THE EFFECT OF CREDIT LINES AND RISKS ON OPERATIONS OF MICROFINANCE BANKS

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Abstract

This study examines the new era of microfinance banks (MFBs) in Nigeria considering the challenges that is being faced by them in recent times and their prospects of survival in a dynamic environment like Nigeria. The objectives of this paper are to assess the poor implementation of government policy on microfinance banks; to examine other factors like credit lines, credit risks that had weakened the microfinance sub sector and its ability to achieve the policy objective of economic empowerment so as to uncover areas of necessary modification in the policy. The data for this study were obtained from primary source and were analyzed using correlation coefficient, chi-square, frequency and simple percentage. The paper recommended that the regulatory authorities are to make sure that the microfinance policy is properly implemented. Also, the banks should follow strictly their code of conduct and monitor their customersô businesses and make sure that loans are used for the purpose for which they were given as this will reduce the number of non performing loans.

Keywords: Microfinance, Microfinance banks, Credit lines, Credit risks, Banksô depositors

Introduction

The Nigerian microfinance industry (MFI) has come a long way; it boasts of all the four well-known models in the industry. A Central Bank of Nigeria (CBN) study identified, as of 2001, 160 registered MFIs in Nigeria with aggregate savings worth N99.4 million and outstanding credit of N649.6 million, indicating huge business transactions in the sector (Anyanwu, 2004). Institutional structures for the provision of microcredit vary and may be any of the following: government or public sector oriented, NGO-supported, traditional or a mixture of two or more of these.

With a population of about 150 million and GDP/capita of $641 (2006), two-thirds of Nigeriaôs people are poor. Indeed, it has the third highest number of poor people in the world (UNDP, 2003). Most of these poor people also earn low income and they are dependent on micro and small-scale farm and small scale enterprises for their livelihood. As such, their entrepreneurial contributions are strategic to the Nigerian economic development and their growth has great potential to contribute to income generation and poverty alleviation.

In order to enhance the flow of financial services to Nigerian low income earners, Government has, in the past, initiated a series of publicly-financed micro/rural credit programmes and policies targeted at the poor. Notable among such programmes were the Rural Banking Programme, Peoples Bank of Nigeria, National Poverty Eradication Programme and Community Banks just to mention a few.

In December, 2007, the new government policy gave licenses to 107 microfinance banks and converted 600 out of 761 community banks to microfinance banks which make the total number of microfinance banks 707 in the country (Soludo, 2008). The microfinance industry in Nigeria had been confronted with numerous challenges since the launch of the Microfinance Policy Framework in December, 2005. A significant number of the microfinance banks (MFBs), were deficient in their understanding of the microfinance concept and the 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 to, in spite of efforts of the regulatory authorities to put them back on track.

Unfortunately, the impact of the global financial crisis on MFBs had been more severe than anticipated. Credit lines dried up, competition became more intense and credit risk increased, as many customers of MFBs were unable to pay back their credit facilities owing to the hostile economic environment. The combination of these factors had significantly weakened the microfinance sub-sector and its ability to achieve the policy objective of economic empowerment at the lower end of the market.

Statement of the Problem

Recently the operating licenses of 224 out of the 820 banks were revoked because they were found to be ÷Terminally Distressedô and ÷Technically Insolventô and/or had closed shop for at least six months (CBN, 2010). The major problem that has affected the microfinance banks in Nigeria was poor implementation of government policy on microfinance banks by the regulatory authorities and the rush into the business by big financial institutions in the country. They used their intimidating financial might to corner microfinance banking business to the detriment of many genuine but small microfinance banks.

When the banks started business, they engaged in aggressive mobilization of savings from micro depositors to shore up their operating funds and many people responded positively. But as time went on, some commercial banks, on seeing the huge success recorded by the small microfinance banks, went ahead to establish their own microfinance banks and evade the market with their reputation and goodwill to lure the customers of the small time microfinance to their own MBFs. The stiff competition for depositors occasioned by the entrance of big banks into the business became the problem of MBFs. (Okpugie 2010).

The fund which government policy assured would come from the state and local governments was not forthcoming. The loans granted to customers without collateral were not paid by those to whom the loans were given and many of them had even abandoned their former microfinance banks to the ones owned by the big banks. The problem of sourcing for cheap funds to give to the customers at low interest rates would have been avoided if the local and state governments made available funds to the microfinance banks in their locality the one percent from their statutory allocation which the microfinance banks policy required from them.

