchase and sell of securities and improved profile of the market. However, it was also found that the new regime lacks the needed awareness. There is also insufficient number of selected banks to open trading account with stock brokers; illiquidity of the economy, and low level of foreign investment and the general attitude of buy and keep as well as wait - and - see among investors and cases of failed trade are militating against the effective operations of CSCS.

It was recommended that NSE and/or the subsidiary company, CSCS, should mount a saturated publicity on the new system. The number of trading banks should be increased and the trading account balances (funds and securities)

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should be closely monitored at the beginning of each trading day to strengthen CSCS and to avoid further trading failures. SEC, NSE and CSCS have roles to play in this direction. Guided CSCS and privatization programmes should be encouraged.

1. INTRODUCTION

Nigerian capital market has undergone a number of metamorphosis. This, no doubt, is in line with the phenomenon of economic growth. Essentially, the reforms of the Nigerian capital market over the years is in line with the economic law of progression and an effort to broaden the operations of the market as well as meeting international standards.

Generally, world financial markets in recent years have been characterised by trends towards increased integration, securitization and liberation. The extent to which a capital markets meet the trend depends on the facilities available in the market and more specifically on the easy flow of funds within and across the market. Unfortunately, Nigerian capital market, as one of the emerging markets, has been described as not yet efficient, at least when compared with the markets of industrial countries like United Kingdom, USA, etc. For instance, return behaviour, both on a cross-section and a time-series basis, displays some patterns that raise questions about the effectiveness of the asset allocation role played by the stock markets in developing countries.. (Claessens, 1995:11). Claessens, et al. (1995:131) also report that rates of return in many emerging markets have significant positive first order autocorrelation which indicates return predictability and possible inefficiencies. Harvey, among others also reports that many of the emerging market returns depart from normality. In addition, there are inherent bottlenecks adversely affecting the efficient and effective operations of capital markets in developing countries including Nigeria. There is the difficulty associated with pricing of stocks, transfer of shares, settlement/delivery of share certificates and non-transparency of the market. These shortcomings notwithstanding, it is evident that the emerging markets like the Nigerian capital market can still improve their functioning.

The Nigerian economy and in particular the Nigerian capital market have been anchored on a global economic rating because of the inefficiency and creation of delays in exchange transactions in the market. A number of reforms and policies has been put in place to facilitate operations of the market. Recently, the Nigerian Stock Exchange (NSE) incorporated a subsidiary company: The Central Securities Clearing System Limited (CSCS) to implement computerised Stock Exchange Management System which emphasises immobilization of share certificates in a central depository of shares certificates and the elimination of bottlenecks between registrars and company executives in issuing new certificates to investors. The new system has come to stay since almost two years running. The extent to which the new system achieves the objectives of Stock Exchange in Nigeria remains uncovered. Again, how effective is the new system and what are the possible problems militating against the operations and consequent realisation of the CSCS which hinges on enhancing transparency and competitiveness in the capital market. This is with a view to having a competitive, viable, vibrant and accessible capital market comparable to other developed capital markets in industrial countries of the world.

2. METHODOLOGY

The nature of the topic under study made the use of field study most relevant. This presupposes the selection of sample of the Nigerian capital market participants. Essentially, data collection was done through both primary and secondary sources.

Primary data was collected through oral interviews conducted among sampled groups including staff of NSE, Port Harcourt Branch, brokerage houses like Allbond Investment Limited, Valueline Securities, OSL (Stock Brokers), IMB Securities Limited, and some individual investors.

Secondary data were collected from NSE fact book, Business Times and other related Journals. Referencing of Finance text books was not possible because of the virgin nature of the topic in Nigerian finance theory and practice.

The Old Regime

Before the introduction of the current computerised stock Exchange management system which applied CSCS, the stock exchange made use of the manual system. Generally, the call-over-system is adopted in the

transactions in the market. This is because of the smallness of the securities in the Stock Exchange. The conclusion of transaction in the floor of the exchange, which is binding on members is effected by delivery and settlement usually carried out by manual operations.

Stock/Share ownership, which is evidenced by stock certificate, can be transferred by means of cancellation in the books of the owner's company (seller) and entry in the books of the buyer's company. The actual extension of this exchange is finalised by the completion of a transfer form by the transferee (seller) to enable the firm up-date its share register and appropriately corresponding with the new owner. This process has its drawbacks. In most cases, it takes 3 months to one year for the new owner to receive share certificate. Generally, the manual operational system has a number of problems as follows.

- i. cancellation and frequent issuance and re-issuance of certificates whenever sales occur.
- ii. constant verification of signature
- iii. Capital Gains not exploited.

