Microfinance Institutions in Nigeria: Policy, Practice and Potentials

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Abstract

This study examines the outreach performance of microfinance institutions (MFIs) in Nigeria, based on a survey of ten major MFIs. The findings indicate that the operations of MFIs have grown phenomenally in the last ten years, driven lagely by expanding informal sector activities and the relucance of banks to fund the emerging micro enterprises. The financial services provided by the MFIs have neither been given any publicity nor captured explicitly in the official financial statistics. The study also reveals that the sub sector faces a number of challenges which have been addressed in this paper. They include the urgent need to approve and implement a policy framework that would regulate and standardise MFI operations; accessing medium to long term sustainable commercial sources of fund, such as SMIEIES and DFI funds and increased mobilisation of savings; and shifting a good proportion of credit portfolio to the promotion of real sector activities, especially in agricultural and manufacturing.

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Summary

This study examines the outreach performance of microfinance institutions (MFIs) in Nigeria, based on a survey of ten major MFIs. The findings indicate that the operations of MFIs have grown phenomenally in the last ten years, driven largely by expanding informal sector activities and the reluctance of banks to fund the emerging micro enterprises. The number of MFI branches increased five fold and the employees ten times. Their asset base and clients rose six and sixty-seven times, respectively. The value of outstanding loans and savings increased in multiples. Yet the number of beneficiaries of MFI operators is an insignificant proportion of over 60 million people that are in need of microfinance services. The financial services provided by the MFIs have neither been given any publicity nor captured explicitly in the official financial statistics.

The study also reveals that the sub sector faces a number of challenges which have been addressed in this paper. They include the urgent need to approve and implement a policy framework that would regulate and standardize MFI operations; accessing medium to long term sustainable commercial sources of fund, such as SMIEIES and DFI funds; increased mobilisation of savings; and shifting a good proportion of credit portfolio to the promotion of real sector activities, especially in agriculture and manufacturing

1. Introduction

Commercial banks traditionally lend to medium and large enterprises which are judged to be creditworthy. They avoid doing business with the poor and their micro enterprises because the associated cost and risks are considered to be relatively high. Microfinance institutions (MFIs) have therefore become the main source of funding micro enterprises in Africa and in other developing regions.

Initially, the objective of this study was to undertake a survey of microfinance institutions in Nigeria. However, a similar survey was carried out by the Development Finance Department of the Central Bank of Nigeria in 2001. The focus of the 2001 study was to gather and analyze data that would provide a basis for "developing appropriate policy, regulatory and supervisory framework for the operations of MFIs in Nigeria" (CBN, 2003). This paper builds on the 2001 survey and undertakes a more detailed analysis of ten major MFIs, to assess their performance and highlights the potentials of the sub-sector in Nigeria.

A survey of ten major MFIs was conducted in July 2004 and all of them responded positively. These were Farmers' Development Union (FADU), Ibadan; Community Women and Development (COWAD), Ibadan; Country Women Association of Nigeria (COWAN), Akure; Life Above Poverty (LPO), Benin; Justice Development and Peace Commission (JDPC), Ijebu-Ode; Women Development Initiative (WDI), Kano; Development Education Centre (DEC ENUGU), Enugu; Development Exchange Centre (DEC BAUCHI), Bauchi; Outreach Foundation (OF), Lagos; and Nsukka Area Leaders of Thought United Self-Help Organization (NLTNUSHO), Nsukka.

The paper is in five sections. Following the Introduction, Section 11 contains an Overview of the Characteristics and Policy of Microfinance Institutions in Nigeria. Section 111 discuses the Performance of Ten Selected Microfinance Institutions, while Section 1V proposes development finance institutions (DFIs) as an additional funding source to MFIs. Section V concludes the paper with an assessment of the Potentials and Challenges of Microfinance in Nigeria.

2. An Overview of the Characteristics and Policy of Microfinance Institutions in Nigeria

2.1 Characteristics

The unwillingness or inability of the formal financial institutions to provide financial services to the urban and rural poor, coupled with the unsustainability of government sponsored development financial schemes contributed to the growth of private sector-led microfinance in Nigeria. Before the emergence of formal microfinance institutions, informal microfinance activities flourished all over the country.

Informal microfinance is provided by traditional groups that work together for the mutual benefits of their members. These groups provide savings and credit services to their members. The informal microfinance arrangements operate under different names: 'esusu' among the Yorubas of Western Nigeria, 'etoto' for the Igbos in the East and 'adashi' in the North for the Hausas (CBN, 2000). The key features of these informal schemes are savings and credit

components, informality of operations and higher interest rates in relation to the formal banking sector. **The informal associations that operate traditional microfinance in various forms are found in all the rural communities in Nigeria (Otu, et al, 2003). They also operate in the urban centres. However, the size of activities covered under the scheme has not been determined.**
The non-traditional, formalized microfinance institutions (MFIs), are operating side by side with the informal services. The financial services provided by the MFIs in Nigeria include savings, credit and insurance facilities. The stated objectives of the MFIs obtained through the survey exercise are summarized as:

(a) to improve the socio-economic conditions of women, especially those in the rural areas through the provision of loan assistance, skills acquisition, reproductive health care service, adult literacy and girl child education;
(b) to build community capacities for wealth creation among enterprising poor people and to promote sustainable livelihood by strengthening rural responsive banking methodology; and
(c) to eradicate poverty through the provision of microfinance and skill acquisition development for income generation.

The Central Bank of Nigeria survey (2001) indicated that the operations of formal microfinance institutions in Nigeria are relatively new, as most of them were registered after 1981. The 10 MFI analyzed in this study were also registered from 1982 as non-governmental organizations (NGOs). They operate in both urban and rural areas except for three institutions that operate exclusively in the rural areas (Table 1).

The result of our survey showed that the bulk of credit beneficiaries were women, as most of the MFIs began as NGOs that had the promotion of female welfare as the basis for their establishment. Thus, about 97.4 per cent of the clients in the sample were women. Four of the institutions exclusively provide services to women, while five had over 90 per cent of their clients as females. Apart from the general belief that women are marginalized in terms of economic opportunities and should therefore have separate promotional agenda, the MFIs are of the view that women perform better than men in managing meager resources and promoting micro enterprises. Other reasons revealed by the survey were that the ego problem of men makes it difficult for them to solicit for small sums of money; and that cultural practices prevent men from engaging in certain businesses, such as petty-trading, hair-dressing, etc.

