

Micro Finance in Nigeria: Problems and Prospects

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Abstract

This paper set to provide an overview of microfinance in Nigeria and examine its problems and prospects. The data collected from secondary sources, were analysed descriptively. The microfinance scheme holds a lot of prospects for the Nigerian economy as it is expected to empower of Low-Income Earners, reduce poverty, generate employment, among others. However, the paper observed that among the problems faced in the micro finance industry are inadequate finance, high risk, heavy transaction cost, mounting loan losses, low capacity and low technical skills on micro financing. As a result of some of these problems, some micro finance institutions in Nigeria have collapsed. Consequent upon the problems noted, the following recommendations given, among others, are: the supervisory authorities should enforce standards so as to address the issue of poor management of funds meant for credit disbursement, the capital base of micro finance institutions should be strengthened in order to mobilize domestic savings and promote banking culture among low-income groups and the issue of private participation should seriously be encouraged.

Introduction

The history of microfinance sector is as old as when man started using money. People have always been borrowing, lending and saving, for as long

as there has been money. This has always been done within communities, using their own system and methods without any external assistance or services.

The micro finance scheme has primarily developed as a response to the inability or apathy of commercial banks and the formal financial system to serve the needs of low-income households and micro enterprise. According to the central Bank of Nigeria (2005), the formal financial system provides services to about 35% of the economically active population, while the remaining 65% are excluded from access to financial services.

Looking back into history, one would see that Nigerians have always engaged in economic activities, but such activities continued for a long time on subsistence basis. Agriculture, for instance was in most cases carried out simply to feed the immediate family. Other activities such as pottery, weaving, etc were for personal needs and market within the locality (Oladele, 1988).

Currently, these traditional rural occupations such as pottery, basket making, cloth dying, local brewing etc which used to keep people employed, have escaped the reach of small scale undertakers. This is because, these poor entrepreneurs do not have access to financial services, which will support their activities to enable them succeed in business and consequently reduce poverty and possibly bring about economic growth and development.

Furthermore, UNDP Human Development Report (1997) estimated that 40% of Nigerians live in absolute poverty, with 80% of them living in the rural areas. The significance of this is that most of these rural dwellers have been denied access to banking facilities to enable them engage successfully in agriculture, handicraft etc. 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. Most microfinance funding go 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 and 3.5 per cent of total MFI funding went to these sectors, respectively, while the bulk, 78.4 percent, funded commerce (Anyanwu, 2004).

Over the years, a lot of programs and policies have emerged in a bid to improve the living condition of the Nigerian population. The CBN, in consultation with other relevant agencies, included the microfinance policy

as one of its initiatives that started in 2004. The policy was designed to boost capacity of micro, small and medium enterprises towards economic growth and development through financial intermediation (Nwaogazi, 2010). In December, 2005, the micro finance policy, regulatory and supervisory framework for Nigeria was released by the Central Bank of Nigeria. Its main objective is to support the delivery of very small, uncollateralized or less than normally collateralized loans or other financial services such as savings or insurance for low income clients. In spite of these programs and policies, most of the poor entrepreneurs are yet to have access to micro finance. The purpose of this paper, therefore, is to provide an overview of microfinance in Nigeria and examine its problems and prospects.

The paper is organized as follows: Section one is the introduction. Section two treats the conceptual frame work of micro finance. Section three dwells on the overview of microfinance scheme in Nigeria. Section four analyses the performance of micro finance banks in Nigeria. The problems and prospects of micro finance scheme in Nigeria are examined in sections five and six respectively, finally conclusion is drawn and recommendations given, in section seven.

The Concept of Micro-Finance

The term “micro finance” refers to the activity of the provision of financial services to clients who are excluded from the traditional financial system on account of their lower economic status. These financial services will most commonly be in the form of loans and savings, through some micro finance institution who will offer other services such as insurance and payment services. According to CBN (2004), micro finance is a development tool used to create access for the economically active poor to financial services at a sustainably affordable price.

Micro finance is about providing financial services to the poor who are traditionally not served by the conventional financial institutions. Accessing financial services by the poor enables them to have control over factors of production, be more self-reliant, generate employment, enhance household income and create wealth.

Three features distinguish micro finance from other formal financial sector. They are, the smallness of loans advanced, the absence of asset based collateral and simplicity of the operation. Therefore, micro finance is about providing finance to small scale enterprises.