- iv. Some dealing members sold what they did not have thereby leading to frequent overtrading.
- v. Some dealing members could not pay for what they bought
- vi. Numerous complaints on failed transactions
- vii. Loss of share certificates.
- viii. Very high risk arising from undue delay, manually operated system, manipulation due to long transaction cycle, minimal transparency which leads to general lack of trust in the system and
- ix. Death of securities.

These problems negate the mission statement of the Nigerian Stock Exchange which according to the NSE, (1997:4) is

"To promote increased capital formation in Nigeria by providing issuers and investors with a responsive, fair and efficient stock market through competent and dedicated professionals using the latest technology, thus assuring local and foreign investors access to the

Nigerian Stock Exchange with confidence both in the regulatory and in the reliability of trading and settlement system".

In an effort to meet this mission and most importantly in consolidating the internationalization arrangement of the Nigerian Stock Exchange Market, a subsidiary company, CSCS, was incorporated in 1992 but started actual operation on April 14, 1997. The ownership structure which is composed of Exchange 51% and others 49% (Market Operators, Institutional Investors, Registrars, and settlement Banks), is a reflection of the extent of their involvement in the implementation of the new system.

3. CSCS: An Overview

The introduction of central securities Clearing System (CSCS) in the Nigerian capital market is in response to the endorsement in 1989 by Federation of International Stock Exchanges (FIBV) of the recommendations of the Group of Thirty (G30), a private sector organisation, for improved efficiency and effectiveness of the clearing and settlement systems of capital markets. Fundamentally, FIBV recommended that every member country, which Nigeria is one, should operate the

new system, latest 1992. In compliance to this directive from FIBV, Central Securities clearing System was introduced.

CSCS implies the introduction of automated securities trading and clearing system. Its main goal is to improve the speed and ease by which shares may be traded via an electronic settling system. According to Asinobi (1997:23) CSCS

- (i) facilitates the delivery (transfer of shares from seller to buyer) and settlement (payment for securities bought) of securities transacted in an organised stock market.
- ii) assembles in the same place most of the activities done at various spot in the capital market to substantially reduce the period it takes a transaction to commence and its conclusion.
- iii) commences with immobilization of share certificates in a central location enabling stocks to be processed in an electronic book entry form. Physical delivery of shares certificates to fulfil settlement obligations is replaced by Electronic Credits and Debits to shareholders stock positions. This enables

securities transactions on the Nigerian Stock Exchange to be processed and concluded within five (5) working days (ie T + 5) in electronic book entry form. The registers of members of quoted securities are constantly updated via the registrars.

Essentially, CSCS has a mission statement that is complimentary to that of the Nigeria Stock Exchange. According to Okereke Onyiuke (1997:2), the mission of CSCS is to implement and operate a clearing, Depository, settlement and Registry System of Stock transactions that is efficient, investors-friendly and effective with minimum risk. By extension, improved market liquidity, integrity, transparency and attraction for domestic and foreign investors would have been assured.

In pursuit and in line with the above mission, the objectives of CSCS include:

- a) Function as Agency for Central Depository for share certificates in organised stock market.
- b) To facilitate stock delivery and settlement cycle or securities transacted in an organised stock market.
- c) Reduction of risks associated with stock transactions by providing

electronic book-entry system and delivery versus payment (Ibid).

These are laudable objectives aimed at improving the performance of the Nigerian capital market. But whether the Nigerian Stock Exchange (NSE) is achieving these objectives demands further investigation.

4. PERFORMANCE OF NSE: PRE-AND POST CSCS PERIODS

Ordinarily, one would expect a remarkable improvement in the performance of the market after the introduction of the new system. Unfortunately our findings revealed the contrary. Key performance indicators like all-share index grew from 1107.6 in 1992 to 6992.10 in 1996 but showed a nose dive from 1997 (when the new system became operational) to 1998 from 6440.5 to 5672.76 respectively. Market capitalization was found to have increased from N32.5b in 1992 to N285.6b in 1996 and N292b in 1997 but dropped to N230b in 1998.

This poor performance has not been attributed wholly to the introduction of CSCS but to other number of factors among which include fall in corporate earnings delisting of some equities and mature bonds, interplay of market forces;

poor implementation of the 1998 budget and attendant harsh operating environment for companies arising from political instability and rapid changes of economic policies.

Volume of shares at the NSE increased consistently from 262m in 1992 to 882m in 1996, 1.3b in 1997 and 2.1b in 1998. This growth is probably due to the boom witnessed in the primary market in this late '90s occasioned to policy demand of increased capital base and illiquidity of the economy.

FINDINGS

Generally, there have been some misfeelings about the introduction of the new system especially among shareholders. They are worried about the certificatelessness of the system. Naturally, people always resist change. But for CSCS, it has come to stay.

