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MICROFINANCE BANKING IN NIGERIA: PROBLEMS AND PROSPECTS

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Abstract

Since the advent of microfinance banking in Bangladesh in the mid 1970's, several countries have copied this financing model. The seeming popularity of this model among developing countries is predicated on poverty reduction prospect it offers. The Nigerian government cued into this popular thinking in 2005 when it inaugurated the microfinance banking scheme. This was founded to provide finance to economically active poor excluded from financing by conventional banks, provide employment, engender rural development and reduce poverty. This paper theoretically examines the challenges these banks have had to grapple with from their inception. Furthermore, it scans the business environment to assess the prospects of microfinance banks in Nigeria. The paper shows that microfinance banking in Nigeria faces enormous challenges in infrastructural inadequacies, social misconception, poor legal and regulatory framework, unbridled competition from other financial institutions, abandonment of core microfinance function and paucity of qualified manpower. Despite this plethora of challenges, the study identified several areas where opportunities exist for these banks. The growing entrepreneurial awareness, increasing government interest, large unbanked rural area and high population of poor people were identified as some of these opportunities. The paper argues that with proper regulatory interventions and commitment of other stakeholders to the core mission of microfinance banking, its challenges can be addressed and its prospects enhanced. This paper therefore concludes that the future of microfinance banking in Nigeria is bright.

Keywords: *Rural Development, Poverty Alleviation, Micro Leasing*

INTRODUCTION

One of Nigeria's economic peculiarities is financial dualism. There is a formal financial sector made up of the ministry of finance, the Central Bank of Nigeria (CBN), banks, other financial institutions, Nigerian Stock Exchange (NSE), etc. Beside this formal sector exists an informal financial sector with people lending and borrowing directly from each other through methods like esusu, daily contributions and through cooperatives (Okpara, G. C., 1990). The presence of a large informal finance sector in Nigeria had been blamed on several factors, some of which are; population concentration in rural areas most of which are unbanked, low literary level, loss of confidence in the banking system due to distress, elitist banking practices and absence of other financial institutions in the rural areas (Acha, I. A., 2007).

A major consequence of a large informal sector is difficulty in economic management. The experience of Nigeria in this regard is not different as the monetary authorities have had to watch impotently as their monetary policy measures fall short of desired objectives (Acha I. A., 2008a; Acha I. A., 2009).

Apart from the difficulties experienced in monetary management, the Nigerian governments over the years have had to grapple with poverty and unemployment. The realization that many of these poor and/or unemployed persons are not without skills, ideas and willingness to work, must have propelled the government to make finance accessible to them. This, the government has tried to achieve using different programmes.

Some of the programmes tailored to address the problems of financial dualism, poverty and unemployment by successive Nigerian governments are; rural banking scheme, Peoples Bank, operation feed the nation (OFN), green revolution, Nigerian Bank of Commerce and Industry (NBCI), Nigerian Agricultural and Cooperative Bank, Nigerian Economic Reconstruction Fund (NERFUND), Nigerian Directorate of Employment (NDE), Family Economic Advancement Programme (FEAP), Poverty Alleviation Programme (PAP), Nigerian Industrial Development Bank (NIDB), Bank of Industry (BOI), Nigerian Agricultural Cooperative and Rural Development Bank (NACRDB), community banking and microfinance banking.

Many of these programmes failed to achieve the objectives for which they were established and were scrapped. One of the last programmes to suffer this fate was community banking and in its place the microfinance banking scheme has been instituted. The failure of these government programmes can be attributed to the problems and challenges which they faced. The current scheme – microfinance banking – is not without its own challenges.

It is in the light of the above that this paper sets to; highlight the challenges facing the microfinance banking scheme, examined the prospects of the scheme and suggest ways it can adopt in order to avoid the pitfalls of its predecessors and overcome current challenges.

