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Finance for the Poor: An Assessment of the Performance of Microfinance Institutions in Nigeria

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Ademu, Wada Attah - Department of Economics, University of Jos, P.M.B. 2084, Jos, Nigeria

Email: ademuw2001@yahoo.com

Abstract

The introduction of microfinance in the Nigerian financial system is an attempt to provide the poor with access to micro-financial services. Micro-banks that are supposed to provide these services are faced with many challenges. Among these are: inability to reach a greater number of the poor; funding of commercial sectors at the expense of the poor's activities; lack of sufficient knowledge of the financial needs of the poor and in-depth understanding of the financial services requirements of the poor; lack of capacity of the clients to utilize the credit facilities and lack of institutional capacity of micro-banks for their own management and operations; the urban-biased location of these micro-banks across the country; the financial unsoundness of the MFBs. These challenges can be addressed by taking the following measures: adoption of more flexible credit procurement procedures by microfinance institutions; establishment of credit guarantee scheme by the federal government for the poor; building the capacity of micro-bank and that of the poor and their confidence in the formal financial institutions and making microfinance universal for commercial banks to participate.

Key words: Microfinance, Assessment, Poor, Challenges

Introduction

The growing poverty situation in Nigeria has been an issue of concern for those affected, the governments and other stakeholders in the economy. As a response, concerted efforts have been made by individuals to change their situations by creating their own employment thus engaging in different kinds of income-yielding activities. Governments through the introduction of various policies and programmes have also attempted to alleviate poverty and external agencies have also been playing their parts but the situation has remained unchanged.

One major problem confronting the poor in Nigeria in their survival struggle is lack of capital. As rightly noted by Bottomley (1971), if we are to identify a catalyst for a more productive combination of what is abundant supply of "under utilised" land and labour, that catalyst would be probably be cash. Also, Khandker (1998) observed that lack of savings and capital makes it difficult for many poor people to become self-employed and to undertake productive employment-generating. Consequently, the poor's productive base and contributions to the economy remain small, the production process is rudimentary and inefficient, growth is stifled and opportunities for links with the larger economy, particularly the forward linkages do not seem to exist.

Providing credit with sufficient consideration for its volume and its price therefore seems to be a way to generate self-employment opportunities for the poor. Credit to the poor is micro-credit and it is defined as lending small sums to poor people to set up or expand small business. Micro-lenders try to satisfy poor people's hunger for credit less brutally (The Economist, 2001). Thus, the importance of credit to the activities of the poor includes: (i) it helps to create and maintain a reasonable business size as it is used to establish and, or expand the business to take advantage of economies of scale, (ii) credit can be used to improve the poor's activity and increase its efficiency, (iii) credit can be used to supplement fluctuations in income and expenditure associated with the poor's activity, (iv) credit can be used to adjust to changing economic conditions in the economy. For instance, the adoption and acquisition of new technologies is made easier through the use of credit. Obsolete machines and even production lines can be replaced and, or updated if credit is obtained to purchase such capital items (Oladunmi, 1992), (v) credit can be used to protect an economic activity against risk which is very common with the poor's activities. It can be used to prevent an economic activity from total collapse in the event of natural disasters like flood, diseases, fire, among others. This is made possible by garnering credit to revive an economic activity that has suffered such a set-back. Also, as noted by UNDP (2009), credit opens markets to the poor and can make small farmers and artisans more economically viable by allowing them to enlarge their scale of production, to take more risks and take a longer-term view on their productive activities.

This credit that could be obtained to support the activities of the poor, particularly from the formal financial sources, is not accessible. The rigid credit procurement procedures, lack of physical collateral, high transaction cost, among others have made credit inaccessible to the poor. Thus, informal lenders have become the basic source of credit for the poor. The problem of inaccessibility to institutional credit has forced the poor to seek for alternative sources in the informal financial sector. Although informal financial institutions exist to occasionally meet part of the financial needs of the poor, they are inadequate and not reliable sources of finance for income-generating activities.

Governments' reaction to this problem of inaccessibility to formal credit by the poor has been various poverty alleviation/eradication policies and programmes like sectoral allocations and prioritization, determination of credit rates ceilings, and establishment of semi-financial institutions such as the National Director of Employment. Unfortunately however, as rightly pointed out by Akanji (2001) and Aderibigbe (2001), the problem most of government's micro-credit schemes is that they are in many instances incompatible with the existing traditional savings and loans operated by the local communities and are usually politicised. Thus, the objectives of micro-credit provided by government to the poor have not been significantly achieved. It is an attempt to provide access to credit for the poor's legitimate economic activities that microfinance arrangement was put in place.