The performance of CSCS so far is commendable judging from the activities in the market. According to Uzor (1998:37) the new system has improved the securities clearing and settlement in the market. It has also improved the profile of the market as one of the main criteria for assessing a capital market, in terms of custodian, clearing and settlement infrastructures.

It is now impossible for stockbrokers to price stocks/shares the roof in a stampede to buy stocks for their clients at all costs, which is partly responsible for the inefficient pricing of stocks in the market prior to the introduction of CSCS.

Transfer of purchased shares to their new owners now takes just about 5 days (T + 5) as opposed to about 18 months. Some of these findings are summarised by Alile (1998:28) as benefits, which include:

1. Trade on company's securities would increase
2. Realistic pricing of securities
3. Increase in market capitalisation network
4. Amalgamation of several accounts of a shareholders on the register thereby leading to a reduction of cost to the company.

Apart from the above, there are some other findings that are either lapsing or militating against the successful implementation of the new system. Thus, the number of selected banks to open trading Account with stock brokers are not enough and may require more exposure in the operations of the new system. According to sampled opinion in THIS DAY, Brokers have expressed their dissatisfaction over the "Laxity, exhibited

by some of these trading banks. Some of the banks selected are yet to achieve the desire sophistication needed to successfully harness the CSCS.

The awareness already created for the new system is not enough. Consequently, many investors and prospective investors are ignorant of the existence and/or operations of the new system. A situation which hampers the growth of the capital market.

There is lack of timely reconciliation with companies; and incomplete documentation to the Registrars' department, a condition which according to Ezem (1998:29) has deprived investors of their dividends and other entitlements.

Low purchasing power among Nigerians, occasioned by illiquidity in the system, is very evident. This has led to lower consumer demand, which affects the benefits from CSCS negatively.

There is low level of foreign investment in the Nigerian capital market because of the perceived high risk in emerging markets. This is all attributed to administrative bottlenecks, poor policy implementation, lack of

transparency of the market, policy inconsistency, massive corruption and above all political instability. According to Anaeto (1999:19), capital flows from international markets plunged to \$72b in 1998, nearly one-half the figure for the previous year, reflecting investors perceptions of high risk in emerging markets.

There is a general attitude of buy-and-keep as well as wait-and-see among investors. This has caused low activities in the market.

There are cases of failed trade, which occur when buyers buy without enough funds in their trading account and sellers sell without sufficient securities in their trading account with CSCS. This automatically means cancellation of a concluded transaction of the floor of the exchange.

6. RECOMMENDATIONS:

The Nigerian Stock Exchange (NSE) should work hard to mount a saturated publicity to publicise the use of the new system so that the investing public can accept and internalise the virtues of demobilization of shares. According to Idowu (1998:29) there is need to widen the investors education programme

beyond the intellectual levels of the institutional investors and current market players currently adopted.

Again, consideration should be given to the level of support for CSCS among all market operators (Stock broking firms, Registrars, and the investing public). This requires aggressive market drive to garner support for the new system. According to Idowu (1998:161) they comprise key change elements or catalysts for a successful implementation of the programme.

There must also be internal marketing drive. A situation where SEC and NSE disagree openly on certain issues is not healthy. For example, initial disagreement on equity holding of CSCS and the general implementation of CSCS are unhealthy.

The number of trading banks should be increased. This will go a long way to enhancing efficiency and at the same time strengthen and broaden the ability of investors to sources of funds in these banks using the statement of stockholding issued by CSCS as collateral.

There should be strick implementation of the proposed plan by government to securitise domestic debts which will be traded on the exchange.

Government should ensure urgent implementation of the privatization programme as well as release the comprehensive decree on Nigerian Capital Market Reforms. This will go a long way to streamlining the operations of the market. Privalisation programme should be guided to reflect the realities of our immediate environment rather than obeying external 'mandates.'

NSE should carefully watch the rate of modernization of the exchange in relation to the composition, the attitude and background of the investing public. Guided CSCS is, therefore, the best option.

SEC should appraise the control measures imposed on the activities of the market players in the new regime, especially now that the verification and authentication of shares are entrusted with the brokers. They should closely monitor the code of conduct prescribed for market operators by regulatory institutions.

CONCLUSION

The findings obviously revealed an improved operational performance and a significant drop in most of the key performance indicators in the market. This may be a fall out of the new regime especially in a situation of change-resistance with its attendant economic down-turn. However, there is room for improvement. This is only when the recommendations preferred above are religiously and consistently implemented. Surely, new era of vibrant, transparent and efficient stock exchange market in Nigeria is already in place. Time will tell. All hands must be on deck!

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