LITERATURE REVIEW

Microfinance is the provision of financial services to the poor who are traditionally not served by the conventional banks (Jaffari S. I. A. *et al,* 2011), (CBN, 2005), (Conroy J. D., 2003). These financial services include credit, savings, micro-leasing and money transfer and payment services[8]. The features that distinguish microfinance from other forms of formal financial products are; smallness of loans advanced and savings collected, near absence of assets–based collateral and simplicity of operations (Eboh, E. F. 2008), (Iorchir, D. 2006). It can be deduced from the foregoing that microfinance is a poverty alleviation strategy which operates by providing credit and other financial services to economically active and low income households and their businesses. To achieve this poverty alleviation objective, microfinance helps the poor increase their income, build viable business, reduce vulnerability to shocks and create employment (Yunus M. & Alan J., 1999; Yunus M., 2002).

The practice of microfinance is not new in Nigeria. Nigerians have always tried to provide themselves with needed finances through informal microfinance approaches like self-help groups (SHGs), rotating savings and credit associations, (ROSCAs), accumulating credit and savings associations (ASCAs) and direct borrowings from friends and relations (CBN,2005; Akpan I., 2009; Okpara G. C., 2009; Okpara G. C., 2010). These approaches may have sufficed in the traditional society but the growth in the sophistication of the economy and the increasing incidence of poverty among citizens has revealed the shortcomings of this approach. The Central Bank of Nigeria (CBN) alluded to this when it pointed out that the informal financial institutions that attempt to provide microfinance services generally have limited outreach due primarily to paucity of loanable funds (CBN, 2005).

It was in a bid to resolve this identified deficiency of the informal microfinance sector that the CBN in 2005 introduced a microfinance policy a prelude to the licensing of microfinance banks in Nigeria. According to this policy document, its aim is to provide a microfinance framework that would enhance the provision of diversified microfinance services on a long-term sustainable basis for the poor and low income groups, create a platform for the establishment of microfinance banks and improve CBN's regulatory/supervisory performance in ensuring monetary stability and liquidity management.

Microfinance banks were therefore established because of the failure of the existing microfinance institutions to adequately address the financing needs of the poor and low income groups (Acha I. A., 2008b). The CBN further justified its licensing of microfinance banks with the lack of institutional capacity and weak capital base of existing community banks, existence of huge un-served market and need for increased savings opportunity (CBN, 2005). Taking the issue of lack of capacity by existing financial institutions further the CBN pointed out that only 35% of Nigerians had access to financial services and that most of those without access to financial services dwell in the rural areas.

In the same vein, (Nwankwo O., 2008) noted that over 95% of the businesses in Nigeria are small and that conventional banks choose not to finance such businesses. This is attributed to the high risks inherent in them and their inability to provide asset-based collateral. It was therefore to make up for the shortfall in the financing of the entrepreneurial poor and their small businesses that microfinance banks were established.

Microfinance Banks in Nigeria

As already noted microfinance banks were founded because of the perceived deficiencies in the existing financing schemes for the poor and small businesses. They were licensed to begin operations in 2007 and existing community banks and NGO microfinance institutions that met the conditions spelt out by CBN for licensing were allowed to transmute into microfinance banks.

To qualify for a microfinance license an existing community bank was required to increase its paid-up capital from N5m to N20m. Unlike the community banking policy framework which compulsorily confined all community banks to unit banking, the microfinance banking guideline permitted the branching of microfinance banks within a state. For the microfinance banks intending to open branches within a state their paid-up capital was put at N1 billion. Another point of divergence between the community banks and their microfinance successors is in those which the regulatory guideline allows to own them. In addition to individuals, group of individuals, community development associations, private corporate entities which could own community banks, foreign investors and commercial banks, foreign investors could also own microfinance banks.