This paper is divided into four sections. With the introduction of the paper in section I, section II considers the models of micro financing, section III deals with the microfinance and its challenges in Nigeria, and section IV concludes the paper and presents recommendations for financing the poor in Nigeria.

Models of micro-financing

Microfinance in the 1990s was marked by a major debate between two leading views: the financial system approach and the poverty lending approach. The financial systems approach emphasizes large-scale outreach to the economically active poor—both to borrowers who can repay microloans from household and enterprise income streams, and to savers. The financial systems approach focuses on institutional self-sufficiency because, given the scale of the demand for microfinance worldwide, this is the only possible means to meet widespread client demand for convenient, appropriate financial services.

The poverty lending approach concentrates on reducing poverty through credit, often provided together with complementary services such as skills training, and the teaching of literacy and numeracy, health, nutrition, family planning, and the like. Under this approach, donor- and government- funded credit is provided to poor borrowers, typically at a below-market interest rates. The goal is to reach the poor, especially the extreme poor—the poorest of the poor—with credit to help overcome poverty and gain empowerment. Except for mandatory savings required as a condition for receiving a loan, the mobilization of local savings is normally not a significant part of the poverty lending approach to microfinance.

Bangladesh's Grameen Bank and some of its replicators in other countries represent leading examples of the poverty lending approach. The micro-banking division of Bank Rakyat Indonesia (BRI), Banco Sol in Bolivia, and the Association for Social Advancement (ASA) in Bangladesh are at the forefront of the financial systems approach.

The two models of microfinance highlighted above split in two camps between those in poverty camp and those in sustainability camp. While the poverty lending approach considers the entire poor, the financial system approach focuses on the economically active poor. As pointed out by Ryhne (1998),the sustainability camp views the private sector as the future home of microfinance, while those in the poverty camp seem wary of allowing that future to be dominated by commercial, for-profit operators. They foresee donor and government involvement in microfinance for an extended period of time. Faced with the choice between donors, governments, and the private sector, they seem to be more comfortable keeping microfinance attached to donors and governments, perhaps because they trust donors and governments to have some ongoing concern for the poor. They also fear that for-profit operators will ignore the poorest clients.

In contrast, the sustainability group argues that any future which continues dependence on donors and governments is a future in which few microfinance clients will be served. Donors and governments are both unlikely to continue subsidizing microfinance indefinitely and are not generous enough to do so on a major scale. This group believes that the only way to assure access by the poor to financial services is to ensure that private sector finds it profitable to provide such services. Only the private sector has plenty of resources and will stick with a moneymaking activity even if it is not in fashion.

Arising from the debate above, it could be argued that there is no group of the poor that is not economically active. The notion of classifying some poor as economically active while the rest of the poor are not economically active remains debatable. This is because all of them are engaged in economic activities though with different objectives and there is no group of the poor that is not essentially economically active. The dividing line between the two is that while the so-called economically active poor struggle to go beyond survival in their engagement in economic activities to generate returns, the poorest of the poor engages in economic activities basically for survival.

However, the choice of the approach to be used depends on the objective of the government. If the government's intention is to address poverty problem generally, then it cannot ignore the poverty lending approach as it does not exclude any group of the poor. On the other hand, if the intention of the government is to address poverty through promoting entrepreneurship, then the financial systems approach becomes a better option, though the poorest of the poor would be excluded using this approach because they are said not to be economically active owing to their poverty situation.

Microfinance and its challenges in Nigeria

Microfinance in Nigeria is modelled after the financial systems approach that tends to place emphasis on the development and promotion of entrepreneurship by necessarily making credit available to the economically active poor while sidelining the poorest of the poor. The specific objectives of this microfinance policy are the following:

i. Make financial services accessible to a large segment of the potentially productive Nigerian population which otherwise would have little or no access to financial services;

ii. Promote synergy and mainstreaming of the informal sub-sector into the national financial system;

iii. Enhance service delivery by microfinance institutions to micro, small and medium entrepreneurs;

iv. Contribute to rural transformation; and

v. Promote linkage programmes between universal/development banks, specialized institutions and microfinance banks (CBN, 2005).