Looking at the emerging theory of micro-finance, recent developments in developing countries have reinforced the contention that micro finance structures are essential for development of rural areas in consideration of the fact that areas of development in these countries have been traditionally urban-centered (Iheduru, 2002). The development of micro finance institutions over the last few decades and its success have shown that micro finance is a major stimulus for combating poverty. Therefore, micro finance as a strategy for economic development should target the poor given its multiplier effect on production and marginal propensity to consume. Access to credit by this group of people accelerates their income and equally increases their savings and consumption.

Overview of Micro Finance in Nigeria

The practice of micro finance in Nigeria has always existed since time immemorial, mainly through informal micro finance activities, but there were no established government policies and mechanisms for regulating and supervising activities in the sector. The Central Bank of Nigeria (2004) observed that the inability of the formal financial institutions to provide financial services to both the urban and rural poor induced the growth of microfinance institutions. Micro finance institutions provide access to credit for the rural and urban low-income-earners. These institutions are grouped into informal, and formal. The informal micro finance institutions are self help groups, savings collectors and co-operative societies etc. They generally have limited outreach due to paucity of loanable funds. The formal micro finance institutions are the banks.

Babalola (1999) observed that the main aim of micro finance scheme is to increase the productive capacity of the poor and vulnerable, basically enhancing the place of economic growth and development in the country. Since every administration is always poised to improving the living condition of its people, especially the poor, several programmes and institutions were established in that direction in Nigeria by various governments. There was a call by governments and non-governmental agencies, for Nigeria to emulate the general world wide practice, whereby government as a matter of deliberate policy was asked to institute schemes for providing concessionary finance to the poor entrepreneurs in recognition of their highly disadvantaged position in the open market competition for finance and other resources with big companies. In view of this, both government and non government agencies established series of micro finance programmes and institutions.

Most microfinance institutions are Non Governmental Organisation (NGO) based and derive their capital from original owners.

Informal micro finance groups/schemes are:

The Esusu/Itutu/Adashi: This is a contribution based savings scheme, which is operated on the basis of rotating savings and loans association. This is common in Nigeria especially among rural dwellers.

Daily/Periodic Contribution: This is like a savings scheme amongst traders in which an agreed amount of money is paid daily to convener, agreed upon by the traders.

The formal micro finance institutions and programmes are:

The Nigeria Industrial Development Bank (NIDB): It was established in 1964 with the major aim of ensuring that credit facilities were provided for medium and large scale enterprises. It also had the responsibility of funding small scale businesses with total capital outlay of not more than 750,000.00. The bank could grant loans ranging from a minimum of N50,000.00 to a maximum of N15 million or 15 percent of NIDBS' equity base but not more than 75 percent of the fixed assets of the business being financed (Otiti, 2007).

The Nigeria Bank for Commerce and Industry (NBCI): was established in 1973, with an objective of providing financial services such as equity investment and granting of loans and guarantees to indigenous enterprise in commercial and manufacturing activities. In 1990, government established the National Economic Reconstruction fund (NERFUND) to facilitate access to low cost long-term finance to SMEs and to enable SMEs have access to funds from international lending agencies.

Nigeria Agricultural and Cooperative Bank (NACB): Established in 1973, to lend to agriculture, using cooperative societies as a channel of loan disbursement and repayment. Records available on NACB'S financial services indicate that the number of agricultural projects that were granted loans by NACB increased from 2446 in 1990 to 6286 in 1994, which account for 157% growth in the number of loan approved by the bank in five years.

The Agricultural Credit Guarantee Scheme Fund (ACGSF): It was established in 1977 by CBN to bridge the gap between rural farmers and urban-based financial institutions as regards the packages of collateral for

credit acquisition. ACGSF was established to provide guarantee in respect of loans granted by commercial and merchant banks for agricultural purposes with the aim of increasing the level of bank credit to the sector and to ensure continuous production. According to the CBN statistical bulletin (2001) about 97% of the loans guaranteed by ACGSF were mostly to small farmers from rural areas in various Nigerian states.

Community Banks: These are self-sustaining financial institutions owned and managed by local communities such as community development associations, town unions, cooperative societies, farmers group social clubs, etc to provide financial services to the respective communities. They are to promote rural development and enhance economic development at the grassroots level (CBN, 2004).