These changes in the policy framework establishing microfinance were due to the perceived failure of the existing microfinance framework. (Adeyemi K. S., 2008) captured this thus, "despite decades of public provision and direction of provision of microcredit, policy orientation, and the entry of new players, the supply of microcredit is still inadequate". He identified some of the challenges which microfinance institutions face that impinge on their ability to perform to include; undercapitalization, inefficient management and regulatory and supervisory loopholes. To these, (Mohammed A. D. and Hassan Z., 2009) added usurious interest rates and poor outreach. Further buttressing the challenges facing microfinance banks, (Nwanyanwu O. J., 2011) identified diversion of funds, inadequate finance, and frequent changes in government policies, heavy transaction costs, huge loan losses, low capacity and low technical skill in the industry as impediments to the growth of this subsector. These challenges many of which contributed to the failure of previous microfinance schemes are still bedeviling the microfinance banking scheme in Nigeria. The next section discusses some of them.

The Challenges of Microfinance

As highlighted in the previous section, the failure of community banking scheme and many previous government's micro financing schemes was predicated on the challenges they faced. Many of these challenges are still bedeviling microfinance banking. This section discusses some of these; One of the most fundamental difficulties microfinance banks in Nigeria have is the near absence of basic infrastructure. This lack of basic infrastructure compounds the operational difficulties of these banks, which ordinarily are faced by high operational costs because of their nature of business. By dealing with many small clients microfinance banks' transaction costs are usually higher than those of conventional banks. Unfortunately, these banks are also forced to incur additional costs to provide themselves with electricity and water. The absence of good roads especially in the rural areas also distorts their outreach (Bamisile A. S. 2006). All these work in concert to drive cost of operations up and put them at a very big competitive disadvantage.

The lack of banking culture in the rural areas and among the urban poor is another factor militating against the progress of microfinance banks. Traditionally, these people borrow money from friends and relatives and repay the same amount of money borrowed no matter the tenure of such loans. They therefore find it difficult to understand the payment of interest on bank loans.

In the northern part of the country, the issue of frowning at interest on loans takes a religious dimension. This part of the country is populated by mainly Muslims, a religion which abhors usury. This has hampered the development of microfinance banking in that part of the country. This was buttressed by (Mohammed A. D. and Hassan Z., 2009) who opined that "conventional micro financing violates Islamic principles by charging interest. This matter is of concern for Muslims due to the consequences of dealing with interest (ribia)". This may account for the lopsided location of microfinance banks in country as over 75% of them are located in the southern part of the country while the northern part with a higher incidence of poverty has less than 25% of (Bamisile A. S. 2006).

The failure of many community banks and the withdrawal of the license of 224 microfinance banks in 2010 have badly damaged public confidence in these banks. Many microfinance banks established in communities where failed community banks existed are faced with an uphill task of convincing these communities that they will not go through the unfortunate experience of losing money in a bank failure. The sudden withdrawal of the license of 224 of these banks has fuelled the lack of public confidence which community banks bequeathed them. Many of the customers of these banks have refrained from dealing with them in fearing the same fate would befall them. On the other hand, the Central Bank of Nigeria has constantly assured the public that it will not allow any commercial bank to fail; this, places the microfinance banks at a great disadvantage by tilting public confidence in favour of commercial banks that are normally bigger and stronger.

Another important factor identified to militate against the performance of microfinance banks in Nigeria as identified by (CBN, 2005; Irobi N. C., 2008) is limited support for human an institutional capacity building. The paucity of human capacity in the microfinance sub-sector in Nigeria has been an issue from the days of community banking. According to (Ikeanyibe, O. M. 2009) one of the major problems of the microfinance sub-sector is recruitment of effective and appropriate manpower. This he ascribed to the inability of the sector to adequately remunerate staff. Other human resource problems faced by microfinance banks include lack of training opportunities and poor conditions of service. The quality of manpower in these banks is reflected in the poor performance of many of them, inefficiency and high levels of frauds and forgeries. The banks also suffer from high labour turnover a further indication of low staff motivation and poor personnel practices.