Unlike in the banks, asset based collateral is de-emphasized by the MFIs. Lending is done on group basis and a group is made up of between 5 and 10 clients. The collateral is the collective pledge of the group to repay, based on community recognition. In addition, the MFIs concentrate on short term financing, owing to the large demand for loans and their limited assets. Over 78 per cent of their financing was for trading activities (Table 2). Two of the MFIs surveyed exclusively funded trading/commerce, while another five had not less than seventy per cent of their activities being commerce. About 14.1 per cent of the total funding was for farming activities and only 3.5 per cent went into manufacturing. Credit to the service sector was very minimal and the MFIs gave no loans for consumption. All the clients were low income individuals, operating micro enterprises. The disproportionate coverage of commerce in the loan portfolios of MFIs is attributed to the quick and high returns that come from investments in the sector, compared with the long gestation periods and lower returns that are associated with businesses in agriculture and manufacturing.

The principal source of funds for the organized MFIs in Nigeria is aid and grants which come mainly from abroad. On the average, about 51.2 per cent of their operations were funded from this source (Table 3). Seven out of the ten MFIs in the sample sourced over 50 per cent of their funds from grants and aid. The major donor organizations to the ten surveyed MFI were UNDP, the Ford Foundation, the African Development Foundation, Community Development Foundation, Development and Peace of Canada, EZE of Germany and the Catholic Agency for International Development of The Netherlands.

2.2 Microfinance Policy in Nigeria

Although the availability of microfinance and the establishment of MFIs are expanding in Nigeria, there are yet no established government policies and mechanisms for regulating and supervising activities in the sector. In 2000, a National Conference on Microfinance organized by the Federal Government of Nigeria and the World Bank recommended that the Central Bank of Nigeria should take up the responsibility of developing an appropriate policy, as well as regulatory and supervisory framework for the operation of MFIs. The workshop recognized that the development of appropriate Microfinance Policy (MFP) was critical to the development of sound microfinance practice, sustainable MFIs and by implication viable micro enterprises in Nigeria. In responding to this recommendation, the Central Bank conducted a baseline study of MFIs in 2001. The objectives of the study were to:

(i) identify the role of MFIs in financial intermediation in Nigeria;
(ii) determine the level of financial intermediation of MFI with a view to developing a regulatory and supervisory framework to guide and enhance its operations in Nigeria; and
(iii) recommend policies that would facilitate the linkage of informal, semi-formal and formal financial services providers to micro and small scale rural entrepreneurs.

The CBN study identified 160 registered MFIs in Nigeria as at 2001. Out of this number, 96 or 60 per cent responded to the administered questionnaire. The study revealed that as at the third quarter of 2001, the respondents had aggregate savings worth ₦99.4 million and outstanding credit of ₦649.6 million, indicating huge business transactions in the sector. The survey identified several constraints on the operations of MFIs, including the lack of performance standards and the absence of a regulatory framework. The Central Bank study made the following recommendations:

1. There is need to development of a regulatory and supervisory framework for the operations of MFIs in Nigeria. It is desirable to regulate only MFIs that mobilize savings for purposes of lending to their clients. MFIs that do not belong to this category may be encouraged to be self-regulatory.
2. An apex regulatory institution should be established and charged with the responsibility of building capacity through the training of directors and managers of MFIs to enable them develop an efficient information system for identifying and managing risks, and satisfying relevant data and information requirement of regulators and stakeholders.

3. The Government should also improve on the state of infrastructural facilities to reduce the transactional costs associated with the administration of micro credit in the country.

Consequent on the findings of the study and as part implementation of these recommendations, a draft national policy on MFIs was prepared by the Development Finance Department of the CBN and subjected to a stakeholders' review on 26th – 27th February, 2004 and an international validation summit on 17th – 19th March, 2004. The policy document provided for the definition of MFIs, the group of institutions to be covered, allowable and non-allowable activities, procedures and requirements for the application of license, sources of funds, publication of audited accounts, prudential requirements, penalties for contraventions, etc (a summary of the policy document is in the Appendix). The policy package is however yet to be adopted. **Hopefully, it would be approved by the Management of the CBN before the end of 2004 and should become operational early 2005.**

3.0 The Performance of Selected Microfinance Institutions in Nigeria

Two major criteria, outreach and sustainability, have been selected for evaluating the performance of MFIs (CGAP, 1996 and Yaron, 1997). Since then, many studies have been conducted using these criteria. Outreach is defined as the ability of an MFI to provide high quality financial services to a large number of clients (Youssoufou, 2002). The indicators of outreach performance include changes in number of clients, the percentage of female clients, total value of assets, amount of savings on deposit, value of outstanding loan portfolio, average savings deposit size, average credit size, number of branches, etc. Sustainability on the other hand requires MFIs to meet all transaction costs, including loan losses, financial costs, administrative cost, etc, with some return on equity, which will ensure renewal and self-sustenance. However, this study uses mainly the outreach criteria, in addition to the evaluation of some economic indicators because sufficient data was not available to analyze sustainability conditions.

3.1 Outreach Performance

The demand for microfinance services is high and increasing in Nigeria but the exact amount is not known. The continuous lay-off of labour from both the public and private sectors since the introduction of the structural adjustment programme in 1986 and the growing number of graduates from schools and colleges is pushing a large proportion of the population into informal sector activities. Many micro enterprises are, therefore, springing up but without bank financial support. Also the domestic market is large, with over 130 million people in need of various goods and services, including financial services. The growth in microfinance activities reflects the expansion of informal sector activities and the exclusion of a large proportion of economically active population from the various financial services of the formal sector.

Large volumes of financial transactions are carried out by microfinance institutions, with little or no publicity around them. Their operations are not explicitly captured in official financial statistics and their activities are hardly reported on by the mass media. Yet their transactions impact directly on a large section of the population, especially the poor.

The CBN survey indicated there were 160 registered MFIs in Nigeria in 2001, located in 28 out of 36 States in the country. They operated largely in the rural areas (Table 1). Their activities have expanded phenomenally in the last ten years, in terms of size, branch expansion, staffing, volume and value of both credit and savings. Apart from the emerging trend that microfinance has become a commercial enterprise with some return on capital, the driving force is the desire to extend financial services and improve the living conditions of the poor.