Following from the above objectives, the Central Bank of Nigeria set the following goals for the microfinance banks. Accordingly, the establishment of microfinance banks is to serve the following purposes:

i. Provide diversified, affordable and dependable financial services to the active poor, in a timely and competitive manner, that would enable them to undertake and develop long-term, sustainable entrepreneurial activities;

ii. Mobilize savings for intermediation;

iii. Create employment opportunities and increase the productivity of the active poor in the country, thereby increasing their individual household income and uplifting their standard of living;

iv. Enhance organized, systematic and focused participation of the poor in the socio-economic development and resource allocation process;

v. Provide veritable avenues for the administration of the micro credit programmes of government and high net worth individuals on anon-recourse case basis. In particular, this policy ensures that state governments shall dedicate an amount of not less than 1% of their annual budgets for the on-lending activities of micro finance banks in favour of their residents; and

vi. Render payment services, such as salaries, gratuities, and pensions for various tiers of government (CBN, 2005).

A closer look at the microfinance policy objectives and the goals of microfinance banks in Nigeria reveals that the establishment of microfinance institutions is not to actually finance the entire poor but a section of the poor that has the investment tendencies but lack capital for this purpose. Thus, the concern of the poorest of the poor whose major goal is survival is not and cannot be addressed by the existence of microfinance institutions and by their set goals in Nigeria for now. This exclusion of the poorest of the poor from access to micro-credit by the above arrangement may be one of the reasons why poverty has remained at a high level in this country.

As rightly observed by Mejeha, Remy O. and Nwachukwu, Ifeanyi N. (2008), one of the challenges microfinance currently faces in Nigeria is for the MFIs to reach a greater number of the poor. The CBN survey indicated that their client base was about600, 000 in 2001, and there were indications that they may not be above 1.5 million in2003. The existing microfinance in Nigeria serves less than 1 million people out of 40million potential people that need the service (CBN, 2005).Also, the aggregate micro-credit facilities in Nigeria accounts for about 0.2 percent of GDP and less than one percent of total credit to the economy.

Another challenge is that most of microfinance funding goes to the commercial sector to the detriment of the more vital economic activities, especially agricultural and manufacturing sectors which provide the foundation for sustainable growth and development. Currently, only about 14.1 and3.5 per cent of total MFI funding went to these sectors, respectively, while the bulk, 78.4percent, funded commerce (Anyanwu, 2004). About 90% of Nigeria’s businesses are considered microenterprises and these farm or non-farm activities serve as the main income source for the majority of the labour force. Due to the unwillingness or inability of commercial banks to provide financial services to the urban and rural poor, coupled with the lack of sustainability of government-sponsored development financial institutions and programs, most micro-entrepreneurs still access financial services from informal sources, including savings and credit associations, traders, or moneylenders. Semi-formal and formal providers of microfinance are a small but rapidly growing part of the financial sector in Nigeria with a handful of large microcredit NGOs and locally-owned community banks providing the bulk of services.

The above challenges highlight another challenge that of lack of sufficient knowledge of the financial needs of the poor and in-depth understanding of the financial services requirements of the poor in Nigeria. Thilairajah (1994) asserted that the poor (households and enterprises) lean more on the informal system both as savers and as borrowers, for obvious reasons, such as:

1. The ease of obtaining loans, simplicity of procedure, convenience and personal attention, confidentiality, dependability and timelessness;
2. Low transaction costs in terms of time and money, and low interest (often no interest) on loans except from professional money lenders;

3. Facilities available closer to home, and flexible hours of accessibility;
4. Personal guarantee accepted as collateral, and flexibility of instrument and terms;
5. Ease of exit and entry.

These features do not exist in the operations of Microfinance banks that are said to be established to finance the poor. What obtains in the operations of these Microfinance banks is that they are similar in their operations to those of the conventional commercial banks and are largely located in semi-urban and urban centres.