Corruption is a cankerworm that has wrecked-havoc in many sectors of the Nigerian economy. The microfinance sub-sector is not left out of the ravages of corruption. This manifests in many ways, such as, corporate governance failures, frauds and forgeries, theft and refusal by customers to repay loans. The standard of corporate governance in many microfinance banks in Nigeria is poor. Board members are known to misuse their positions to obtain facilities way above the regulatory limit for insider related loans and worse still with no intentions of repaying such facilities. They also use their positions to unduly influence and manipulate the recruitment processes in favour of their cronies.

Frauds and forgeries by both insiders and outsiders to the banks are rife and people generally obtain loans with no intention to repay.

It is important to note that there is over nine hundred (900) microfinance banks today in Nigeria and they are regulated and supervised by the Central Bank of Nigeria (CBN). The CBN also has the responsibility of supervising commercial banks, development finance institutions, primary mortgage institutions, and bureau de change and credit bureaus. The multiplicity of the institutions and their diverse nature possess a regulatory challenge. This is against the backdrop that since for instance commercial banks and microfinance banks differ in operational method and scope, a regulator trained to inspect/supervise the activities of one may be handicapped in the supervision of another.

The emergence of miracle or magic banks from time to time has done a lot of disservice to the image of microfinance banks. These banks spring up without any license, promise to pay outlandish interest on deposits, mobilize deposits from the uninformed and/or greedy and disappear. Most of the victims of these scams are customers that microfinance banks should service but become skeptical about banking after the miracle bank experience. Many others do not see any difference between those magic banks and the licensed microfinance banks.

Another prevalent problem among microfinance banks is the copying, competing and mimicking the practices of commercial banks. Many microfinance bank managers and other management staff were commercial banks' staff who were either retired or sacked by their former employers. To these staff microfinance banking is just an extension of the commercial banking they know. They also come with their organizational orientation, philosophy and culture. They refuse to understand that microfinance is not micro-commercial banking but a different kind of banking requiring a different approach, philosophy and client base. This may be why many microfinance banks spend colossal sums on office complex, exotic cars and the wardrobe of their staff. They also engage in inordinate competition with the commercial banks. This class of staff lack orientation as to the essence of microfinance.

The constant government policy changes offer its set of challenges to the microfinance banks. In 2007, commercial banks were consolidated; they became so big obviously leaving the not too wealthy client segment to microfinance banks. Today banks have been reclassified into regional, national and international, fuelling fears that the regional banks might be in direct competition with microfinance banks. In addition to this, Islamic banks are being licensed and may end up in the same market segments as microfinance banks.

The rate of interest charged by microfinance banks leaves a lot to be desired. According to a study carried out by (UNDP 2003), microfinance banks charge between 30% - 100% interest on loans while they pay 4.5% to 6% on savings. (Anyanwu C. M., 2004), confirmed that the microfinance banks rates are way too high and may not augur well for the smooth development of this sector.

Prospects of Microfinance Banking in Nigeria

That a lot of opportunities exist in the microfinance subsector in Nigeria is unarguable. Scholars are unanimous in their agreement that there exist a large untapped market for microfinance banks. (Olaitan M. A. 2006; Oluyombo O. O. and Ogundimu K. M., 2006) buttresses this by pointing out that about 70% of the Nigerian population is engaged in the informal sector or agricultural production. Going by the country's population of over one hundred and fifty million people we can deduce that about one hundred and five million are in this sector. In the same line though differing in figures, (Mohammed A. D. and Hassan Z., 2009) held that microfinance banks in Nigeria only serve less than one million people against the over 40 million that require their services. The gap in this subsector was further demonstrated by (CBN, 2005) when it showed that microcredit facilities in Nigeria account for about 0.2 percent of GDP and less than one percent of total credit to the economy.

The scenario above is indicative of an enormous market which microfinance banks can take advantage of. This large untapped market in the microfinance subsector is further enhanced by the fact that over 65% of the entire population of Nigeria has no access to banking services[6]. To say that this leaves a lot of room for existing microfinance banks to expand their scope of operations and for new ones to enter will be stating the obvious.