The number of branches or units operated by six MFIs that reported on this issue increased almost five fold, from 266 to 1,193 between 1993 and 2003, while their employees rose over ten-times to 705 (Table 4a). Table 4b indicates that the number of staff employed by the ten MFIs was 777 in 2003, but this cannot be compared with 1999 as some MFI did supply data for that year. The total asset base of the six firms that gave data on the two years rose over six fold, from just ₦54 million in 1993 to well over ₦348 million in 2003. The two largest MFIs in the sample were excluded in this aggregate because they did not supply data for 1993. They had asset base of ₦268 million and ₦173 million, respectively, and adding them will bring the total asset base to over ₦789 million in 2003 (Table 4b).

The number of borrowers from the ten MFIs rose over sixty-seven times, from 6,013 in 1993 to 405,915 in 2003, with the average borrower per MFI rising to 40,592, as more and more people and enterprises that cannot be catered for by the banks seek for assistance from the MFI. Correspondingly, the aggregate value of outstanding credit for four reporting firms shot up from ₦16.42 million in 1993 to ₦591.1 million in 2004 (Table 4a). For nine MFIs that gave full information for 2003, the value of their outstanding loans was ₦644.7 million (table 4b). However, the outstanding loans were very disproportionately distributed as only two MFIs accounted for over 67 per cent of the total.

The mobilization of savings was not seen as an integral part of micro finance in the earlier years. The main sources of funding were the personal savings of members and grants from international organizations. However, given the waning interest of donors, the problem of financial sustainability has induced the operators to see the mobilization of domestic savings as being important to long-term survival. Only three firms gave full information on savings. For these three, the number of clients doing savings with them rose from 6,958 in 1993 to 61,895 in 2003, while the value of savings increased twenty fold, from ₦4.868 million to ₦107.751 million (table 4a). However, nine gave full information for 2003 and their aggregate value of savings was ₦252.71 million, with an average of ₦25.3 million per MFI (Table 4b).

Over the past decade, the activities of microfinance institutions have expanded significantly. The rising volume of financial transactions indicates that the low income group and indeed the poor are bankable in Nigeria. All they need is access and convenience which the banks denied them. Also the rising volume of transactions carried out by the MFIs can no longer be ignored by the monetary authorities. There is, therefore, need for a policy framework that will regulate their activities and capture their operations directly for the official financial statistics.

3.2 **Economic Indicators**

The economic indicators are discussed for 2003 only although the table contains data for 1993. The willingness of the low income group to borrow and repay at seemingly high interest rates confirm the view that their financial problem has more to do with access to funds than high interest rates. Interest rates in the microfinance institutions are much higher than the prevailing rates in the banks, reflecting perhaps the perceived greater risks and higher operations costs which the MFIs have to bear. Yet the poor, the low income group readily patronize them.

The average lending rate was much higher at 32.0 per cent. One firm charged rates as high as 48 per cent, and two others charged 42 per cent each. However, another two were at the base with 23 per cent apiece. For the banks, the average prime and maximum lending rates were 19.5 and 21.6 per cent in December 2003, respectively. Although bank rates were lower, the low income group did not have access them as they could not provide the required collateral.

The average loan size of the MFIs was small at ₦8,800, reflecting the small size of activities that are covered by microfinance in Nigeria. The credits range from ₦5,000 to ₦13,762, hence the main activities funded were petty-trading, and micro hair-dressing, sewing, low level agro-allied activities, etc.

In line with the structure of lending rates, the average savings deposit rate for nine reporting firms was estimated at 7.5 per cent in 2003 (table 5), which was significantly higher than the 3.5 per cent recorded in the banking sector. The savings rate in the MFIs is therefore more attractive, hence their ability to mobilize lots of savings from the poor. However, reflecting the low income level of the clients, the average savings deposit size was small at ₦3,707.30 in 2003. There is, however, wide variation among firms, as the average savings size ranged from ₦1,483.00 to ₦15,000. These savings which the MFIs are mobilizing are not captured by the banks, owing to the associated high administrative cost.

All the available data indicate that the poor are creditworthy. Despite the high level of interest rates, repayment rates were high, averaging 92.5 per cent in 2003 (Table 5). Two of the firms recorded 100 per cent repayment rate; two others had 98 per cent each, while the lowest was 80 per cent. The repayment rate was lower in the banking sector. It averaged 79 per cent in 2002 and was much lower at 58.6 per cent during the distress period of 1990-95.

The higher repayment rates in the microfinance sector were traceable to the collective responsibility of clients who are required to be in groups. Grouping of clients enhances the security of credits because they jointly assume responsibility for repayment. A defaulting member jeopardizes the chances of other members in the group getting new loans, thus they put pressure on one another to ensure repayment for the collective good.

The MFIs were funded through a number of sources. Donations and grants from international organizations accounted for about 51.2 per cent of total funding source in 2003 (Table 3). This source was followed by mobilized savings which contributed 20.9 per cent and owners' capital 9.0 per cent. Unidentified sources and bank loans accounted for 7.0 and 1.9 per cent, respectively. The need for financial sustainability makes it necessary that funding from equity and savings, as well as other sustainable avenues should increase substantially to reduce the high dependence on aid and grants from abroad.

Bank funding of MFIs in Nigeria should be given special consideration. The financial engineering of microfinance institutions has shown that the poor are good credit risks. The increasing access of the poor to credit and their unmatchable repayment rates has turned the provision of microfinance into a huge viable business. Thus commercial banks in Nigeria should begin to play a larger role in the provision of micro credit funding. The experiences in Bangladesh, Egypt and Kenya are very good examples, in which banks have done much to fund MFIs and micro enterprises. Also, in Indonesia, the world's fourth largest country, a single micro banking institution, Bank Rakyat Indonesia, serves about one third of the country's households through its micro banking system (Charistenento, 2001).