Unfortunately, the impact of the global financial crisis on microfinance banks had been severe. Credit lines dried up, competition became more intense and credit risk increased, as many customers were unable to pay back their credit facilities owing to the hostile economic environment. The combination of these factors had weakened the microfinance sub-sector and its ability to achieve the policy objective of economic empowerment.

According to CBNǿs operational guidelines for the establishment of microfinance banks, they are not expected to engage in excessive spending (CBN 2005). The aim was to minimize the cost of operations by spending less on buildings, cars and other facilities. Some microfinance banks deviated from this guideline by spending fortunes on operational facilities.

The dishonesty of Nigerian borrowers has left many operators with huge debt. Customers would borrow money from these banks and may later relocate to another environment and this may make it difficult for the operators to find them when the loan is due for payment. Some of the customers would even divert the loan to other areas apart from the real purpose of the loan.

Poor infrastructure is another factor which can be pointed to as the bane of microfinance banks in Nigeria. Power, for instance, is taking its toll on the various sectors of the economy. The financial sector spends huge amount of money on generators. Though the microfinance banks use less equipment, the cost of generating power is still very high (Nweze, 2010).

The target examination conducted on all the microfinance banks across the country by CBN identified these factors as contributing to their unsoundness as: high level of non-performing loans, which had impaired their capital, gross under-capitalization in relation to the level of operations, high level of non-performing insider related credits, and other forms of insider abuse, poor corporate governance and incompetent Board, poor asset-liability management owing to mismatch, heavy fixed assets beyond the maximum limit prescribed, failure to meet matured obligations to customers, among others.

Objectives of the Study

The objectives of this paper are:

i. To assess the implementation of government policy on microfinance banks.
ii. To examine how low credit lines have weakened the microfinance banks in terms of their ability to give out loans.
iii. To find out how the cost of operations has affected microfinance banks.
iv. To examine how credit risks have affected the operations of microfinance banks

Based on the above specific objectives, the study seeks to test the following hypotheses. The hypotheses are stated in their null form:

1. Credit lines do not have any relationship with loans given out by microfinance banks.
2. The credit risks of banks do not have significant effect on their operations.

The Need for Microfinance Banks

Microfinance institutions are essentially needed to serve the poor city dwellers overcrowding in slums or squatter settlements in appalling conditions. They lack access to basic services such as education for children and health care. Their survival tool kit lacks skills that are essential to enter the employment mainstream of the economy. Many of them are women, poorly trained and playing dual roles of provider and caregiver. These poor people are more exposed to the threats of contamination, bad sanitation, and disease than the rest of the population (Kolawole, 2006)

óMicro financingô is the provision of financial services to poor and low income households without access to formal financial institutions (Conroy, 2003). Microfinance is also described as óbanking for the poorö. Microfinance programmes provide loans, savings and other financial services to low income and poor people for use in small enterprises.

Originally based on traditional forms of community financing (a cross between finance and development assistance), microfinance is found all over the world in places such as Africa, Latin America and Asia. The microfinance movement began in earnest in the early 1980s in places like Bangladesh and Bolivia and has, over the last 20 years, captured the interest of multilateral donor agencies and private sector bankers (Enugu Forum, 2006).

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Hulme (2000) argues that MFIs are not a cure for poverty. However, MFIs could create and provide a broad range of micro financial services that would support poor people in their efforts to improve their own prospects and the prospects of their families. He believes that effective microfinance makes these agencies designed to help the poor more likely to achieve the goals that poor people seek to achieve.

Microfinance provides both credit and savings services to low income group. Microfinance refers to the entire unique processes by which financial and enterprise development services are channeled to owners of micro and small enterprises in a sustainable manner. It entails effective engagement of clients in order to adequately determine their financial needs. Microfinance involves the provision of credit, savings, repositories and other financial services to low income earners or poor households to create or expand their economic activities to improve their living standard (Osuji, 2005). Credit is considered to be an essential input to increase productivity. It also boosts level of income, increases employment at the household level thereby alleviating poverty. Micro-credit helps the low income earners to smooth out their consumption patterns during the lean periods of the year and by so doing maintains the productive capacity of this group. The professed goal of micro credit is to improve the welfare of the poor as a result of better access to small loans (Conroy, 2000).