Government's renewed interest and improved regulatory environment in the microfinance sub-sector also enhances the prospects for development and success of microfinance banks. One indication of this is the implementation of training programmes for regulators, promoters and practitioners by the Central Bank of Nigeria (CBN). The CBN has even gone ahead to adapt the suggestion of (Irobi N. C., 2008) that it subsidizes the training of practitioners in the sector to reduce the burden on the banks. Today the CBN pays 60 per cent of the cost of training the management staff of these banks, this is aimed at improving capacity in the industry. The programme which the CBN runs in collaboration with Nigerian Deposit Insurance Corporation (NDIC) will culminate in these managers passing a certification examination set by the Chartered Institute of Bankers of Nigeria (CIBN). The regulators are taking this certification/human capacity building programme so seriously that they have issued a guideline that only certified persons will qualify to manage microfinance banks in the near future.

Another sign of regulatory will to ensure vibrancy in the micro financing banking subsector is the inclusion of microfinance banks' deposits in the deposit insurance scheme. This has improved public confidence in the subsector. Furthermore, the review of the deposit insurance limit from one hundred thousand (N100,000.00) naira as stipulated by the NDIC Act of 2006 to two hundred thousand (N200,000.00) naira is a further sign of regulatory intention to build confidence in these banks.

CONCLUSIONS

Nigeria is a country with enormous resources, unfortunately despite this a great number of Nigerians still live in poverty. It is in the bid to address this that the government formulated the microfinance policy guidelines in 2005. This guideline among other things provided for the licensing of microfinance banks. The microfinance banking subsector in Nigeria is therefore relatively young having taken-off in 2007. Like many new ideas, it is undergoing a challenging and trying period. Some the challenges microfinance banks in Nigeria face are, regular changes in government policies, lack of requisite human capital, infrastructural inadequacies and socio-cultural misconceptions. In addition to these, the banks are further inhibited by corruption, frauds and forgeries and poor corporate governance. To address these issues concerted efforts on the part of regulators, promoters, practitioners and other stakeholders in the microfinance banking subsector is required. This is to ensure that they do not drag the subsector under as was the case of previous microfinance schemes of government. It is expedient that these banks succeed and grow considering their poverty amelioration potentials. The extent of poverty being experienced in the country, the large informal finance sector, the huge rural economy and the involvement of over 70 per cent of the population in agriculture and small and medium scale enterprise are clear indications that a vast untapped market exist for these banks. If this huge market challenges identified are addressed, then the prospects of microfinance banking in Nigeria is very bright.

RECOMMENDATIONS

To enable microfinance banks in Nigeria take advantage of the enormous market potentials, the following suggestions to mitigate the challenges they face are advanced;

i. The capacity building for the practitioners which the CBN and NDIC are undertaking is a welcome development and should be extended to the Board of Directors of these banks. This will ensure that the Directors who craft the policies for these banks are on the same page with their management staff. They should be made to understand the operational limits, modalities and objectives of microfinance banks. Particularly, they should be made to realize that these banks are not mini commercial banks and that microfinance banks pursue social motives in addition to financial sustainability.

ii. The government should make good its promises of improving social infrastructure in the country. Special attention should be paid to power supply as this constitutes a major cost to microfinance banks.

iii. Since poor banking culture is one of the fundamental problem plaguing microfinance banking in Nigeria, it becomes expedient that these banks should train their clients in financial literacy before disbursing loans to them. The clients should be made to understand the intricacies of such facilities, including repayment mode, interest charges and benefits of keeping to the terms of the credit contract.

iv. There is need for microfinance banks especially those operating in the Northern part of the country to be proactive in product development. Since the religious precepts of many people in that part make them abhor interest on loans, the banks should provide them with interest free loans. Better still the regulators should encourage interest free microfinance banking by producing guidelines to ensure its success as they have done for the conventional banks.

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