The response of the banking community in Nigeria is changing. The Bankers' Committee has taken a decision that 10 per cent of the funds accruing to the Small and Medium Industries Equity Investment (SMIEIS) should be channeled to micro enterprises through registered microfinance institutions. Under the SMIEIS arrangement, banks in Nigeria agreed to set aside 10 per cent of their pre-tax profit annually for equity investment in small and medium industries. At the end of June 2004, over ₦24 billion had been set aside under the scheme, while less than ₦10 billion had been invested. The micro finance institutions can therefore access 10 per cent of the total funds set aside which is now over N2.4 billion. Apart from providing a large volume of resources, the fund is fairly medium to long term in nature and this has the potential of positively changing the structure of the microfinance industry in Nigeria. With this additional financing, the MFIs can finance activities in the real sector, particularly agriculture and manufacturing.

4. Development Finance Institutions and Microfinance in Nigeria

The development finance institutions (DFIs) can provide an additional funding source to the MFIs, on on-lending basis, instead of the current practice of dealing directly with micro enterprise owners. Using the later as an intermediary could be more efficient because the MFIs have grass root orientation and greater expertise in financing smaller enterprises. An overview of the performance of DFIs in Nigeria will give credence to this proposal.

Between 1964 and 1977, various development finance institutions (DFIs) were established at both the national and state levels in Nigeria. The national DFIs included the Nigerian Industrial Development Bank (NIDB), Nigerian Bank for Commerce and Industry (NBCI), Nigerian Agricultural and Cooperative Bank (NACB) and Federal Mortgage Bank of Nigeria (FMBN). Each institution was given the responsibility of promoting the development of a specific sector or sub-sector (CBN, 2000). The NIDB was established in 1964, from the restructuring of an existing Investment Corporation of Nigeria (ICON), and given the mandate of developing new industrial enterprises and expanding existing ones through the provision of medium and long term loans and equity participation. A decade later in 1973, the NBCI was established to provide funding to small and medium scale enterprises. Of more relevance to micro enterprises, the NACB was also established in 1973 to promote the development of the agricultural sector in which most of the operators are micro enterprises. Also the FMBN, which took over the assets and liabilities of the Nigerian Building Society (NBS) was established in 1977, with the mandate to provide funding for residential and other housing needs of individuals and corporate organizations. Two other DFIs, the Urban Development Bank and Education Bank, were established in 1992 and 1993, respectively, to cater for these two important sectors.

These DFIs made varying contributions to their various sectors of responsibility. They funded various projects and enterprises, many of which are in operation today. However, with the drastic reduction in government subventions to them in the 1990s, their operations reduced drastically and by late 1990, they all ceased operating, as all of them depended mainly on government funding. Pervasive incidence of non-performing loans and generalized distress in the financial services sector constrained reliance on internally generated funds. Other militating factors included political instability and build-up of external debt which reduced both the country's credit worthiness abroad and the associated off-shore funding. There was also the deregulation of the financial sector and lifting of control on credit allocation by banks, which stopped channeling of penalty funds to the DFIs.

The poor performance of the DFIs notwithstanding, the need to channel financial resources to the productive sectors has remained a major challenge to the government and the monetary authorities. Attempts have therefore been made to restructure the DFIs, give them commercial orientation and make sustainability the guiding principle. Consequently, two new development banks were established recently.

a. **Nigerian Agricultural Cooperative and Rural Development Bank (NACRDB)**

The Nigerian Agricultural Cooperative and Rural Development Bank Limited (NACRDB) is an amalgam of the former Peoples Bank of Nigeria, Nigerian Agricultural and Cooperative Bank (NACB) and the Family Economic Advancement Programme (FEAP). It was set up in 2000, primarily to finance agriculture as well as small and medium enterprises. The bulk of agricultural enterprises in Nigeria are micro in size. The NACRDB is structured to accept deposits and offer loans/advances in which the interest rates are stratified according to the purpose for the loan. The bank also offers a number of microfinance services, including targets savings, start-up as well as smallholder loan schemes. The NACRBD commenced full operation in July 2001. The Authorized share capital was initially ₦1 billion, but now reviewed upwards to ₦50 billion. The Paid-Up **capital** is ₦1 billion, with an additional ₦9.1 billion in deposit for shares account. The sources of NACRDB's funding are mainly equity, as well as interest on loans and investments.

The financial assistance extended by the NACRBD can be classified into direct micro credit, on lending credit and macro credit. From the inception of the bank in July 2001 to December 2003, the total sum of ₦4.6 billion had been invested in loans and venture capital.

b. **Bank of Industry (BOI)**

The Nigerian Industrial Development Bank was restructured into the Bank of Industry (BOI) in 2000. the BOI formally took off in 2001. It has an authorized share capital of ₦10.0 billion and ₦1.0 billion had been issued and fully paid. The nature of funding of the sector by BOI has been in form of loans, debentures and equity. The interest rates on BOI's loans range from 10 to 20 per cent per annum. Repayment period for loans range from three (3) to seven (7) years (including one-year moratorium). Aggregated data indicate that total disbursement of funds from the inauguration of BOI in 2001 to 31st March, 2004 amounted to **₦1.72 billion**, out of which ₦1.26 billion went to large enterprises and ₦0.46 billion to smaller enterprises.

5. Potentials and Challenges of Microfinance in Nigeria

5.1 The Potentials of Microfinance

Nigerians, the rich and the poor, are enterprising and industrious. But the poor who account for over half of the population do not have access to formal banking services and they rely heavily on formal and informal micro finance institutions for credit. Nigeria's large population, over 130 million people, requires the production of goods and services on daily basis and funding is required for the production. There is therefore huge demand for financial services and the MFIs have a prominent role to play. The MFI operations are, therefore, expanding, but they have very limited financial resources. The SMIEIS funds and the development finance institutions (DFI) have been identified as potential sources of long-term funding for MFI operations. In addition, deposit money banks are beginning to develop interest in microfinance funding, given the unfolding commercial viability of the sector. The future of the industry is therefore very bright in Nigeria.

5.2 The Challenges of Microfinance

The expanding microfinance industry in Nigeria faces enormous challenges. The first challenge is for the MFIs to reach a greater number of the poor. The CBN survey indicated that their client base was about 600,000 in 2001, and there are indications that they may not be above 1.5 million in 2003. This is too small for a country that has over 60 million people that require microfinance services. The Government and its institutions, including the Central Bank, should work in concert to promote the sector, as a means of mobilizing domestic savings, widening the financial system, promoting enterprises, creating employment and income and reducing poverty.