Another challenge of the microfinance institutions is lack of capacity of the clients to utilizethe credit facilities and lack of institutional capacity for their own management and operations. As noted by the Central bank of Nigeria (2005), as at December 2004, only N8.5billion (29.5%) of the N28.8billion Small and Medium Enterprises Equity

Investment Scheme (SMEEIS) fund had been utilised. Moreover, 10% of the credit fund meant for micro credit had not been utilized due to lack of an appropriate framework and confidence in the existing institutions that would have helped in credit delivery. Added to this is the capacity of the microfinance institutions themselves. As rightly noted by Isern, Agbakoba, et al (2009), Nigeria's microfinance sector is experiencing explosive growth with new green field institutions and significant volumes of deposits and loans under management. Yet many institutions interviewed identified capacity building needs for their own management and operations. This is consistent with observations made by donors and investors and the mission's own findings during interviews with NGOs, MFBs and banks.

One other challenge is the urban-biased location of these micro-banks across the country. Many of these micro-banks are largely located and operate in the urban areas like the State capitals or semi-urban areas like the Local Government headquarters. Thus, the urban and semi-urban poor may have access to the services of these banks but not the rural poor.

Furthermore, the outcome of the target examination conducted by Central Bank of Nigeria and Nigeria Deposit Insurance Corporation from February, 2010 to June, 2010 is another challenge to financing the poor in Nigeria. The Target Examination was conducted on 820 MFBs across the country and a total of 224 (27%) MFBs were found to be "terminally distressed" and "technically insolvent" and/or had closed for at least six months. The report explained that the factors that contributed to the financial unsoundness of the MFBs were attributable to some or all of the following:

i) High of non-performing loans, resulting in high portfolio at risk which had impaired their capital,

ii) Gross undercapitalization in relation to the level of operations,

iii) Poor corporate governance and incompetent boards,

iv) high level of non-performing insider-related credits, and other forms of insider abuse,

v) Heavy investments in the capital market, with the resultant diminution in the value of the investment after the meltdown,

vi) Poor asset-liability management owing to portfolio mismatch,

vii) Heavy investments in fixed assets beyond the maximum limit prescribed,

viii) Operating losses sustained as a result of high expenditure on staff and other overheads,

ix) Weak management evidenced by poor asset quality, poor credit administration, inadequate controls, high rate of fraud and labour turnover,

x) Failure to meet matured obligations to customers (Sunday Trust, 2010:11).

Given this long list of militating factors associated with the failure of 224 MFBs and hence their closure, it may significantly erode the confidence of depositors in these unit banks and therefore create problem of negative perception for the existing ones.

Conclusion/Recommendations

Given the challenges above, it is obvious microfinance is be devilled with a myriad of problems. These problems combine to frustrate attempts to address the finance-access problem of the poor and therefore sustained the poverty challenge for Nigeria. However, there are some steps that could be taken to salvage the present situation and put the poor on a hopeful part. These measures are discussed below.

a) **Adoption of more flexible credit procurement procedures by Microfinance Institutions.**

In order to effectively deliver credit to the poor, formal financial institutions should build into their operations the following principles identified by Akanji (2001).They are:

Simplify services: make credit delivery customer-friendly. Use a simple application process appropriate to the level of literacy and numeracy of the beneficiaries and streamline operations to minimize loans processing cost (e.g. one-page application form).

Offer small initial loans: start with very small loans appropriate for meeting day to day financial requirement of micro-enterprises and motivate repayment by offering larger loans as incentives to customers.

Offer short term loans: offer initial loans of between three and six months with frequent repayment periods, say, weekly or fortnightly.

Localize services: Locate close to entrepreneurs such as small scale industrial estates and city peripherals so as to reduce transaction costs. Select staff from local communities, including people with low level of education and income rather than formal bank staff. Such people must be respected for honesty within their communities.

Shorten turnaround time: limit the time between loan application and disbursement. Since the majority of micro-credit is for working capital, speed of processing is ideal for borrowers and reduces administrative cost of lending for financial institutions involved. Turn around time can be minimized by relying on solidarity groups to screen clients and also by decentralizing loans approval.

Motivate repayment: motivate repayment through group solidarity and joint liability. Group lending is more efficient because it externalizes costs and spreads the burden to a number of people, though character-based lending to individuals can be effective where social structure is cohesive and there is little potential for political abuse.

b) Establishment of credit guarantee scheme by the federal government for the poor

The fact that formal financial institutions make use of depositors' money for business and have a duty to make positive returns to their shareholders puts on them the responsibility to make proper use of the money entrusted to them. And because providing credit for the poor is believed to be associated with high risk, they do not grant credit to them. One way to encourage formal financial institutions to allow access to credit by the poor is by establishing a credit guarantee scheme to serve as the security needed by the formal financial institutions. Such a scheme should go beyond mere policies and be backed up by financial deposits by the various levels of government at some chosen banks, with availability of many branches as a major criterion, and the fund should be managed by these banks.