Other micro finance institutions are Community Banks, Bank of Industry, Family Economic Advancement Programme, the Natural Economic Reconstruction Fund (NERFUND) established in 1990. They all have similar objective of providing credit.

Special schemes and funds that were established to also provide micro finance are:

National Directorate of Employment (NDE): The establishment of NDE in 1986 constituted another channel by which government achieved its objective of promoting SMEs in Nigeria. Prior to this time, Nigeria witnessed a serious problem of employment. Olagunju (2008) observed that at 1985, a conservative estimate of unemployment in Nigeria was put at 8.5%. In order to solve the problem of unemployment, the federal government of Nigeria on March 26, 1986, appointed a think tank known as the National Committee on Strategies for Dealing with Mass Unemployment, Labour and Productivity. The reports of the committee gave rise to the establishment of the National Directorate of Employment (NDE) on November 23 1986. Through the directorate, a number of programmes emerged such as the Rural Employment Program, Vocational Skill Development Programme, Small Scale Enterprises Programme and Special Public Workers programmes.

The Small and Medium Enterprises Equity Investment Scheme (SMEEIS): The scheme is an initiative of the Bankers Committee, representing banks contribution to the efforts of the federal government towards stimulating sustainable economic growth, development of local technology, poverty alleviation and employment generation. Through the

initiative, banks are required to set aside 10 percent of their Profit after Tax (PAT) for loans to or equity investment or a combination of both in eligible SMEs. The scheme covered the following activities: manufacturing information technology and telecommunications Agro-allied, Tourism and leisure, Educational, solid mineral, construction, service (Financial and Insurance services) and other legal activities as may be determined by the Bankers' committee. The maximum amount a participating bank can invest in an enterprise is limited to 20% of the total funds set aside by the banks subject to a maximum of N500 million.

Small and Medium Enterprises Development Agency of Nigeria (SMEDAN): It was established by the SMEDAN act of 2003, to promote the development of Micro, small, and medium Enterprises (MSME). Its functions are: to stimulate, monitor and co-ordinate development of MSME sector, to initiate and articulate policy ideas for MSME growth, to promote and facilitate development programmes, instrument and support services to accelerate the development and modernization of MSME operations, serving as a vanguard for rural industrialization, poverty reduction and job creation and enhanced sustainable livelihood, link MSME to internal and external service of finance, technology and technical skills, among others.

Another programme initiated by government is the National poverty Eradication programme (NAPEP), established with focus on providing a conducive environment for skill acquisition, agricultural and extension services to rural dwellers as well as the provision of micro credit to beneficiaries (NAPEP,2001).

The Microfinance Policy, Regulatory and Supervisory Framework for Nigeria was launched on 15th December, 2005. The frame work of micro finance scheme in Nigeria is centered on three elements. They are policy objectives, policy targets and policy strategies. The objectives of the micro finance scheme, as noted by the Central Bank of Nigeria (2005) are:

- a) To 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.
- b) Promote synergy and main streaming of the informal sub-sector into the natural financial system.

- c) Enhance service delivery by micro-finance institutions to micro, small and medium entrepreneurs
- d) Contribute to rural transformation
- e) Promote linkage programmes between universal/development banks, specialized institutions and micro finance banks.

Based on the objectives of micro finance scheme, the target of the scheme are as follows:

- a) To cover the majority of the poor but economically active population by 2020, thereby creating jobs and reducing poverty.
- b) To increase the share of micro-credit as a percentage of total credit to the economy from 0-9 percentage in 2005 to attest 20 percent in 2020.
- c) To promote the participation of at least two-third of the states and local governments in micro-credit financing by 2015.
- d) To increase the number of linkages among universal bank, development banks, specialized financial institutions and micro finance banks by 10% annually.

A number of strategies have been derived from the objectives and targets. They include the following:

- a) Promote the establishment of NGO-based micro finance institutions
- b) License and regulate the establishment of micro finance Banks (MFBs)
- c) Promote the participation of government in the micro finance industry by encouraging states and local government to devote at least 1% of their annual budgets in micro credit initiatives, administered through MFBs.
- d) Strengthen the regulatory and supervisory frame work for micro finance banks.
- e) Promote the establishment of institutes that support the development and growth of micro finance service providers and clients.