Second, there is urgent need to have in place a policy framework that will regulate the establishment, operations and activities of MFI in Nigeria. This is very important for those MFIs that accept deposits from the public for which there is need for confidence building, efficiency of operations and safety of deposits. The current situation of lack of a policy framework encourages multiple standards and lack of uniformity in financial transactions. The draft policy document, which was prepared by the Development Finance Department of the CBN, was ready after the international validation summit held in March 2004. The management of the Central Bank of Nigeria should take urgent measures to accept and operationalise the policy. In addition to regulating operations in the industry, the MFI policy will encourage the gathering of financial statistics which will aid monetary policy formulation in Nigeria.

Third, funding of real sector activities, especially agricultural and manufacturing production, need to be promoted by the MFIs as these sectors 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 per cent, funded commerce. This is understandable, as the bulk of the funds came from grants which are not sustainable, but this structure is not desirable. The MFIs can take advantage of the banks' small and medium industries equity investment scheme (SMIEIS) fund, ten per cent of which has been reserved for micro enterprises, to finance real sector activities. This will also integrate the MFIs and micro enterprises into the formal sector and widen the financial system. Arrangements are almost concluded to make it possible for MFI to access the fund. The MFIs can also access funding from the development finance institutions on on-lending basis because they have greater capacity to reach micro enterprises than the DFI. Such funding can be channeled exclusively to the agricultural and manufacturing sectors since they are long-term funds.

Fourth, the issue of sustainability is crucial to the continuous operation of the MFIs. Although the indicators have not been computed, there are indications that the level of financial self-sufficiency is low. The level of grants as a source of funding is very high, while the contribution of commercial sources, such as savings, is low. There is need to reverse the trend, to emphasize savings mobilization, source long-term bank funding, negotiate funding arrangements with the DFIs and reduce dependence on grants.

Fifth, there is need for a comprehensive study on the MFIs in Nigeria that will cover the entire population; estimate the level of financial activities and number of clients; and determine the financial and operational sustainability of the MFI sector. **In particular, the recommended study should give priority to the determination of the viability of the MFIs and estimate the dependency ratio, sustainable interest rate, quality of loan port folio, administrative efficiency, etc. Such a study will be a useful guide for the regulators, operators and donor agencies.**

TABLE 1

CHARACTERISTICS OF MICROFINANCE INSTITUTIONS IN NIGERIA

Date of establishment	Classification by legal status	Registration status	Geographical Coverage	Percentage of women Beneficiaries	Funding Sources	
					Grants	others
1989	NGO	YES	Rural	85.6	59.0	41.0
1982	NGO	YES	Rural & Urban	99	0	0.0
1982	NGO, Cooperative & Banking Institution	YES	Rural&Urban	99	60.0	40.0
1987	NGO	YES	Rural&Urban	98	43.0	57.0
2000	NGO	YES	Rural&Urban	100	46.5	53.5
1995	NGO	YES	Rural&Urban	98	64.7	35.3
1988	NGO	YES	Rural	100	50.0	50.0
1987	NGO	YES	Rural&Urban	100	70.0	30.0
1996	NGO	YES		94.5	60.0	40.0
1984	NGO	YES	Rural	100	59.0	41.0
				97.41	51.2	38.8

le up of the following : income/internally generated funds

Table 2

PRINCIPAL ACTIVITIES FUNDED (%)

NAME OF INSTITUTION	AGRICULTURAL LOANS	MANUFACTURING LOANS	HOUSING LOANS	TRADE/COMMERCIAL LOANS	CONSUMPTION LOANS	MULTI-PURPOSE LOANS	SERVICE LOANS	OTHERS
FADU	35	20	0	45	0	0	0	0.0
COWAD	20	0	0	70	0	10	0	0.0
COWAN	20	15	0	50	0	5	5	5.0
LAPO	0.46	0	0	89	0	10	0	0.5
JDPC	0	0	0	100	0	0	0	0.0
WDI	40	0	0	60	0	0	0	0.0
DEC ENUGU	5	0	0	95	0	0	0	0.0
DEC BAUCHI	15	0	0	80	0	3	2	0.0
OF	5	0	0	95	0	0	0	0.0
NALTNUSHO	0	0	0	100	0	0	0	0.0
Average	14.1	3.5	0	78.4	0	2.8	0.7	0.6

TABLE 3

SOURCES OF FUNDS (2003)

Name of Institution	Equity	Mobilized Savings	Bank Loans	Government support/loan	Donor/Grants	Others
FADU	20	20	1	0	59	0
COWAD	0	0	0	0	0	0
COWAN	0	33	7	0	60	0
LAPO	15	22	1	0	43	19
JDPC	13.67	39.82	0	0	46.51	0
WDI	15.9	0	0	0	64.7	19.4
DEC ENUGU	25	0	10	0	50	15
DEC BAUCHI	0	25	0	0	70	5
OF	0	40	0	0	60	0
NALTNUSHO	0	29	0	0	59	12
TOTAL	89.57	208.82	19	0	512.21	70.4
AVERAGE	8.957	20.882	1.9	0	51.221	7.04

* others are made up of the following : income/internally generated funds

Table 4a

VOLUME OF ACTIVITY

Name of Institution		Total Asset Base	Number of Branches	Number of borrowers	Value of outstanding loans (N m)	Number of Savers	Value of Savings (N m)	Number of Staff
FADU	1993	5,000,000.00	32	240	483,000.00			6
	2003	154,000,000.00	116	80360	201,000,000.00			299
COWAD	1993	1,200,000.00						
	2003	35,773,625.00						
COWAN	1993	32,000,000.00	57					
	2003	55,000,000.00	162	260000	10,000,000.00		78,000,000.00	
LAPO	1993		2	623	430,058.00	623	94,395.00	6
	2003		27	23270	230,851,901.00	24,545	57,287,194.00	168
JDPC	1993	15,231,848.00	3	2204	14,657,940.00	3,395	4,513,808.00	18
	2003	71,758,859.00	12	10147	78,848,680.00	11,811	28,574,735.00	53
WDI	1993	500,000.00	4					1
	2003	10,000,000.00	17					7
DEC ENUGU	1993							
	2003							
DEC BAUCHI	1993			480	94,500.00	480	9,450.00	5
	2003			8482	59,469,000.00	11,517	17,077,000.00	64
OF	1993			6				1
	2003			2110				24
NALTNUSHO	1993	73,439.00	3					16
	2003	21,469,676.00	9					45
Total 1993		54,005,287.00	266	6013	16,415,498.00	6,958	4,867,653.00	67
Total 2003		348,002,160.00	1193	139291	591,093,206.00	61,895	107,751,363.00	705
Average 1993		9,000,881.17	33	1002	3,283,099.00	1,740	1,216,913.25	8
Average 2003		58,000,360.00	170	23215	118,218,641.00	15,474	26,937,840.75	88