Effects of Microfinance Banks on the Society

The effects of the failure on the part of the regulatory authority to implement the microfinance policy properly and the operatorsô lack of understanding of the microfinance concept had been very devastating on the society at large. It is always the depositors that suffer when banks fail because their hard earned savings in these banks go down the drain.

The news about the revocation of license of some of the microfinance banks by the CBN came as a shock to the depositors. The announcement led to panic withdrawals by depositors as they do not want to be caught in the problems depositors faced after the collapse of commercial banks. Even the other microfinance banks that were considered safe by the CBN had their share. Some microfinance bank are now facing a cash crunch situation as a result of increasing lack of confidence of customers which led to panic withdrawal.

Depositors suffer when banks fail because some of the deposits may not be recoverable again. Many, however, will rely on the Nigerian Deposit Insurance Corporation (NDIC) for succour. But the worse cases are those who would be beneficiaries of the minimum amount NDIC repays. No matter the value of their deposit at the time of the collapse, NDIC has been mandated to pay up to N100, 000 as insurance coverage per depositor.

Those who lost their money to these collapsed microfinance banks may have their businesses, families and even their life adversely affected, since these banks were essentially to provide credit and other financial services to people in the low income groups. These are the people that are struggling to survive. They put in all their money into the banks, hoping to get loan for their businesses and further reduce poverty to a minimum level in Nigeria. But unfortunately, they lost the money to the crisis in those banks.

The fall of microfinance banks may also lead to other health hazards because depositors may experience trauma, agony, and frustration. It may lead to high blood pressure, death and so on. Also many of the employees of these microfinance banks will lose their jobs. Microfinance banks have done but little to improve the society. These are providing money to co-operate groups (such as cooperative societies and age groups) which ordinarily cannot obtain loan due to no collateral. They also go to the extent of buying tools, buying tricycles, paying for shops and proving business capitals to budding enterprises.

Methodology

The research is descriptive in nature and employs the survey method in assessing the prospects and challenges of microfinance banks (MFBs) in Nigeria. The population of study consisted of three microfinance banks in Lagos. The selection of the microfinance banks was done randomly.

Primary data were collected using questionnaires as data collection instrument. The questionnaires was divided into two parts to capture the background information about the respondents, the credit line of the microfinance banks, their operation cost and the effectiveness/ proper implementation of the government policy on microfinance banks in Nigeria. A total of 250 questionnaires were distributed.

The analyses of the respondents were done using Pearson Correlation Coefficient, simple percentages, frequencies and chi- squared statistical tools. The Pearson Correlation Coefficient is given as follows:

$$r = \frac{\sum (x ï x)(y ï y)}{\sqrt{\sum (x ï x)^2 * \sum (y ï y)^2}}$$

Analysis of Data and Discussion of Findings

A total of 250 questionnaires were distributed but only 235 of these questionnaires were returned. Out of the returned questionnaires, 35 were either badly or sparsely completed. Hence, only 200 questionnaires were accepted as properly completed and the analysis is based on this figure.

Table 1: Respondents Responses to How Government Implemented the Microfinance Policy in Nigeria

RESPONSES	FREQUENCY	PERCENTAGE
POORLY	150	75
FAIRLY	32	16
PROPERLY	18	9
TOTAL	200	100

Source: Field survey 2010

The responses from government implementation of microfinance policy, Table 1, show that many of them 75% believe that the government has poorly implemented the policy as against 16% that feel that the policy has been fairly implemented. Only 9% agreed that the government have properly implemented the policy. The funds which government policy assured would come from the state and local governments were not forthcoming. This led to many of the affected microfinance banks to start grappling for survival through sourcing loans from commercial banks on high interest rates to continue in business. Faced with ugly scenario, many of the affected microfinance banks started grappling for survival through sourcing loans from commercial banks on high interest rates to continue in business. The microfinance banks in turn charged high interest rate which resulted in huge unpaid loans by their customers which can be referred to as ónon-performing loans.