This policy was aimed at stimulating rural entrepreneurship through synergistic mainstreaming, rural transformation, and the promotion of linkage programmes between the commercial banks, development banks, and specialized banks. In the regulators, instead of scrapping the entire community banking system as was the dictate of the times then, they were given the first option of converting to MFBs under very favourable conditions and incentives. Of the total number of Community Banks of 1,259, a total of 607 were found manageable as having met the mild licensing requirements. A further 138 new licenses were given for fresh MFBs, with an additional 95 representing those granted Approval-In-Principle (AIP status). The spread of the MFBs reflects the erstwhile commercial texture of the states within the Nigerian Federation, and it is further a reflection of the concentration of community banks before the transition that took place. Accordingly, Lagos accounts for the highest concentration with 23%, followed by Anambra State with 9%. The South West states of Oyo and Ogun constitute 6% each, while Imo State accounts for 5%. By inference also, the spread within each geo-political zone is not different: the highest concentration of 42% is within the South West, while South East accounts for 21%. The lowest of all the zones is North East, which is 4% (Nwaogazi, 2010).

Performance of Micro Finance Banks in Nigeria

This section examines the performance of microfinance banks in Nigeria using some generally accepted criteria. The data for analysis were sourced from CBN publication. It covers a time period of 8 years, from 2001-2008, with a descriptive analysis of the following criteria:

1. Number of Microfinance banks/Community Banks.
2. Volume of credit granted to the target group by microfinance banks.

Table 1 shows the number of microfinance banks/community banks between 2001 and 2008. The number of microfinance banks grew from 747 in 2001 to 774 in 2003. In 2004, it dropped to 753. 2008 witnessed a sharp fall in the number of microfinance banks to 695. This implies that in 2008, some microfinance banks collapsed as a result of the problems which they face.

The graph of table 1 shows the growth of microfinance banks in Nigeria, which is seen to have fluctuated within 2001 and 2008. It reached its peak in 2003 and fell drastically in 2008. This shows that the growth of microfinance banks within the year under review has been not been impressive.

Table 2 shows that the total credit of microfinance banks has increased over the years in spite of the collapse of some microfinance banks.

From the graphs, it is observed that the number of microfinance banks have fallen but the volume of credit disbursed by microfinance banks has increased. This is an indication of awareness and encouragement of the functions of the sector.

Problems of Micro Finance Scheme in Nigeria

The idea behind every micro finance programme is to improve accessibility to appropriate financial and non-financial services to the active poor, in order to enhance their economic activities, increase their revenues and promote opportunities for ownership. Looking at the volume of credit disbursed, one will tend to believe that there is an increase in the volume of credit, given the importance of the sector and its awareness by clients willing to access funds, but it is still not what it is supposed to be. The table 1 shows that in Nigeria most coordinated credit programmes and institutions are threatened by sustainability and continuity in service delivery, despite the well spelt out policy and objectives due to the following problems:

- 1. Diversion of Micro Finance Fund:** There have been several cases of corrupt public officials, diverting credit meant for small scale farmers. Sometimes, loans were disbursed to friends and relatives in a manner that do not suggest that it was meant for business. It could be seen that because of the high level of poverty in the country, loans are diverted into solving problem of feeding. Thus, micro finance is supposed to meet the need of the poor to raising their financial sustainability, which in this case is not so.
- 2. Inadequate finance:** One of the critical problems facing micro finance institutions in Nigeria is the lack of finance needed to expand financial services to clients. This, according to microfinance letter (2007), primarily arises from low capital base of the institution, inordinate fixed asset acquisition, ostentatious operational disposition, inability to mobilize deposits, poor lending and questionable governance and management arrangement. Although, the capital requirement of one billion for state owned and unit banks has not improved the situation as most microfinance institutions need reorientation, reorganization and restructuring. As a result of the problem of finance, Ovim (2007) observed that there

is an inadequate channeling of fund for real sector development especially agriculture and manufacturing. According to him, only about 14.1% and 3.5% respectively is allocated to these sectors as against 78% funding for commerce.