Table 4b

VOLUME OF ACTIVITY

Name of Institution		Total Asset Base	Number of Branches	Number of borrowers	Value of outstanding loans (N m)	Number of Savers	Value of Savings (N m)	Number of Staff
FADU	1993	5,000,000.00	32	240	483,000.00			6
	2003	154,000,000.00	116	80360	201,000,000.00	109,230	44,000,000.00	299
COWAD	1993	1,200,000.00						
	2003	35,773,625.00						
COWAN	1993	32,000,000.00	57					
	2003	55,000,000.00	162	260000	10,000,000.00	260,000	78,000,000.00	42
LAPO	1993		2	623	430,058.00	623	94,395.00	6
	2003	268,071,044.00	27	23270	230,851,901.00	24,545	57,287,194.00	168
JDPC	1993	15,231,848.00	3	2204	14,657,940.00	3,395	4,513,808.00	18
	2003	71,758,859.00	12	10147	78,848,680.00	11,811	28,574,735.00	53
WDI	1993	500,000.00	4					1
	2003	10,000,000.00	17	600	5,991,901.90	600	1,258,062.09	7
DEC ENUGU	1993							
	2003			20	5,000.00		8,000,000.00	30
DEC BAUCHI	1993			480	94,500.00	480	9,450.00	5
	2003	173,000,000.00		8482	59,469,000.00	11,517	17,077,000.00	64
OF	1993			6				1
	2003			2110	10,569,896.00		5,697,827.00	24
NALTNUSHO	1993	73,439.00	3					16
	2003	21,469,676.00	9	6004	27,000,000.00	7,757	8,000,000.00	45
Total 1993		54,005,287.00	266	6013	16,415,498.00	6,958	4,867,653.00	67
Total 2003		789,073,204.00	1193	405915	644,660,003.00	439,482	252,707,252.09	777
Average 1993		9,000,881.17	33	1002	3,283,099.00	1,740	1,216,913.25	8
Average 2003		98,634,150.50	170	40592	64,466,000.00	54,935	25,270,725.21	78

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Appendix

Summary of Proposed Guidelines for Micro Finance Institutions (MFIs) In Nigeria Prepared by the Central Bank of Nigeria

1. Introduction

The guidelines are to regulate the establishment, operations and other activities of Microfinance Institutions (MFIs) that seek to take savings/deposits from members of the public and engage in microfinance intermediation services in Nigeria.

A Microfinance Institution (MFI) shall be construed as any company licensed to carry on the business of providing microfinance services, such as savings, loans, domestic fund transfers and other financial support services, that micro enterprises need to conduct or expand their businesses.

No Microfinance Institution shall engage in sophisticated banking services directly, especially those involving foreign exchange transactions or international commercial papers or corporate finance, international electronic funds transfer, cheque clearing activities and any other activity as the Central Bank of Nigeria may stipulate, from time to time.

Every company seeking to be licensed as a MFI shall be on a "stand alone" basis and thus be strictly limited to solely engaging in MFI business as defined above.

2. Application for License

Any promoter(s) seeking license for a MF company business in Nigeria shall apply in writing to the Governor of the Central Bank of Nigeria. Such application shall be accompanied with the following:

a. A non-refundable application fee of ₦20,000.00 (twenty thousand naira only) in bank draft, payable to the Central Bank of Nigeria.
b. Deposit of the minimum capital of ₦30 million in bank draft made payable to the CBN. The capital thus deposited together with the accrued interest will be released to the promoters on the grant of the final license.
c. A copy of detailed feasibility report disclosing relevant information.
d. A copy of the draft Memorandum and Articles of Association.
e. A letter of intent to subscribe to the shares allotted to the shareholders of the proposed Microfinance Institution, signed by each subscriber.

f. A copy of the list of proposed shareholders in tabular form, showing their business and residential addresses (not post office addresses) and the names and addresses of their bankers.

g. Names and Curriculum Vitae (CV) of the proposed members of the Board of Directors. The CV must be personally singed and dated.

h. The Bank may at any time vary or revoke any conditions of a license or impose additional conditions.

i. Where a license is granted subject to conditions, the Microfinance Institution shall comply with those conditions to the satisfaction of the CBN within such period, as the Bank may deem appropriate in the circumstance. Any Microfinance Institution that fails to comply with such conditions shall be guilty of an offence under BOFIA, 1991 (as amended).

3. **Financial Requirements**

The financial requirements, which may be varied at the instance of the CBN are as follows:

			₦
a.	Minimum paid-up capital	-	30,000,000.00
b.	Non-refundable Application Fee	-	20,000.00
c.	Non-refundable Licensing Fee	-	50,000.00
d.	Change of Name Fee	-	10,000.00

4. **Directors**

a. The maximum number of directors on the Board of a Microfinance Institution shall be seven (7) while the minimum shall be three (3). To qualify for the position of a director in a Microfinance Institution, it is hereby required that the person(s) must not be current employees or directors of banks or other financial institutions, except the Microfinance Institution is promoted by the banks or other financial institutions and are representing the interest of such institutions.

b. The appointment of new directors and Management staff must be preceded by CBN’s approval.

5. **Sources of Funds**

The sources of funds of a Microfinance Institution shall consist of the following:

a. Shareholders’ funds – paid up share capital and reserves.

b. Deposits by customers.

c. Debenture/qualifying medium to long term loans

d. Grants/donations from individuals, organizations, national government, and international sources.