Then enabling laws establishing this scheme should make it mandatory for these levels of government to make a certain amount of money available as their contributions to the scheme. This will go a long way in addressing the problem of insecurity of the loans and as well as facilitating access to credit by the poor.

c) **Building the capacity of the poor and their confidence in the formal financial institutions**

There is the need to improve the skills of the urban informal sector operators so as to increase their capacity to enable them access the credit opportunities provided by the Government. As noted by the Central bank of Nigeria (2005), as at December 2004, only N8.5billion (29.5%) of the N28.8billion Small and Medium Enterprises Equity Investment Scheme (SMEEIS) fund had been utilised. Moreover, 10% of the credit fund meant for micro credit had not been utilized due to lack of an appropriate framework and confidence in the existing institutions that would have helped in credit delivery. As rightly pointed out by ILO (2000), basic life skills such as numeracy and literacy, problem-solving and management, communication and negotiation skills improve confidence and capacity to explore and try income-earning opportunities. In addition, the government should improve the state of infrastructural facilities to reduce transactional costs associated with administration of micro-credit in the country (CBN Baseline Study of MFIs, 2001).

The confidence of the poor could be built in the formal financial institutions through the following four main elements:

i. accommodating small and frequent money transactions;

ii. promoting regularity of such transactions;

iii. making use of inter-personal relationships;

iv. reducing transactions costs, especially those borne by the client. Examples of these elements include the following:

Daily deposit collection—A number of banks in India have introduced daily deposit collectors, which operate in a fashion similar to *esusu* collectors (Aliber, 2002). This method is very important for the poor who often earn money on a daily basis. The collectors are placed on commission based on the volume of collections. This is similar to the spirit of *esusu* collection systems practised currently in Nigeria.

Group solidarity—The principle of the group-credit method, made famous by Grameen bank in Bangladesh, is that the members' joint and several liability for their loan inspires "peer monitoring", effectively eliminating the need for conventional collateral. In a more general sense, however, group-credit schemes can be thought of as harnessing the same sort of group solidarity and interdependence that lie at the heart of indigenous savings associations. The link between group credit and such savings associations is explicit for some formal financial institutions. All that is required is that group members engage in regular savings for some months before they are eligible for loans. The purpose of this is partly, to give time to groups to build up some collateral for the loan, but it also serves to inculcate the group cooperation and interdependence that are critical for future success.

Fostering personal relationship and structuring incentives—Personal relationships are central, not only to indigenous savings associations, but also to the business of traditional money-lending, where the moneylender prefers to lend to people he knows personally or vicariously through a broker. The personnel of the credit departments of formal financial institutions could go beyond paper work to establish personal relationships with this category of clients so that credit delivery to the poor can be built on this relationship.

Continuity and stepping-up—Moneylenders would prefer to make repeat loans to a small number of clients, rather than one-off loans to a large number of clients. This continuity of contact with the same client serves to reduce

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information asymmetries between the moneylender and his clients, thus improving the moneylender's estimate of the client's credit-worthiness. Similarly, an almost universal feature of micro-credit programmes is that they employ a step-up system, whereby a client's successful repayment of small loan signals eligibility for a subsequent larger loan. The principle here is that the client becomes better known over time in terms of his/her deeds.

d) **Making microfinance universal for commercial banks to participate**

The challenges facing microfinance bank make them incapable of adequately and effectively providing financial services to the poor. Thus, microfinance services should not be made the exclusive business of the unit banks. There is therefore the need to involve conventional commercial banks in the business of providing credit for the poor. In order to do this, a policy mandating all conventional banks to operate a department of microfinance should be put in place and seriously enforced to ensure compliance. Following this, the rural banking programme of the 70s should be reactivated to make the banks operate rural branches so as to reach the rural poor. As a follow-up, an awareness campaign programme should be mounted to inform the poor of the special department in the banks for their own services. This effort is however, in combination with the ones suggested above.

This service by banks to the economy should be seen as part of their contribution to economic development of the country.

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