3. **Unfavorable/Frequent Changes in Government Policies:** Instability has impacted negatively on the performance of primary institutions responsible for policy monitoring and implementation. There were cases of sudden reversal of policy which has resulted to incomplete and abandoned projects. This creates distortions in the macro-economic structure and low productivity. According to CBN (2004), state owned programmes particularly, those that lack profit incentive, are very vulnerable to political influence. Borrowers were frequently selected for political reasons rather than because they fit the profile of the ostensibly targeted beneficiaries.
4. **High Risk, Heavy Transaction Cost and Mounting Loan Losses:** These are identified as inhibiting micro-finance of small scale enterprises, especially in the rural areas. According to Anyanwu, (2004), about 70% of micro credits given to micro enterprises via government microfinance scheme were not recovered. Some people see the loans as their own share of the national cake and do not see any need for the repayment. The consequence of this is that it leads to other applicants not getting loan. The programme only gets to reach only a fraction of target population and consequently have failed to provide financial self-sustainability. Some micro finance institutions are faced with heavy transaction cost. Microfinance letter (2008) observed that the some microfinance institutions conduct their businesses in manners that are at variance with international best practices. For example, expenses on office accommodation, official cars, and fixed asset acquisition have constituted a heavy burden on the institutions. Also, salaries and allowances of Board members and staff have not, in some cases, been based on affordability of the institution. This hinders sustainability and continuity in service delivery.

Low Capacity and low Technical Skills on Micro financing: Most staff recruited in the microfinance institutions, particularly at management level, have little or no experience in microfinance banking and practice.

Management of micro finance institutions would require a pedigree of knowledge on micro financing to successfully operate in the industry.

According to Sunday Trust (2010), the microfinance industry had been confronted with numerous challenges since the launch of the microfinance policy framework in December 2005. A significant number of the microfinance banks were deficient in their understanding of the microfinance concept and methodology for delivery of microfinance services to the target groups. Many of them lost focus and began to compete with deposit money banks for customers and deposits, leaving their target market unattended, in spite of efforts by regulatory authorities to put them back in track. The impact of the global financial crisis on microfinance banks had been more severe than anticipated as credit lines dried up, competition became more intense and credit risk increased. Many customers were unable to pay back their facilities owing to the hostile economic environment.

The combination of all these problems has significantly affected the micro finance sub-sector and its ability to achieve the policy objective of economic empowerment at the lower end of the market. As a result of some of these problems, some micro finance institutions in Nigeria have collapsed.

A target examination was conducted by Central Bank of Nigeria and Nigeria Deposit Insurance Corporation on 820 microfinance banks across the country. A total number of 224 (27%) microfinance banks were found to be terminally distressed and technically insolvent and/or had closed down for at least six months (Sunday Trust, 2010).

Prospects of Micro Finance Scheme in Nigeria

In spite of the problems faced, micro finance institutions and programmes hold a lot of prospects for the Nigeria economy. They are:

1. Economic Empowerment of Low-Income Earners: The global effort to combat poverty by empowering the deprived members of the society through the functional micro credit and micro finance scheme, has given the poor the opportunity to develop their talents and contributes meaning fully to economic growth and development. By setting up micro business, the poor will be gainfully employed.
2. Poverty Reduction: There is a growing awareness of the potentials of micro finance on poverty reduction, economic growth and

development. Micro finance scheme is aimed at developing the rural poor and providing a broad access to financial services to grow their business, which is the most basic condition for sustainable livelihood. Therefore, will rural based micro finance institutions, the poor will experience increase in households income, productivity, labour participation and rural wages. These will consequently reduce the level of poverty.

3. Gains from international trade: It is quite regrettable that a fairly large chunk of the nation's scarce foreign exchange is frittered away regularly on massive importation of products on which the raw materials are available in the country and can be produced within. With available and accessible micro-credit, there is the potential of and tremendous scope to boost export of so many products such as leather garments, cassava etc. which will earn the country's foreign exchange and position it at an advantage in international trade.
4. Employment Generations: Nigerians are industrious and enterprising. The poor who account for over half of the population rely heavily on microfinance institutions for credit. With the microfinance scheme, they will have access to credit which increase their productivity level, and enable them to employ more people. In other words, the growth of small businesses as a result of the activity of micro finance will lead to high level of employment.
5. Other prospects include rural development, skill development, new innovations, effective utilization of local resources, output expansion etc.