6. **Publication of Audited Accounts**

Every Microfinance Institution shall submit its audited financial statements and the abridged version of the accounts to the Director of Other Financial Institutions of the CBN for approval not later than four months after the end of the company's financial year. The Domestic Report on the Accounts from the External Auditors should be forwarded to the Director, Other Financial Institutions Department (OFID), not later than three months after the end of the accounting year. After approval, the MFI shall publish the accounts in at least two (2) national daily newspapers. Every published account shall disclose in detail the penalties paid as a result of the contravention of BOFIA 25, 1991 (as amended) and any policy guideline in force during the year in question and the auditor's report shall reflect such contraventions. Any Microfinance Institution that fails to comply with any of the above requirements will be liable to a fine not exceeding ₦20,000.00 each day during which the offence continues.

7. **Penalties for Late or False/Inaccurate Returns or Other Information**

a. For lateness in submitting return/furnishing any information required, the penalty shall be a fine of ₦2,500.00 for each day during which such failure occurs. Persistent failure/refusal to render returns in the prescribed form may be a ground for the revocation of a MFI's licence.

b. Where the CBN considers it necessary, it may appoint a firm of qualified accountants to prepare proper books of account or render accurate returns, as the case may be, for the MFI concerned and the cost of preparing the account or rendering the returns shall be borne by the Microfinance Institution.

c. If any Director or Officer of an MFI fails to take all reasonable steps to ensure that proper books of accounts are kept with respect to all transactions of the company at its Head Office and/or at its branches, the CBN may impose on him a fine not exceeding ₦20,000.00. If any default in this respect is caused by the willful act of any Director or Officer of the Microfinance Institution, the CBN may impose on him a fine not exceeding ₦100,000.00 or cause the removal of such Director or Officer in order to protect the integrity of the financial system. In addition, the Bank may impose on the MFI such other penalties as are deemed appropriate.

8. **Prudential Requirements**

Every MFI shall comply with the following requirements:

a. **Liquidity ratio**

A minimum ratio of forty per cent (40%) on specified liquid assets against deposits liabilities. Specified liquid assets shall include treasury bills, fund placements, money at call and short-term investments with NOT more than 90 days maturity.

b. **Capital Funds Adequacy**

The minimum capital adequacy ratio (Capital/Risk Weighted Assets Ratio) for each Microfinance Institution shall be 12%. Furthermore, a Microfinance Institution is expected to maintain a ratio of not less than 1:10 between its shareholders fund unimpaired by losses and net credits. When any of the above ratios falls below the prescribed level, the MFI may not do any or all of the following until the required ratio is restored:

i. Grant credits and make further investment.
ii. Pay dividend to shareholders.
iii. Borrow from the investing public.

In addition, the MFI may be required to submit within a specified period, a recapitalisation plan acceptable to the CBN. Failure to comply with the above may constitute grounds for the revocation of the licence of the MFI or such other penalties as may be deemed appropriate. MFI are enjoined to ensure that their shareholders' funds do NOT fall below the required minimum paid-up capital.

c. **Fixed Assets/Long-terms Investments and Branch Expansion**

No MFI shall be allowed to finance any of the following other than from the shareholders' funds, unimpaired by losses:

i. Acquisition of fixed assets
ii. Equity investments and investments in longer-term debentures.
iii. Branch expansion.

d. **Maintenance of Capital Funds**

Transfer of Statutory Reserve from profit after tax shall be at a minimum of 25% until the Reserve Fund equals the paid-up capital and a minimum of 12.5% thereafter. The CBN may vary from time to time the proportion of net profit transferable to Statutory Reserves. No accretion shall be made to the reserve fund until:

i. All preliminary and pre-operational expenses have been written off;
ii. All preliminary losses have been made for loan/assets deterioration;

iii. All identifiable losses have been fully provided for.

e. **Payment of Dividend**

No dividend shall be paid until:

i. All accumulated losses have been fully absorbed and written off.
ii. All preliminary and pre-operational expenses have been written off.
iii. Capital Adequacy ratio has been met.
iv. All matured obligations have been met.

f. **Limit of lending to Single Borrower**

The maximum loan by a MFI to any person or maximum investment in any venture by a MFI shall be 5% of the MFI's shareholders' funds unimpaired by losses or as may be prescribed by the CBN from time to time.

Any contravention will attract a penalty of ₦100,000.00 on the Microfinance Institution and a fine of ₦10,000.00 on the directors/managers who failed to comply.

g. **Maximum Equity Investment Holding Ratio**

No MFI shall invest more than seven and half per cent (7.5%) of its shareholders' funds, unimpaired by losses, in the equity share of any venture or undertakings without the prior approval of the Bank.

h. **Provision for Classified Assets**

Each MFI shall review at least once every thirty days, its loans and advances and other investments and make appropriate provisions for loan losses or assets deterioration in accordance with the CBN Prudential Guidelines for Licensed Microfinance Institutions as specified below:

Days at risk	Description	Provisioning Requirement
1-30 days	Pass and watch	20%
31-90 days	Sub-standard and doubtful	50%
>90 days	Loss	100%

Every MFI must send to the Other Financial Institutions Department every quarter a schedule of loans/investments, showing the provisions made for losses or deterioration in the quality of the loans/investments.

i. **Limit of Investment in Fixed Assets**

The maximum amount which a MFI can invest in fixed assets is 20% of its shareholders' funds unimpaired by losses. Any contravention will attract a penalty not exceeding ₦200,000.00 or suspension of the licence.

9. **Disclosure of Interest by Directors and Officers of MFIs**

Every Director and Officer of a MFI, who has any personal interest, whether directly or indirectly, in an advance, loan or credit facility or proposed advance, loan or credit facility from the MFI in which he is serving, shall promptly declare the nature of his interest in writing to the Board of Directors of the MFI and the declaration shall be circulated to all the directors.

Every Director or Officer of a MFI that holds any office or possesses any property whereby whether directly or indirectly, duties or interests might be created in conflict with his duties or interest as a Director or Officer of the MFI, shall declare at a meeting of the Board of Directors of the MFI, the fact and the nature, character and extent of such interests. Any Director or Officer that contravenes either of these regulations shall be liable to a fine of ₦100,000.00 or removal from office.

10. **Opening/Closing of Branches of Microfinance Institutions**

Prior approval of the CBN is required for the opening and closing of branches. If in contravention, the MFI shall be made to pay a fine not exceeding ₦200,000.00 and the closing/reopening of the branch as the case may be and in addition, a fine of ₦10,000.00 for each day during which the offence continues.