Table 2: Respondents Responses to Operating Cost of their Microfinance Bank

RESPONSES	FREQUENCY	PERCENTAGE
HIGH	160	80
ADEQUATE	40	20
LOW	0	0
TOTAL	200	100

Source: Field survey 2010

What we can deduce from the responses of the staff of the microfinance banks is that their operating cost is on the high side. But, the operational guidelines for the establishment of microfinance banks expect them not to engage in excessive spending. There were situations where these banks erected massive structures for their operation, bought exotic cars that gulped a large chunk of their shareholdersô fund, over dressed their offices and later discovered that they could not meet up with their responsibilities. Some of these microfinance banks were simply ostentatious, with some of them having their executive remuneration to include a two-week holiday abroad. Many of the microfinance banks lost focus and began to compete with the commercial banks.

Poor infrastructure is another factor which can be pointed out as the bane of microfinance banks in Nigeria and this also added to their cost of operation. Power, for instance, is taking its toll on the various sectors of the economy. Most microfinance banks ended up with huge amount of money to fuel their generators.

Test of Hypotheses
Hypothesis one

H_0: The credit lines of microfinance banks do not have significant effect on their operations

H_1: The credit lines of banks do have significant effect on their operations

Table 3: Respondent Responses on Credit Lines of Microfinance Banks in Relation to Loans

	Minutes	Satisfaction
CREDIT LINES Pearson Correlation	1	785*
Sig (2- tailed)		.136
N	200	200
LOANS Pearson Correlation	785*	1
Sig (2- tailed)	.136	
N	120	120

*Correlation is significant at the 0.05 level (2 tailed)

The correlation result presented above shows that there is a strong and positive correlation between credit line and loans given out to customers. Therefore, the null hypothesis will be rejected and the alternative hypothesis which says that credit lines do not have any relationship with loans given by microfinance banks will be accepted.

The implication of the above is that credit lines of the microfinance banks are one of their life lines. When this dries up the banks will not be able to give out loans to their customers as required. The only option they will be left with is to source for funds probably from the commercial banks and this will be at high interest rates. The implication will be to give out loans to their customers at high interest rate. In return the customers that are mostly low income earners may not be able to repay their loans when they fall due and this may result into bad debt.

Hypothesis two

H_0: The credit risks of microfinance banks do not have significant effect on their operation

H_1: The credit risks of microfinance banks have significant effect on their operation

Table 4: Respondent Responses on Credit Risks of Microfinance Banks

RESPONSES	OBSERVED FREQUENCY	EXPECTED FREQUENCY	O – E	(O – E)2	(O – E)2 / E
YES	55	100	-45	2025	20.25
NO	145	100	45	2025	20.25
TOTAL	200				40.50

Source: Field survey 2010

The computed chi ï square value is 40.50. At 5% significant level and 1 degree of freedom the critical chi ï square value is 0.004. Since the computed chi ï square value is greater than the critical chi ï square value we reject the null hypothesis and accept the alternative which states that the credit risks of microfinance banks do have significant effect on their operations.

This simply means that the amount of non - performing loans will have effects on the operations of microfinance banks. These banks are to ensure that the loans given to their customers are used for the purposes for which they are given. There should be a kind of check put in place by the banks to ensure strict compliance by their customers.

Conclusion

Microfinance is a sure way to assist economic agents including households and small businesses to survive and perhaps rise above the daily pre- occupation of three square meals, and begin to think of serious profitable investment. There is therefore a huge demand for financial services on the part of low income earners that cannot afford the cost which the conventional banks offer. Microfinance banks have a prominent role to play in this because they are expected to provide these financial services at low interest rate.

The continual existence of these microfinance banks is central to the growth of the small and medium scale enterprises in Nigeria as this will have a direct influence on the economic growth of the country. The government should implement the policy properly. In this new era of microfinance business in Nigeria, the expectation of the survival of these banks is high despite their challenges. The prospects of these banks are many but, this depends largely on the strict compliance to the policy by the government, operators of microfinance banks and the customers.

Recommendations

The study recommends that the regulatory authorities are to make sure that the microfinance policy is properly implemented. The state and local governments are to make available in their locality the one per cent fund, which the microfinance banks policy requires them to provide from their statutory allocation. Also, Central Bank of Nigeria should consider increasing the minimum paid-up capital of microfinance banks despite the recent increase because capital is grossly insufficient for the business given the huge demand for microfinance in the country.

Microfinance banks should follow strictly their code of conduct. They should follow the CBN's operational guidelines for the establishment of microfinance banks that discourage them from engaging in excessive spending. These banks should cut their costs on operational facilities.

The microfinance banks credit department should make sure that before loans are disbursed to customers, the loan proposal must have been properly assessed to be a viable one.

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