Conclusion and Recommendations

This paper was motivated by the need to examine the problems and prospects of micro finance scheme in Nigeria. It was observed that micro finance is all about providing services to the poor who are traditionally not served by the conventional financial institutions. The scheme holds a lot of prospects for Nigerians especially the poor as it will enable them develop their skills, engage in production etc. Among the problems identified are frequent change in government policy and diversion of micro finance fund. Consequent upon the problems noted, the following recommendations given are:

1. The supervisory authorities should enforce standards so as to address the issue of poor management of funds meant for credit disbursement.
2. The capital base of micro finance institutions should be strengthened in order to mobilize domestic savings and promote banking culture among low-income groups.
3. There is a need to reduce the expenses which weigh heavily on the earnings of the institutions if break even point is to be attained in record time.
4. Private participation should seriously be encouraged as this will reduce the burden on government.
5. The Central Bank of Nigeria in collaboration with some development partners should organize training for staff of micro finance institutions. And the institution on their own part should continually train and retain their human capital, segment and build up in dept knowledge of the market, develop appropriate products and services for small enterprises.
6. The training of clients on loan usage, management and repayment is very important as this will reduce loan losses. The training should come in form of counseling, mentoring, and other form of support.
7. The financing of the real sector such as agriculture and manufacturing is very important for sustainable growth and development. The activities of micro finance institutions should be focused on these real sectors.

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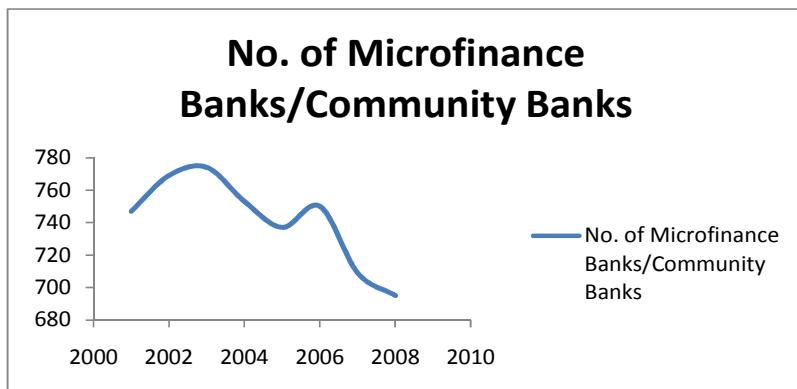
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Table 1: Number of Microfinance Banks/Community Banks

YEAR	2001	2002	2003	2004	2005	2006	2007	2008
No. of Microfinance Banks/Community Banks	747	769	774	753	737	750	709	695

Source: CBN Statistical Bulletin (2008)

Graphical Presentation of the Number of Microfinance Banks/Community Banks



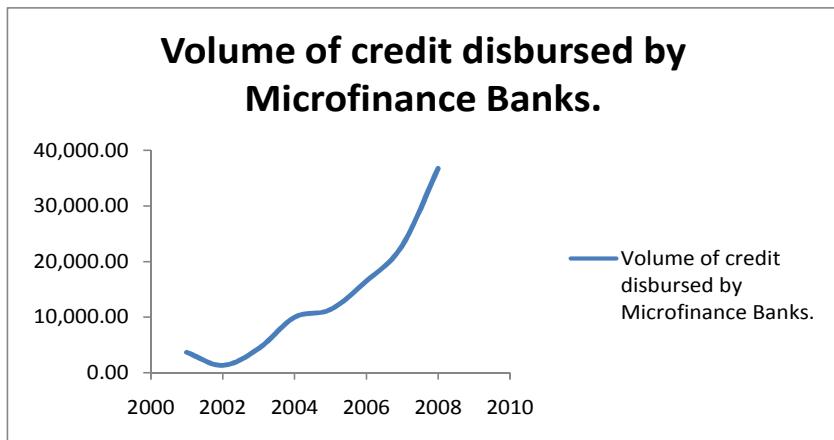
Source: plotted from table 1

Table 2: Volume of Credit Granted To The Target Group By Microfinance Banks (₦ = Millions)

YEAR	2001	2002	2003	2004	2005	2006	2007	2008
Volume of credit disbursed by Microfinance Banks.	3,666.6	1,314.0	4,310.9	9,954.8	11,353.8	16,450.2	22,850.2	36,793.7

Source: CBN Statistical Bulletin (2008)

Graphical Presentation of the Volume of Credit Granted to the Target Group by Microfinance Banks (₦ = Millions)



Source: plotted from table 2