11. **Display of Interest Rates**

Every MFI shall display on a daily basis in a conspicuous place at its Head Office and branches, its rates of interest.

Interest rates shall be quoted on annual basis and not per month. In contravention, the Microfinance Institution shall be liable to a fine of ₦20,000.00 and additional ₦5,000.00 for every day during which the offence continues or such other penalties deemed appropriate.

12. **Internal Controls**

Every MFI shall have an Internal Audit, which should ensure that the operations of the company conform to the law as well as to its internal rules and regulations. Every fraud or attempted fraud must be promptly reported to the Director of Other Financial Institutions Department. Also a quarterly report on Frauds and Forgeries affecting the company and any default in meeting any obligation to lenders or investors shall be submitted to the Director, Other Financial Institutions Department. Where no frauds/forgeries and defaults occurred during the quarter, a Nil return shall be forwarded. The report shall be made along with the quarterly returns on assets and liabilities. Failure to comply with this requirement will attract a fine of ₦25,000.00 per quarter.

13. **Appointment of Chief Executive and Principal Officer**

The appointment or replacement of the Chief Executive Officer or any of the Principal Officers of any Microfinance Institution must be cleared with the CBN before such appointments are made. Where the turnover of principal and senior officers is considered to be unduly high, or where the reason for leaving by an officer suggests an attempt to cover up a fraud or other illegal activity, or punish the officer for attempting to prevent illegal activities, the CBN shall cause an investigation to be conducted into the matter and other affairs of the MFI as may be considered necessary. The report of such investigation or special examination shall determine the penalty to be imposed on the MFI concerned.

14. **Appointment of Auditor**

Every MFI shall appoint an auditor to be approved by the Bank whose duties shall be to make to the shareholders a report on the annual financial statements of the company and every such report shall contain true and fair statements and such other information as may be prescribed from time to time by the CBN.

The approved auditor shall satisfy the following requirements:

a. a member of a recognized professional accountancy body in Nigeria;
b. carries on in professional practice as accountant and auditor in Nigeria;
c. No person shall be appointed as the auditor of a MFI if:
   - He has interest in the MFI otherwise than a depositor
   - He is a director, officer or agent of such institution
   - It is a firm in which a director of the MFI has interest as partner or director
d. Any auditor who is subsequently affected by Section 14(c) above shall immediately cease to continue as auditor of the MFI.
e. If an approved auditor in the course of his duties as an auditor of a MFI is satisfied that:

- There has been contravention of BOFIA, 1991 as amended or that an offence under any other law, guidelines, circulars, etc. has been committed by the MFI or any of its officers; or
- Losses have been incurred by the MFI which substantially reduces its capital funds; or
- Any irregularity which jeopardizes the interest of depositors or creditors of the MFI or any other irregularity has occurred, or
- He is unable to confirm that the assets of the MFI cover the claims of depositors or creditors.

He shall immediately report the matter to the Central Bank of Nigeria;

f. The approved auditor shall also forward to the CBN two (2) copies of domestic report on the activities of the MFI not later than three (3) months after the end of the financial year of such MFI.

g. The approved auditor shall have the right of access at all times to all books, accounts and vouchers of the MFI and shall be entitled to require from directors, managers and officers of the MFI all information and explanation he considers necessary for the performance of his audit.

h. If any MFI fails to appoint or fill a vacancy for an approved auditor, the CBN shall appoint a suitable person for that purpose and shall fix the remuneration to be paid by the MFI to such auditor.

i. The appointment of an approved auditor shall not be determined without a prior written approval of CBN.

j. Any approved auditor who acts in contravention of the foregoing requirements or fails deliberately or negligently to comply with the requirements of this section shall be liable to a fine of a maximum of ₦50,000.00 or a determination of his status as an approved auditor to all financial institutions under the supervisory purview of the CBN.

15. **Schemes of Arrangement**

No Microfinance Institution shall enter into any "Scheme of Arrangement" with its creditors/investors without the prior approval of the CBN. Any Microfinance Institution that is unable to meet its obligations to its creditors or investors must submit its proposals to restore liquidity or viability and for eventual settlement of its outstanding obligations to the Director of the Other Financial Institutions Department for consideration and approval. Failure to comply with this will attract a penalty of ₦2,500.00 for each day during which the contravention exists.

16. **Restructuring and Reorganisation Of Microfinance Institution**

Except with the prior consent of the Governor of the CBN, no Microfinance Institution shall enter into an agreement or arrangement:

a. which results in a change in the control of the Microfinance Institution;

b. for the sale, disposal or transfer of the whole or any part of the business of the Microfinance Institution;

c. for the amalgamation or merger of the Microfinance Institution with any other company.

d. for the reconstruction of the Microfinance Institution;

e. to employ a management agent or to transfer its business to any such agent.

17. **Prohibitions**

No Microfinance Institution shall:

a. Deal in foreign currency;

b. Give any credit facility or enter into any other transaction against the security of its own shares or the shares of its holding company;

c. Pay any dividend on its shares without CBN's prior approval in writing;

d. Engage in any business other than those for which it was licensed;

e. Remit either in whole or in part the debts owed to it by its directors/officers or waive interest thereon without the prior approval of the CBN, in writing.

18. **Conditions for Revocation of License**

The grounds for revoking a license granted to a Microfinance Institution may be any or all of the following:

a. Submission of false information/data during and/or after the processing of the application for license.

b. Engaging in functions/activities outside the scope of its license as specified in Section 1 of these guidelines.

c. Persistent failure to comply with request for information/data in the form required/specified by CBN.

d. Engaging in activities prejudicial to the Nigerian economy.

e. Failure to redeem matured obligations to customers.

f. Unauthorized shop closure.

g. Failure to comply with any directive issued by CBN.

h. Failure to renew operating license within the stipulated period.

i. Any other act(s) which in the opinion of CBN constitute(s) a violation or a serious default.

19. **Exit Conditions**

The condition for exit of a licensed Microfinance Institution shall be as prescribed by the relevant sections of the Banks and Other Financial

Institutions Act (BOFIA) 25 of 1991 (as amended) as applicable to deposit taking financial institutions and the Company and Allied Matters Act (CAMA) 1990.

20. **General**

The list of valid licenses may be published by the CBN from time to time.